Securities and Exchange Commission Historical Society
Interview with David Ruder
Conducted on May 27, 2015 by William Thomas

WT: This is an interview with David Ruder for the SEC Historical Society's virtual museum and archive of the history of financial regulation. My name is William Thomas. The date is May 27th, 2015, and we're at the Northwestern Law School in Chicago. So, thanks very much for agreeing to speak with us. We usually start with a little bit of background. I understand that you're from Wausau, Wisconsin, originally?

DR: That's correct.

WT: And then you did your undergrad at Williams College.

DR: Williams College.

WT: So tell me a little bit about what your aspirations were originally going to Williams, and what did you major in there?

DR: Well, my aspirations in going to Williams were pretty low. I lived in a community of about 25,000 people, and my father had spent a year at law school at Harvard before he enlisted in the U.S. Army in the First World War. At one point, I was active in the Hi-Y in Wausau, Wisconsin, and a young man came to speak to us. He had a brochure published by the *Chicago Tribune* showing many schools in the country based upon various statistics.

He was from Carleton College in Minnesota. Carleton was number two in most of the rankings, but Williams College was number one. I said to my parents, "Where's Williams College?" They told me they had a friend who went there. My Dad was, I think, interested in exposing me to other areas of the country. I selected Williams because I thought it was the best place to go, and I could go away from Wisconsin.

WT: What did you study there?

DR: I studied political economy. I was in the first major in political economy. I started in economics, but it turned out that even at that time at Williams you had to have a very strong math background to be in an honors program in economics. I switched to political economy, which was a combination of political science and economics.

WT: And then I guess after that you were in the Army? This was during the Korean War. You finished in 1951?

DR: Yes. I was editor of the newspaper at Williams College and got to know the president of Williams [James Phinney Baxter, III]. And at my graduation the draft was still on and I wanted to go to law school, but my draft board in northern Wisconsin told me there were no deferments for law school, so I would have to go into military service.

One of my friends told me he was going to work for the CIA, which was then not well known. This was very early in the development of the CIA. I received a recommendation from Phinney Baxter, who was a member of the OSS in Europe and was a friend of the person who was then running CIA. I was admitted into something called the Junior Officers Training Program. The idea was that I might become a full-time CIA person for the rest of my life. I indicated to the CIA that I might be willing to make that commitment.

When I was interviewed in Washington, the CIA told me that if I was going to become a career CIA person I had to become an officer in the military. I selected the U.S. Army because my father had been in the Army. I went through basic training for fourteen weeks, and then to Fort Benning Officer Candidate School for twenty-two weeks. Then I went to Kansas, where I attended intelligence school, went back to Washington, and was then on a desk job for the CIA for eighteen months or so.

One of the interesting things that happened to me was that I had a look at my file when I was at the CIA office. It said, “Do not recommend for covert activities; too honest.” After service, I applied to Harvard Law and to University of Wisconsin Law. I was accepted for both, and decided to go to the University of Wisconsin Law School.

WT: So was that just a decision to go back home?

DR: It was. I had spent four years at Williams and three years basically in Washington, D.C., and I thought it was time to go back. I thought I was going to practice law in my hometown.

WT: So you finished that in, was it 1957?

DR: Right.

WT: And you joined a firm for a few years before you ended up here at Northwestern?

DR: Yes, it was a firm called Quarles, Herriott, Teschner & Noelke in Milwaukee. It was a very large firm at that time in Milwaukee. There were eighteen lawyers.

WT: What sort of work were you doing there?

DR: I did corporate and securities work. I learned about the securities law at that firm. I did not have a course in securities regulation at Wisconsin, but at the firm I participated in the registration and sale of the shares of a client. At the end of my time there I was involved in preparation of a brief in a case called *Kohler v. Kohler Corp*. It was a dispute between the then-governor of Wisconsin and his family corporation. It involved Rule 10b-5 of the Securities and Exchange Commission. When I came to Chicago to become a member of the faculty here at Northwestern, I became curious about the background of Rule 10b-5 and I wrote my first article on the rule.

WT: How is it that you made the turn into being a professor of law?

DR: I became ambivalent about my career after I had practiced law for a few years. I didn't know whether I wanted to be a lawyer or a law professor, or even a law school administrator. I don't think I was seriously interested in law teaching in 1957, but when I graduated, the dean of the Wisconsin law school stopped me on the street and told me that if I ever wanted to go into law teaching I should let him know. I was first in my class at Wisconsin Law, so he must have thought I would be qualified to teach. Later on when I became interested in teaching, I called him. He was then the dean at Northwestern. He told me that if I wanted to go into law teaching I should come to Northwestern.

WT: So you thought straight away then that your specialty would be securities law?

DR: No, I did not. I taught corporate law and wrote that first article on Rule 10b-5. The article turned out to be a very controversial. Rule 10b-5 was a rule adopted by the Securities and Exchange Commission and was enforceable by the Commission in court and in administrative proceedings, but there was no express provision in the Securities and Exchange Act of 1934 giving a private person the right to enforce it. A doctrine had arisen in the federal circuit courts and district courts that there was an implied private right of action by individual plaintiffs to enforce the SEC rule.

WT: Litigation against fraud, essentially?

DR: Yes. Rule 10b-5 is the main anti-fraud rule adopted by the SEC. When I began to do the research about the background of Rule 10b-5, I became interested in the legislative history of the Securities and Exchange Act. I looked at that history. I found that there were express private rights of action in the 1934 Act, but that Rule 10b-5 was being enforced as an implied private right of action.

I read the Congressional hearings and reports about the Securities Act of 1933 and the Securities Exchange Act of 1934 and the statutes themselves very carefully. I came to the conclusion that not only was there no legislative history supporting the implied right of action, but that the legislative history pointed in the other direction. So I wrote the article and observed that despite the fact that all but one federal circuit court had upheld the private right of action, that conclusion was wrong.

WT: The implication was that it would be solely the SEC's right to enforce against fraud?

DR: That's right. My theory was upsetting to the Securities and Exchange Commission, because it was then litigating a case eventually called *J. I. Case Co. v. Borak*, through an <u>amicus</u> brief position. The SEC was supporting the proposition that there was an implied private right of action to enforce a federal proxy rule, not Rule 10b-5, but another rule. My article suggested that there should be no private right of action under Rule 10b-5, and by implication under the federal proxy rules as well. A lawyer at the SEC wrote a reply to my article to which I replied. I received a reply to my reply and wrote another article in reply to that article. That exchange of articles began my scholarly reputation.

WT: Were these issues ever resolved through additional legislation?

DR: Not with legislation. The Supreme Court heard the *Borak* case and decided there was a private right of action. It did very little analysis and simply said, there should be a private right of action because it is a necessary supplement to Commission action.

WT: So, was it this whole set of correspondence or discourse that eventually got you centered in the area of securities law, or did you continue to be more broadly ranging?

DR: At that time, during the 1960's, securities law was not such an important topic as it is in law schools today. One taught corporations, and then taught a little bit of securities law. In about 1965 a securities regulation casebook was published by Dick Jennings and Harold Marsh. That was the first casebook devoted entirely to securities regulation. At about that time I began to teach a seminar in corporation finance. Gradually I began to concentrate more and more on securities matters, and finally I began to teach a course in securities regulation at Northwestern, using the Jennings and Marsh casebook.

WT: Tell me a little bit about the broader academic community who's interested in this. Of course, the figure Louis Loss comes up ubiquitously, but I'm wondering what the broader terrain looked like in the 1960s and '70s. We don't get too much into the academic community in a lot of these interviews and I'm very curious about it

DR: Well, the academic community in securities regulation was very slim at that time. Louis Loss was still at the SEC, and had not gone to Harvard to teach. Dick Jennings and Harold Marsh were in California. Dick Jennings was teaching at Boalt Hall, and Harold Marsh was a practitioner, but I think was teaching as an adjunct at UCLA. I was one of the very first securities law professors in the country, and interestingly, I think it was that fact that led to my future at the SEC.

WT: How much depth do we want to go into on the subject of the things that you looked at in your teaching as a professor? It's something that I frankly don't know a lot about.

DR: I hate to admit how old I am, but I'm one of the few law teachers today who can recollect the history of the anti-fraud rules as it happened. One of the famous cases that I taught was the *Texas Gulf Sulphur* case, in which the SEC had sued Texas Gulf Sulphur under Rule 10b-5 for violating the disclosure laws. I taught that case and wrote about it.

Ultimately, I became involved in the American Bar Association, which was a very important ingredient in my progression through the business law field. The Association then had a section called the Section of Corporations, Banking, and Business Law. The people running that section were the very best corporate lawyers in the country.

WT: Being located here in Chicago, was there any opportunity, or a particular concentration, if not from you then people in the area, on commodities and futures and that sort of thing, that centered here?

DR: Well, as you know, the commodities exchanges started here in Chicago with futures trading in physical commodities. Eventually trading expanded to include financial instruments. During the ‘60s and ‘70s trading was mostly in physicals. It wasn’t until, I believe 1974, that the Commodity Futures Trading Commission was created. But for me, the interesting point was that shortly after I started teaching at Northwestern in 1961. I joined the Chicago Bar Association committee on securities regulation. In 1964, at one of the committee meetings I met a lawyer named Milton Cohen. In the 1930s, Milton had been the director of the Public Utility Holding Company Division at the SEC, administering the Public Utility Holding Company Act. One of the purposes of the Act was to disband the public utility holding companies that had been thought to be a problem in the stock market run-up to the Depression.

Anyway, Milton was head of that division. He later came back to Chicago to practice law, and then was called back to Washington to become the director of the 1963 “Special Study of the Securities Markets.” He has given his papers to the Historical Society. Milton was, in a sense, my mentor. I learned a lot about the securities laws from him. I used to have lunch with him every few months, at his invitation, and eventually I became of counsel to his firm. In 1974-1975 I spent a full year with the firm, just at the time that the Securities Act Amendments of 1975 were being adopted.

Those were very important amendments. They were amendments in which, based upon recommendations in the Special Study, the SEC was given power to impose disclosure requirements on a group of companies that were not then listed on securities exchanges, but which had $10 million in total assets and 500 or more shareholders. It was a large expansion of the disclosure laws in the US. The new disclosure laws required annual and periodic reports from an expanded number of public companies. So, Milton had an enormous impact on the securities area.

During the period that I was in his office working with him I learned a great deal about the securities markets. One of the fascinating parts, as I later looked at my own career, was Milton's representation of the Chicago Board Options Exchange and the Midwest Stock Exchange. He had a great reputation. In 1975, he went to Washington and testified that it was wrong for the New York Stock Exchange to have a monopoly over the securities markets. He argued that what was needed was competition rather than monopolization. If you read the preamble to the '75 Act Amendments you'll see he was successful in persuading Congress to adopt the competition model.

I'm going a little forward in the story here, but when I was nominated for the Commission I had lunch with Milton. I told him I was really happy that I had learned so much under his guidance, that I was following the SEC very carefully, but that I didn't really know a lot about how the securities markets rules were adopted. I asked him whether the commissioners of the Securities and Exchange Commission, most of whom come without background in the markets, have enough skill to adopt all of the complicated stock exchange rules. Milton told me that the Commission has delegated the authority to approve stock exchange rules to the staff of the Commission, so the Commission does not have to deal with every particular matter. That was another example of Milton helping me and advising me.

WT: Was there a more general kind of perceptible pushback against the expansion of regulatory authority, particularly in the 1970s? I'm thinking of people like Frank Easterbrook, for example.

DR: Well, they were not old enough then.

WT: Right. (Laughter)

DR: This was a period of time in which the business community was fascinated with the way in which the securities laws were being expanded, and particularly the '75 Act Amendments. I have to go back one step. The other lawyer in Chicago who was a prominent securities lawyer was Ray Garrett, Jr., who later became chairman of the SEC. He had taught at Northwestern as an adjunct professor, so I knew him that way. And in, I'm going to say 1966, Ray and I talked about a suggestion by some lawyers that there should be a project to codify the six statutes administered by the Securities and Exchange Commission.

At Ray's suggestion a conference was held here at Northwestern in our Lincoln Hall, which brought in all of the great securities lawyers in the country. Ray Garrett was there, Al Sommer was there, Louis Loss was there, David Henkel was there, Milton Cohen was there, and I think Frank Wheat, and Irv Pollack were there. Many of the old names were there. And they decided that it would be very useful to have a project to codify all of the SEC statutes.

So, they went to the American Law Institute, which agreed to start a project called the Federal Securities Code Project. The way the ALI is set up, a Reporter is appointed for each project. Louis Loss was the Reporter. A small group of people act as Consultants. A larger group, called Advisors, also provide input. Finally the project goes to the membership for approval.

That project started and Milton finally suggested to Lou that I be made a Consultant for purposes of the civil liability provisions of that project. The project lasted for almost ten years. At the end of the project, the code was enacted by the ALI members. During its enactment process two events took place that were fascinating to me regarding the project.

One was that Milton Cohen had written an article called "Truth in Securities Revisited," in 1964 or 1965. He argued that the Securities Exchange Act of 1934 should have been passed before the Securities Act of 1933. The Securities Act of 1933 states that when a company raises money from the public, it must make disclosures about its business and about it plans to use the money. The 1934 Act, when it was adopted, required all listed companies to make disclosures about their business on an annual, quarterly, and event-driven basis.

Milton, in his article, asserted that the order of adoption was backwards. He argued that companies should make disclosers about themselves, and then, when they go public, refer to the disclosure documents and explain how they would use the proceeds of the offering. That theory became one of the primary aspects of the Federal Securities Code Project. The theory was that Congress should rewrite the two laws, require the periodic disclosure piece to be first and then authorize companies to use the disclosure documents as part of their registration statements.

Lou, who had spent many years at the SEC, told the Commission that the ALI was planning to support Milton's theory. The SEC liked the idea, and accomplished by rule what the drafters of the new Federal Securities Code would have accomplished by legislation. That step took a lot of the force out of the project.

The other thing that happened was that in 1975 there was a fairly great concern in the business community that the rules of implied private rights of action under Rule 10b-5 were developing so that if a company made a public misstatement, the investors could sue the company. Investors who could sue were not only the investors who had been engaged in transactions with the company or with individuals within the company, but all investors who had purchased or sold securities of the company. The theory was that if the misstatements caused injury to investors they should be able to have private recourse. And, if you think about it, if you eliminate what's called privity of contract, the amount of damages are really potentially substantial.

When I used to teach this subject I asked students to assume that a company had issued a misleading statement, that the company was worth $100 million, that a million shares had been traded during the period and that the misleading statement caused the company's stock to go up by $5 or $10. The damages would be enormous. I used to point out that the problem here for the company is that when a lawsuit is brought in a so-called class action environment, where all of the potential injured investors are in one lawsuit, the numbers are so large that the company can then be involved in "bet-your-company" litigation. You lose, and the company's gone.

So, as the law was developing in that period of time, there was a question about whether the party making a misstatement had done so intentionally or negligently. In 1975, the *Hochfelder* case was decided in which the Supreme Court held that the standard was "scienter," intent to deceive or defraud. That was a big breakthrough because it limited the potential damages in Rule 10b-5 actions. It served to inspire the corporate defendants bar to be concerned about the possibility that the Federal Securities Code Project would result in adoption of a negligence standard for misrepresentation cases.

In the civil liability portions of the Federal Securities Code, we were planning to organize all of the express liabilities together and put them in one place, and to include the Rule

10b-5 liability aspects. It's my observation now in reflection, that what happened was that the members of the corporate bar became concerned that if the whole civil liability panorama was taken back to Congress, giving Congress the opportunity to decide what the mental state would be, there was the possibility that Congress would come out on the wrong side.

So, during the '70s, as there began to be some carving back of the potential remedies, I think many ALI members decided to oppose the project. In addition, as I have described, the SEC had taken steps to implement Milton Cohen's theory that '34 Act disclosures should be incorporated into '33 Act registration statements, making this aspect of the project unnecessary. So, the Federal Securities Code project never was adopted by Congress. But, for me, it was a wonderful experience, because I came to know everybody. In fact, I have here the list of the Consultants of this project. I would like to read some of the names because they are important people in the history of securities regulation.

The Reporter was Louis Loss. The Assistant Reporter was Victor Brudney from Harvard. Consultants included Milton Cohen; Vern Countryman; Ray Garrett, Jr., the former SEC chairman, David Hinkle from New York; Homer Kripke, a famous NYU professor; Milton Kroll, a wonderful Washington lawyer; and Bob Mundheim, who is still active and a good friend of mine. I was a Consultant. And just to give you a few names from the list of Advisers: Kenneth Bialkin, William Cary, a former SEC chairman; Arthur Fleischer, a lawyer in New York and one of those who wrote an article opposing one of my articles; Henry Friendly, a famous judge in the Second Circuit; Richard "Dick" Jennings from California; Al Sommer, a former commissioner; and Frank Wheat, another former commissioner. So, you had this very well-known group of people involved in the project. I knew all of them.

WT: This is very fascinating. It was just a couple months ago that I was interviewing Ed Fleischman, actually, and so he kind of gave me sort of a similar view of this, but of course from the side of the corporate bar.

DR: Did he indicate that the project had failed because of the corporate bar's concern?

WT: I'd have to go back and review what he said, and I understand that he's annotated things in the meantime as well, but I'm not sure.

DR: Art Fleischer and Bob Mundheim were also very active in the Special Study of the Securities Markets with Milton Cohen, so they had that history as well. They are about my age.

WT: And it's educational for me, because most of the people I've been speaking to have been kind of 1980 and forward, and so this older history is something that I've not personally had the opportunity to get into in such depth.

DR: This will be a little forward in chronological development, but I think it's relevant. In the early 1970s Al Sommer, the former commissioner, Jim Hewitt, a tax professor in California, and Allan Levenson, a former senior SEC staff member, decided to organize a program in California about the securities laws that would be similar to what the Practicing Law Institute was presenting in New York City.

They started a securities regulation institute to be held each year in California, in January. They enticed many of the good securities people from the SEC and the securities bar in New York and Washington to come to California as speakers for a three-day meeting. The California program became sort of a house party for securities lawyers. The faculty brought their wives and enjoyed a really wonderful time. Bob Mundheim and Art Fleischer and others were very active. It was another area in which I began to know a lot of people, because I was then a young talky professor.

WT: And how much did all these at-the-time-current events make their way into the teaching? Were the students very much engaged?

DR: Oh, yes. From my point of view, the law was developing fast. I was intensely involved with it, both from a teaching, research and writing point of view and from the Federal Securities Code point of view. Knowing everybody, I was able to kind of live in the securities world. One of the things that I think is very wonderful about my career is that I have known, I would say, all of the commissioners at the SEC from the days of Al Sommer and Ray Garrett forward to now. I have also known many of the directors of the

SEC staff, partly through their activities at the conferences in California. So, now we're back to my teaching.

WT: Right. So then you became dean from 1977 to '85. Did that inhibit you at all from being able to take part in this whole community, or was it something you were able to keep up with in that period?

DR: Obviously it did inhibit my activities somewhat. When you become dean, you're an administrator. However, I continued to teach in the securities field, even though I didn't do any extensive research during that time. I may have written one thing or another, but not much. But I kept teaching, and I stayed current. It's hard for a dean to keep teaching, but I did it and I just kept going.

Indeed, I'm doing some writing now, and I reviewed this Federal Securities Code Project. I found an incident on the floor of the ALI meeting in which Louis Loss was suggesting that there should be liability imposed upon a director of a corporation who had signed the annual report that went out to the public. The idea was that if liability could be imposed on a director, the director would be more diligent. I have just been reading the transcript of the incident. At the meeting I said I regretted that, as a Consultant to the project, I felt compelled to disagree with the Reporter. I said it was wrong to impose personal liability on the directors for misrepresentations in the annual report. My comment caused an enormous floor debate.

The reason this comes to mind is because the speakers in the debates kept referring to me as Dean Ruder. Some of these same people I have just identified to you got up and spoke for and against what I was saying. At the end of the debate, I made a motion against the provision. There were ninety-five votes against my motion and ninety-four in favor. So the project went forward with brackets around these liability provisions, indicating the ALI membership couldn't decide the issue.

WT: Should we cover anything else before I get to your time at the SEC?

DR: No, you can go ahead.

WT: Okay. How did it come about then that you became chairman of the SEC?

DR: After President Reagan was elected, he appointed John Shad as chairman of the SEC. John had been in office for something like six years and was tired of it. He was appointed ambassador to the Netherlands, effective in June of 1987. My name had been circulated in an earlier time as a possible chairman of the SEC. In fact, in 1980 when I was dean I received a call from Harold Williams, who was then the chairman of the SEC. He said he was worried that the Republicans were going to nominate someone as SEC chairman who was too conservative, and asked whether I would be interested in becoming chairman. I told him I was in the middle of a capital campaign at the law school and I couldn't step away. So I said no.

In 1987, when it became known that John Shad was going to leave and the Administration was having trouble finding a replacement for him, there was lots of speculation about who might be chairman. I didn't even know my name was being talked about. In May of 1987 I went to a meeting of the American Law Institute in Washington – not about the Federal Securities Code Project, but about something else. Someone tapped me on the shoulder and said, "They want you at the White House." I said, "What for?" And the person said, "For the job." I said, "You mean *the* job?" The answer was yes. I was told that I would have a message when I returned to my hotel. I did have a message asking if I could come over to the White House to interview the next day.

I was interviewed by the President's Counsel, A. B. Culvahouse, and by the Chief of Personnel, Bob Tuttle. They said they were considering me as a potential chairman of the SEC and asked whether I would be interested. I said yes. They asked me all kinds of questions, and at the end of the time they took me to see Howard Baker, who was then the President's Chief of Staff.

Howard told me that they had been looking for a chairman of the SEC, but had not had much success. He told me they have looked at Wall Street people, including John Whitehead, a former Wall Street person, who was at that time an Assistant Secretary of State. When they had no positive response they began to ask regulators.

WT: I know John Shad had been an executive beforehand, so were they kind of looking to continue in that vein?

DR: Perhaps so, since they said they were looking at Wall Street people. As to regulators they had asked Rudy Giuliani if he would be interested. He said no. Howard Baker was a wonderful man, a lawyer. He looked at me with a twinkle in his eye and said, “We had to look at lawyers.” I asked why I was being considered. I had no political connections at all. In fact, when I was interviewed at lunch, after a series of questions I was asked one last question. Remember this is the Reagan White House. I was asked whether I was a Republican. I hadn’t been active at all, so I said, “How do you tell?” The answer was, “In what party did you last register to vote?” And I said, “Republican.”

So when I asked Howard Baker, “Why me?”, he told me that when the appointment process seemed to be stalled using the Personnel Office the process had been given to the Office of the Counsel of the President. He told me that he and others at the White House had asked their friends who might be a good chairman of the SEC and that my name came up on all the lists.

I was very pleased by that. It turned out that Howard Baker had talked to Howard Trienens, who was the chairman of the Board of Trustees at Northwestern and had known me in my capacity as Northwestern Law School Dean. Former SEC people, had been asked, including Al Sommer, who was involved in the conference in California and in the ALI project. Many American Bar Association people were also asked. One of the people that I knew in the ABA was William Webster, a Federal Circuit Court Judge in St. Louis. I had been with Bill in many three day meetings of the Business Law Section. One day at one of the meetings he asked me to have breakfast with him and told me he was considering an offer to become head of the FBI. He knew I was dean of a law school, and asked what it was like to be an administrator. I gave him my advice as best I could. Eventually he was one of the people who recommended me as SEC chairman.

Howard told me that since so many people were positive about me, my name was now on the list of potential chairmen. There were three people on the list, but he wouldn't tell me the names of the other two because the White House didn't want the names to get out. He told me that if the names become public there would be a flurry of inquiries that would not be helpful. I asked whether I could do anything. The reply was that I should not do anything because the more I talked the more chances there would be for criticism.

To my surprise the next morning the *New York Times* published a story identifying the three persons being considered by the White House for the chairmanship of the SEC. My guess is that the White House wanted to control the publicity regarding the search for a new SEC chairman.

WT: It was very interesting. Like I mentioned, we spoke to Ed Fleischman a couple of months ago.

DR: Ed's name was on the list. He was one of the three.

WT: Right, right. He was telling us about how the staff were saying, "Oh no, anybody but Ed." But more to the point, he was mentioning that – I guess that was in '85, '86, that the administration at that time had been looking out for its ideological legacy, so it was looking for somebody very market-oriented. Of course, John Shad had that reputation.

DR: There was actually a piece in the *Wall Street Journal* in the spring of 1987, when I was on vacation, naming the three possibilities. They were all free market economists.

WT: And even Joe Grundfest said that he was viewed as being a reliably market-oriented Democrat.

DR: He was the most market-oriented commissioner during my tenure.

WT: Right, right. And so do you think it was just them not being able to push that view through? I mean, you're viewed as being more of a moderate Republican, I guess.

DR: They didn't know much about my views. Interestingly enough, I've been writing an article just recently and in the process I have read my old law review articles. I really seemed conservative in those articles. (Laughter) In those articles I was concerned about the undue expansion of Rule 10b-5. If they read those, they would have thought I was very conservative and not pro-regulatory.

But there is one other piece of information about the appointment. There was a third person on the list. I later learned that he had been asked to be chairman and had gone to Wall Street to try to persuade firms to support him. In the context of their discussions with him he was asked about takeovers. He told the firms he was against them. He later told me his response caused a lot of pressure to be put on the White House so that he did not get the appointment after all.

WT: The takeover issue is kind of an interesting one. One thing that Joe Grundfest said in his interview with us was that there were splits within both parties, pro and against regulatory action to try and prevent hostile takeovers. You mentioned in your recollections that you wrote about ten years ago for the Historical Society that you were attacked by Democrats in the confirmation process for your views on the subject. So, I'm wondering if you could kind of give us a sense of what the politics of that were at the time.

DR: Well, as I indicated, this was the middle '80s. Takeovers were really hot items.

WT: Exactly, yes.

DR: It was interesting to me that the chairman of the Senate Banking Committee was Senator William Proxmire, who was from Wisconsin. I had met him when I was editor-in-chief of the law review at the University of Wisconsin Law School. His family owned the printing company where we printed our law review. I had encountered him one day when we were picking up books. He did not remember the encounter, but I did. When I found that Proxmire was head of the Senate Banking Committee I thought my confirmation was going to be a cinch. I thought he would say that since I was a Wisconsin person he would favor my appointment. But in the Banking Committee he voted against me. He said that since I was a Republican, I was not going to be a strong enough regulator.

WT: That's kind of a peculiar position, because, of course, the chairman is expected to be from the president's party. So, I mean, would he have just been against anybody in that?

DR: I never did quite know why he came out against me. There's a lot of posturing in Washington. The main antagonist I had was Senator Sanford from North Carolina. There had just had a takeover attempt in which a North Carolina company was the target. As a result of the takeover attempt the target company was forced to sell off pieces of its business. The sale was injurious to the community. So Senator Sanford was dead set against takeovers.

And in our private conversations – you know, you go around and talk to all the senators before the public hearings – he asked me what my views on takeovers were. I told him it was difficult to know which takeovers are good or bad. Some of them are good for the economy and some are bad. I told him that Congress had written a law to regulate takeovers, and I would enforce it. I took no position for or against takeovers. As a result, Senator Sanford voted against me in committee and later put a hold on my appointment.

In the system that exists, one senator can keep a confirmation vote from coming to the floor. The hold on my confirmation vote existed during the first week in August 1987. Congress was going on recess at the end of that week. It was clear that if my nomination wasn't confirmed in the first week of August, it would be well into September before I became chairman. And by then I knew that the Commission was in some disarray because of the divergent views of the commissioners at that time. They weren't getting anything done, and I wanted to be at the Commission so I could improve the decision making process.

DR: Finally I called Dale Bumpers, who was a senator from Arkansas and a Northwestern Law School alumnus. I had become acquainted with him when I was dean when he gave a speech at the school. Believe me, I knew few people in Washington when I went there and I did not have any political support. I didn't think calling the White House was going to make any sense, because this was a Democrat who was against me.

So I called Dale, who was a Democrat. I told him the vote was 17 to 3 in favor of me in the committee, and that if I was not confirmed, I would not be chairman until September. He said, he would see what he could do. The story that came to me was that Dale Bumpers was seen on the floor of the Senate with his arm around Senator Sanford, and that Senator Sanford then withdrew the hold. To me, that was a very interesting Washington incident.

WT: So when you arrived at the Commission, what were some of the key issues that were on the table? Of course, we're a couple months away from October, but what did it look like things were going to be about? Of course, the tender offers and insider trading are the big ones.

DR: Interestingly, the first issue that came to me was the issue of what to do about the Boesky assets. Ivan Boesky had been criminally convicted and had been charged by the SEC for basically buying and selling inside information. As part of the SEC settlement Boesky had turned over the assets of his investment company in London. The assets were in the hands of a trustee approved by the Commission.

When I came to the Commission there was an issue because the trustee wanted to sell the Boesky assets. I was told that there were concerns that the assets in his company were tainted, because the investment advisory company may have had inside information when it transacted its business. The result would be that the trustees would be selling assets to the public that were not clean, that were subject to attack for being acquired based on inside information.

So essentially on my own I said we would not allow the sale of the assets. My memory may not be right in this, but I believe we caused the trustee to be replaced. So that was the first issue that came up. I was pleased that within the first couple of weeks I was at the Commission I did something.

The second issue that came up in the early days had to do with proposed legislation to define insider trading. Senator Riegle was head of the Securities Subcommittee of the Senate Banking Committee. He wanted to have insider trading legislation. Before I arrived, the SEC commissioners could not agree on legislation that could go forward.

WT: Was that primarily surrounding whether or not the misappropriation theory should be enshrined within that?

DR: There were two interesting issues. One was whether the misappropriation theory should become law. In the *Chiarella* case the misappropriation theory had been suggested but not approved, and was sort of floating out there. And the other issue had to do with how to deal with analysts. What about analysts who received information in the course of their duties? The question was how analysts should be subject to insider trading law.

The proposed legislation attempted to meet both of those problems. We finally sent it over, but as I remember it, it went over on a 3 to 2 vote with Fleischman and Grundfest against it.

The other thing, interestingly, that happened to me in my first days at the Commission was that one of the staff asked me whether I was going to Rio. I asked what was happening in Rio and was told that the IOSCO meeting was being held there. IOSCO is the International Organization of Securities Commissions. The heads of all of the world's securities commissions were going to meet in Rio for the annual meeting. John Shad used to go. Commissioner Charles Cox was planning to attend as the SEC representative. I made arrangements to go as well. For the first time I became familiar with international securities regulation. At that time IOSCO was basically a talking society. Although most of the world's securities commissions belonged to it, IOSCO had no legislative power and little staff.

I was then told that in the summer or fall of 1986, Chairman Shad had given a speech in Paris written for him by the SEC staff in which he urged that IOSCO should be more than a talking society. It should be making policy. He suggested that through working parties IOSCO could make policies in various areas. The chairmen of the various securities commissions could then go back to their countries and have the policies adopted.

So I went to Rio. I became acquainted with the heads of other securities commissions. I had the sense that IOSCO was not a very dynamic organization and that the Shad idea was just barely getting started. Interestingly enough, the SEC staff was then by far the most powerful and well-organized securities commission staff in the world. SEC staff members were heading most of the different working groups. So I was pleased that I went to the meeting and began to know what was going on. As a result, during my time at the Commission I encouraged the staff and the Commission to be more internationally involved.

WT: On the international thing, I know that there are a couple of, kind of, entry points. On the enforcement cases, I know there were all the memoranda of understanding that were coming through with different countries. But also, to what extent were the banking regulators kind of leading the international conversations? I know that we're not too far away from the first Basel Accord, for example – that's what I'm thinking of.

DR: In my interactions, the international banking authorities were not important. We did not have a presence in that area. Our international focus was on entering into memoranda of understanding calling for exchange of enforcement information between countries. We had a very few number of MOUs then. They increased greatly in numbers when I was there. Our international efforts emphasized these two areas, MOUs and IOSCO. In fact, the Office of International Affairs was not in existence then. It was a unit within the Enforcement Division.

WT: That's Michael Mann's area.

DR: Michael Mann.

WT: Should we move faster?

DR: No, go ahead. It's all right.

WT: Okay. Just before we get to the market break, should we handle these two issues and just kind of see them through?

DR: Which ones?

WT: The ones we've just been talking about, insider trading and the legislation –

DR: Well, the insider trading legislation failed.

WT: Right, that failed, but we did get the Insider Trading and Securities Fraud Enforcement Act, which I think –

DR: (Laughter)

WT: Which did neither of those things that we talked about, of course.

DR: Congressman Dingell, who was then chairman of the House Commerce Committee, was a very important figure and very aggressive. He was always after the Commission to do better and more things. Toward the end of the Michael Milken and Drexel Burnham investigation in which we were successful in getting Drexel Burnham to agree to a settlement, I had a call from Congressman Dingell. By that time we knew each other pretty well. He told me that things get done in Congress when there's publicity about a crisis. He asked me whether I had any legislation I would like to have adopted and suggested I send it over.

So I went to Gary Lynch, who was the Director of the Division of Enforcement, and asked him about possible legislation. He told me a draft enforcement bill had been in the Division's hopper for a long time. I told him to polish it up. We would get it adopted by the Commission and send it over to Dingell. And that eventually became the Enforcement Remedies Act, which was passed after I left. That was the way that happened. Congressman Dingell welcomed the legislation.

WT: That's the 1990 act.

DR: Yes.

WT: Okay. And then there was a 1988 act as well, wasn't there? I guess this was when they allowed the SEC to have punitive – what would be the term? – you were allowed to take three times the amount back that had been gained in insider trading.

DR: I don't have a good memory of that legislation. You are talking about Section 21A of the '34 Act. I believe it was adopted before I came to the SEC or shortly thereafter. What happens is that projects start when you are at the Commission and are finished after you're gone. Things that started before you were there get finished during your term.

WT: They finish while you're there.

DR: So the insider trading enforcement provision was not a big part of my life. But, as I say, the Boesky assets were and IOSCO was, and there was always action in and around the enforcement area. It didn't happen right away, but I undertook to go to each of the regional offices while I was chairman. I wanted the regional offices to know that the chairman cared, so I went to Boston, New York, and California, and I ended up at the Denver Regional Office. I wanted to walk through each office and have everybody know I was there. In Denver the regional administration told me I would not be doing a walk around, and asked me to come to his office.

He and his staff wanted to talk about penny stock fraud. They told me about pump and dump schemes in which small investors were persuaded to buy securities as part of fraudulent activities. He told me of cases in which insiders would acquire a registered public company and issue themselves lots of shares. Then they would create a false market for the shares. They would persuade an investor to make a $1,000 purchase, and then call him two weeks later, tell him the thousand dollars holding was now worth $2,000, and ask the investor to buy some more. Once the stock price went way up, the insiders would sell out. The Denver office told me how terrible these schemes were.

When I returned to Washington I asked the enforcement staff what was going on. I was told the problem was important not only in Denver, but in Salt Lake City, South Florida and other places. So I called the staff together and asked for a comprehensive plan. One of the things that was true of the Commission when I was there – and still was true when I left – was that the Commission had a silo organization structure. You've probably heard about that. Each division operated on its own. The divisions didn't talk to each other very much. It was worse than it is now. Anyway, in response to the fraud problem we created something called the Penny Stock Task Force. We brought the disclosure people, the enforcement people, and the general counsel people together. We talked about what might be a good way to deal with penny stock fraud. Eventually the Commission adopted a rule that is still in existence regarding fraudulent activity in stocks that are valued at $5 or less.

WT: That was an area where there was some balance that needed to be struck between small firms that were attempting to capitalize as well? You mentioned this in your reminiscences.

DR: You needed to allow small firms to go forward with their financing. We ended up with a suitability rule requiring that before an investor could buy a stock offered at $5 or under, he had to disclose his financial condition and agree in writing that this investment was suitable for him. This approach put another layer of consent into the transaction.

WT: So part of that's rulemaking, and then part of that becomes part of the Enforcement Remedies and Penny Stock Enforcement Act.

DR: Yes, that act was adopted after I left. As you probably know, recently we have been having reverse merger situations. Chinese firms have come in, bought up companies and then merged and sold them to the public. We have had a re-emergence of bad practices in the small cap stock area.

WT: On the question of the tender offers, I know that most of the Commission at this time was pretty much in agreement with your position, which was that there wasn't a substantial need to address the situation. But to what extent did that continue to exert pressure, particularly from Congress?

DR: The tender offer situation did not take up a very large part of my time. It arose indirectly in one incident later in my time at the Commission when I went to testify before Congress on some tax legislation. Congressman Rostenkowski was head of the House taxation committee. The Office of the Chief Economist had just then finished a report saying that the only identifiable cause of the '87 market crash that could be found without "noise" that made it difficult to measure cause and effect was the proposal in 1987 by the Rostenkowski committee to adopt a special tax on takeover profits. The Office was about to release the report on the day before I was testifying. I asked, "Could you at least wait?" (Laughter) But takeovers were not an important subject for me.

WT: It didn't last.

DR: No. What did last, of course, was the market crash.

WT: Yes. So let's get to that. One of the things that come up as part of that is the relations between the SEC and the CFTC, of course. And you had spoken about the question of stocks index futures just days before the October crash. So could we maybe start at that level and talk about what the status of the Shad-Johnson Accord was when you arrived?

DR: The Shad-Johnson Accord was an accord dealing with jurisdiction between the CFTC and the SEC. One story that was recounted to me – I think by Al Sommer – was that when the Administration was drafting the legislation authorizing the CFTC, Al went over to the White House to talk about what role the Commission would play in futures regulation. He and Ray Garrett talked about the regulation of commodities, which at that point primarily involved contracts on physical commodities and not financial futures. Ray said, "Well, we don't want to regulate pork bellies, do we?"

So the Commission did not seek to regulate commodities futures contracts. However, as you know, the legislation gave exclusive jurisdiction over futures to the CFTC. The problem dealt with by the Shad-Johnson Accord was whether futures on stock indices would be subject to SEC jurisdiction because they dealt with stocks or to CFTC jurisdiction because they were futures contracts. The Shad-Johnson accord gave jurisdiction over stock indices to the CFTC and jurisdiction over single-stock financial futures to the SEC.

By the time the '87 market crash came, trading at the Chicago Mercantile Exchange existed in an index on the S&P 500, called OEX, in fairly large volume. Computer trading was new, and the futures industry was ahead of the stock industry. Although there were some computers on the floor of the New York Stock Exchange, they were primarily devices for the wire houses floor traders to communicate with their branches. Trades in individual stocks would be done at the specialist's post between individuals, not through computerized execution. There was no index trading.

In contrast, the commodities futures markets were conducting some of the trades in index contracts electronically. Although the OEX contracts covered S&P stocks, they were treated as an equivalent to the DOW. The price of one OEX contract on the Merc was treated by the market as equivalent to twelve points in the Dow. So if there was a 10-point swing in the futures contract, there was potentially a 120-point swing in the stock market.

There began to be an arbitrage between the OEX price and the prices of the stocks contained in the index. If the prices of the aggregate stocks in the OEX weighted index were different from the prices reflected in the CFTC futures contract an arbitrage profit capturing the difference in prices in the two markets could be made by buying or selling the stocks in the index and at the same selling or buying the index.

There were two collateral effects to the futures trading. One was that since you could essentially buy all the stocks in the index through one contract on the commodities exchange, institutional investors had a relatively easy way to hedge their broad securities portfolios. As a result institutional investor trading was accelerating. Mutual funds, insurance companies, college endowments, pension plans, and other institutions that were holding large blocks of securities could trade the equivalent of the entire securities market in the commodities markets, which was very difficult to do it in the stock market.

The other effect was that institutional investors began to engage in a so-called portfolio insurance strategy in which they could use the futures market to hedge their stock positions. The portfolio insurance theory did not require the institution to have a hedging contract in place. Theoretically the institution could rely on a dynamic hedging strategy allowing it to wait until the market started to go down or up, and then place its hedging positions. Under that theory, the institution did not have to have its capital tied up in hedging positions. However, the theory did not work in the stock market crash because the institutions as a group could not execute their hedging transaction in the futures market at the same time. Since they couldn't use the futures exit they instead sold stocks in the securities markets, adding to the pressure on securities prices. At the same time there were arbitrage positions being taken in which shares would be sold at prices in the stock market that were greater than the equivalent purchase prices in the futures markets.

WT: So, because of the effects of one market on the other, and globally as well I guess, did it seem like the division of regulatory responsibilities was just becoming problematic at this point and would have to be renegotiated? After the crash, of course, you have the Brady report, which suggests that these things need to come together.

DR: I had been briefed about the dangers of pressure on the stock markets coming from the futures markets. When you've been nominated, before you're confirmed, you go to the Commission for briefings. I spent many, many days there being told about the areas regulated by the SEC. The Division of Market Regulation told me about the possible effect of the futures market on the stock market. There had been an event in January of '87 involving futures related volatility in the stock market. The staff briefed me on that volatility, alerting me to that possibility in the future.

Indeed, on October 6, 1987 I gave a talk in Chicago that was basically a staff-written report, worrying about what John Phelan, the head of the New York Stock Exchange, had referred to as a nuclear melt down, but which we called a cascade theory, that the stock market would go down and the futures market, because it allowed quicker trading, would cause the effects to be exaggerated.

There wasn't much general pre-crash discussion between the two markets about the volatility issues. There was discussion whether hybrid instruments, bond or stock derivative instruments where value was dependent upon an underlying commodity, were securities or futures. But before the crash, stock index derivatives were not a big issue. They certainly were after the crash.

WT: You've told the story of the crash on at least a couple of occasions, and I think you've written about it, and some of the documents are available so I won't ask you to go into your experience of it in great detail. But in the aftermath of that, how long did it take to really kind of appreciate the various factors contributing to what had occurred? And of course, you had some preconception in these issues that we've just been talking about, but there were a number of other things besides that you started to articulate in speeches over the following year.

DR: Well, if you look at my speeches, I did talk about the crash a lot.

WT: Right.

DR: Immediately after the crash, the Division of Market Regulation began to create a report. They wrote the report over about a three month period. I helped to edit the report, and other commissioners did too. It took a fairly long period of time for the Division to get the information. We are not talking about computer-generated audit trails. We are talking about individual brokerage records and stock exchange records. So that took a couple of months. As I remember, it was January before the Commission produced the report and I testified before Congress. I remember my joke was it took three months to prepare a three-pound report. Think about what would have happened if we brought it to full term. (Laughter)

WT: Was this happening at the same time as Nicholas Brady was putting together his report?

DR: Yes. The first post-crash report that came out was the Katzenbach report, and the second one was the Brady report. The most startling aspect of the Brady report was its conclusion that the stock futures and the stock markets should be regulated as one market by a single regulator. I can remember vividly reading the recommendation. It said something like, "And we believe there should be a single regulator. That regulator should be…" I turned the page, and it said, "the Federal Reserve Board." I thought, "Who? What does the Fed know about stock and futures markets?" We knew about futures because we regulated the options exchanges. An options exchange really involves futures. We knew how to regulate stock index futures, were capable of doing it, and should be the single regulator, not the Fed. We had arguments at the Commission about the subject. Eventually the Commission sent to Congress proposals that jurisdiction over stock market futures be transferred to the SEC.

WT: This was a suggestion that you wouldn't have come up with on your own if not for the prodding of the Brady report?

DR: I don't know. I only know that it did happen that way. Certainly, almost as a defensive mechanism to the Brady Report, we wanted to say the SEC should regulate the single market. There's one other important aspect of the market crash. I was called to the White House and met with Howard Baker and others. I was told that the Administration believed there should be high-level discussion of what should be done about the markets. The proposal was to form the President's Working Group on the Financial Markets. The chairman of that group would be the Secretary of the Treasury and the other members would be the chairman of the Federal Reserve Board and the chairman of the SEC. I responded that the chairman of the CFTC should also be included. If I had been really self-interested, I might not have made that suggestion, but at that point I didn't have a sense of a conflict between the two agencies. The group was organized, and we met for about three months before a report was issued in May of 1988.

WT: Now, in the sense that there could have been a really substantial high-level realignment, my understanding is that it simply is something that the people in Congress with the separate committees responsible for the CFTC and the SEC would simply not countenance. But aside from that, was this the sense that something might go forward to that effect?

DR: In our working group?

WT: Sure, or anywhere.

DR: No. Even at the SEC there was disagreement. Commissioners Fleischman and Grundfest were against any transfer of jurisdiction.

WT: Right. And so, I guess there was, between things like your comments about the market possibly closing on that Monday and so forth, there was quite a bit of heat on you in this period as well. I don't even know how to articulate it.

DR: There was pressure, but it didn't come from my remarks on October 19. On that day, about noon I commented to reporters that we could close the markets for a short time if necessary. The problem was that the market was going down. We didn't know what was going on, and could only contemplate possible steps. The comment was reported as a statement that we intended to close the markets. I learned a lesson about the press.

One very significant fact that I learned, eventually, was that the futures exchanges and the stock exchanges didn't have much contact with each other. They weren't communicating. At one point I called Kalo Hineman, who was then the chairman of the CFTC, and suggested we should get the exchange leaders together. Kalo and I organized a meeting in my office at the SEC between John Phalen, who was head of the New York Stock Exchange, and Leo Melamed, who was head of the Chicago Merc, just the four of us. Memories are sometimes one-sided, but my memory is that I told John and Leo that there needed to be cooperation between the two exchanges and that if they didn't at least get to know each other and communicate with each other, the future would be hard to predict.

I was adamant in insisting on cooperation between the two of them. And I think communication got better. One of the things that we learned after the crash was that personnel at the two exchanges didn't even know who to call. They didn't know the names of people at the other exchange to call, other than perhaps the chairman. There was no staff interaction.

WT: The last question that I want to ask about these jurisdictional questions are these court cases, I guess over the stock index futures, where the Board of Trade and the Merc, I guess sue the SEC over the regulatory jurisdiction. How did that unfold? I mean, how did that come about, and how did it become resolved?

DR: Those cases involved jurisdiction over hybrid instruments, derivatives based upon the underlying values of securities. The SEC lost most of the cases. I don't remember being intensely involved in those court cases, and I would have to look back and see when they were litigated and when they were decided. It very well may have been slightly after my time. There was one issue that had to do with jurisdiction over the regulation of bonds. I don't think we lost completely in that case, but I'd have to go back to look at records before I could talk about it intelligently.

WT: And then as far as the reforms that were put into place after October of 1987, I mean, you were an advocate of increasing the margins and that was something that didn't make its way through, but then there were the circuit breakers. It's all a bit of a scrum in the historical record.

DR: Well, I learned a great deal about how a government works. When I was called to the White House and was told of the intention to form the President's Working Group, I was asked to agree not to bring any legislation forward until the Group's report came out. This White House meeting was in early 1988. I had been in office for four months and I was not a Washington insider. It wasn't until the summer of 1988 that we finally put our legislation forward. But by now since it was summer Congress was going to adjourn and was unlikely to act until the fall. I suddenly realized that one of the results of my agreement not to go forward before a Working Group report was issued was that the legislation wouldn't be introduced at a time when Congress was terribly worried about market problems. The issues would have faded away. The time for congressional action in times of crisis would have disappeared. That was a hard lesson, and I learned it the hard way.

There were six pieces of legislation that we eventually proposed. There were four we called the "four easy pieces." The other two transferred jurisdiction over stock indices to the SEC and dealt with margins, and were very difficult. I don't think I can give you all the detail on all of the other ones. I know the Commission was given emergency powers to close the markets and other legislation addressed coordination of the two markets. I'd have to look back to get specific details about all of them. The interesting part about the President's Working Group, at least from my point of view, was that discussion rather quickly eroded into an argument by the Fed, the Treasury, and the CFTC that the margins in the stock market and the margins in the futures market were economically equivalent.

The two markets work quite differently. With stock margins when you buy a security on margin you have a 50 percent initial margin requirement. But if you own other securities, you can borrow against those securities to buy new securities. In fact, what happened was that the brokerage firms installed their own continuing margin requirements – I think in the 25 to 35 percent range. In the futures market, initial margins were approximately 5 percent, but in addition variation margins were required. Variation margins involved a daily calculation as to whether a position has lost or gained in the market, and required posting of additional funds to reflect the differences.

When you buy a futures contract you are placing a bet. I bet that the market will go up and you bet that the market will go down. Every day we settle up. If I owe you something I pay, and if you owe me you pay. Variation margin is a protection against either side not paying. In the President's Working Group the view was presented that futures margins and stock margins were economically equivalent. My position was that the low futures markets initial margins were speculative. That difference in view got everybody very excited and we spent an enormous number of hours worrying whether the margins were equivalent, with all kinds of studies.

The Treasury had an economist who was very free-market oriented. The Fed and Alan Greenspan were free-market oriented. The CFTC, we believed, was primarily interested in protecting the functioning of the futures exchanges. The CFTC's obligation primarily was to protect the ability of the exchanges to function well in the trading environment. Our obligations had to do with market efficiency, protection of investors, and capital formation. We had broader responsibilities that caused us to look at markets in a different way.

So we argued that there was speculation caused by the low margins. The Working Group ended up fighting about margins. The Fed, the Treasury, and the CFTC kept insisting that the margins were equivalent in both markets. In early May or perhaps in late April, before our report was to come out, I was called into the Secretary of Treasury's Office and was asked whether I would agree to a unanimous report of the President's Working Group. I said I would agree on one condition. I told Secretary Baker that there was disagreement about whether futures market margins and securities market margins are the same. I agreed that if the report was silent on that particular point, I would sign it.

When we got to the first drafting session, the proposed draft contained paragraphs asserting that the margins were approximately the same. I was very upset, since I regarded that conclusion as wrong. I found myself in a tough position. I had said I would agree to a unanimous report, and now I was presented with a report I could not agree to. So the SEC ended up drafting a couple of rebuttal paragraphs. I didn't dissent from the whole report, but there were paragraphs in which I dissented from the conclusions about margin. That dissent caused an enormous fuss in Congress.

When we went forward with the two hard pieces of the six legislative pieces, I knew in my heart they wouldn't get adopted but I thought it was the right thing. Shifting jurisdiction over stock index futures was to me the way in which the jurisdictional and margin issues should be solved. That provision created difficulty for me because I had to testify before the Committees whose members didn't particularly like my points of view.

WT: Were the four easy pieces as easy as they were anticipated to be?

DR: They were adopted. I can't remember chapter and verse about all of them, but they were adopted. Later on, it turned out that our emergency powers piece that gave the Commission the power to close the markets after consulting with the President was very important to Harvey Pitt when the World Trade Center catastrophe happened.

WT: Right, right. At the time, reading back over your speeches and some other documents, it seemed as if the repeal of Glass-Steagall was imminent at that time. What's your recollection of that?

DR: One of the interactions I had with the banking community was a long-held position by the SEC that banks engaged in the securities business should be treated as broker-dealers and regulated by the SEC. Over time the Comptroller of the Currency had issued exemptions for the banks, gradually allowing them to engage in certain securities activities. We were upset that the banking regulators were allowing the banks to become securities dealers without being regulated as securities dealers. And the policy reason, I think, is still in existence. You are seeing it today in the FSOC problems. You're still seeing it because the banking regulators are basically concerned with the safety and soundness of banks. The Securities and Exchange Commission is concerned with the protection of investors. The banking regulators want to keep the banks from becoming insolvent. They don't have the same concern for investors. That difference began with a controversy about bank activities as broker-dealers, but it has expanded today into concern that the FSOC will attempt to regulate the securities industry as part of its effort to deal with systemic risk.

In 1988 Senator Proxmire called me to his office. He told me he was going to introduce a bill to repeal Glass-Steagall, and asked for my support. I said I would oppose it unless the bill contained a provision that banks acting as broker-dealers should be regulated by the SEC as broker-dealers. There's an exemption in the '34 Act exempting banks from being regulated as broker-dealers.

The Glass-Steagall repeal incident was quite emotional for me because Senator Proxmire had voted against my nomination on the grounds that I was not a tough regulator. In that first meeting about Glass-Steagall my emotions were stirred up by my comment to Senator Proxmire that we were going to oppose the bill if a provision was not included giving the SEC power to regulate broker-dealer activities. I remembered that during my confirmation the Senator said he wasn't going to vote for me because he didn't think I was going to be a tough regulator. When I said I was going to oppose his bill, he said he was the chairman of my oversight committee and I couldn't do that. I told him I believed we had to oppose the bill in order to protect investors. And in my mind, I was saying, "And you said I wouldn't be a tough regulator? Listen to me now." (Laughter)

Senator Proxmire later agreed to put a provision in the bill giving the SEC the right to regulate banks acting as broker-dealers. Then, at a later point he called me at home to apologize, telling me that the bill was going forward without that provision in it.

Glass-Steagall repeal failed. That incident was a learning experience for me. I remember being in a senator's office in which the senator was all over us about the fact that we weren't going to support the bill. I understood the power of the implied threat.

WT: And then one other thing that I definitely wanted to ask about is municipal securities. We've been looking at, and we're putting together a gallery on those. That's practically finished right now. But of course you were there when Rule 15c2-12 comes through. And, of course, the WPPSS Report is part of that, and I'm wondering if you can give me your perspective on how all that came about and who came up with 15c2-12.

DR: The WPPSS Report came first. The Commission had been working on the WPPSS Report for a long time before I got there. By the time the draft report was completed, three out of the five commissioners had recused themselves, so there were only two of us left to decide whether or not we should go forward and recommend any kind of enforcement action. The report was long and complex. It was written with the background of the New York City problems of some years before. Charles Cox and I were not recused, so he and I talked extensively about it. We learned that there were numerous class actions stemming from the WPPSS. The actions were all consolidated in Texas. The litigants had to rent halls to have meetings of all the plaintiff and defendant class action lawyers.

This matter was fairly far along in my chairmanship. I began to try to figure out what it would cost the Commission in terms of time and resources to pursue WPPSS enforcement actions. It was a difficult decision. I was quite concerned about the failure of the rating agencies to downgrade the WPPSS bonds when they should have known that there were problems. The Washington Public Power Supply System had entered into contracts with electric companies containing "take or pay provisions". The contracts said that if the system didn't take the electricity, it would have to pay for it anyway, something like that. Those take or pay contracts caused tremendous financial problems for the system.

There were some disclosures at the time of the original sale of the municipal bonds, but they were minimal. Additionally, nothing was being done afterwards by either the underwriters or the credit rating agencies to report on the financial condition of WPPSS, the issuer of the bonds. I was concerned that the aftermarket in municipal bonds wasn't being taken care of properly.

Eventually we did not take enforcement action and we received some heat from Congress. Subsequently, the Division of Market Regulation drafted Rule 15c2-12, which was, to my mind, brilliant, dealing with initial disclosures by municipalities when selling bonds. You may know that the Tower Amendment says the SEC can't require disclosures from issuers of municipal bonds. The staff came up with the theory that the underwriters who were selling these bonds had to have a reasonable basis for their recommendations. If they didn't have the offering circular in front of them at the time they sold the bonds, they couldn't have that reasonable basis. That was a really brilliant way of forcing the issuers into preparing an offering circular, forcing the underwriters to read it, and then requiring them to represent to purchasers that they had a factual basis for their recommendation. I thought that was an ingenious way around the Tower Amendment. Of course Rule 15c2-12 as adopted did not solve the problem of adequate continuing disclosure by bond issuers. However, as you know, Rule 15c2-12 has been amended to require some continuous disclosure, and the EMMA depository has been established at the MSRB to make those disclosures public.

WT: Much more recently, of course.

DR: Yes.

WT: That was an interesting set of interviews, getting through the whole array of things that had to happen before one ultimately got to EMMA. We obviously don't have to go into that now.

DR: Well, no, because we're talking about history here.

WT: Yes.

DR: But the brilliant idea of using the underwriter as the fulcrum of the regulation has allowed regulation in the municipal securities area to go forward in a very strong way.

WT: Oh, yeah. I mean, there wasn't much you could do besides, except under the fraud provisions.

DR: Right.

WT: Yeah. No, it is really the fulcrum of that whole history, so it's interesting to get the SEC perspective on that.

DR: And it's wonderful that the Commission is concerned about municipal securities now.

WT: Yes. So we've been going on at some length, and so I'm conscious—I don't want to kill your throat from talking.

DR: It's all right. It's better since I've gotten some water to drink here.

WT: Okay. So is there anything else that you'd like to get into from your time as chairman? I have miscellaneous issues, but like I say, I don't want to go on without end.

DR: Well, I think from a historical point of view, one interesting point is the effect of the Sunshine Act. It is my understanding that before the Sunshine Act, the Commission behaved in a very collegial way. It could adopt rules without all of the underlying discussions being public. The Commission was a more congenial place. It was, for a long period of time, a Commission in which disagreements were not made public.

By the time I became chairman, there were public statements by commissioners with Commission decisions. These were not formal dissents as they are now, but were nevertheless public statements of disagreement. It was disturbing to me that we couldn't behave in that collegial way, and of course that was only the beginning of a Commission environment in which there are many more policy splits. I eventually ended up deciding that measures passed by a 3 to 2 vote were still sufficient Commission action, even if there were policy disagreements. At one point when Chairman Donaldson found himself in the same position, I told him that "three votes are enough."

WT: I was surprised when I was talking to Ed Fleischman. I mentioned the Sunshine Act, and he said, "No, I have no problem with the Sunshine—" I got the impression that he kind of liked to have things out in public a little bit, that that was his preference.

DR: Well, I like Ed. He's a wonderful, fine man.

WT: He said very nice things about you, too.

DR: I really do. I'm really fond of him. But he had one trait that used to bother me. It's part of that same attitude. The way rules would get adopted at the Commission because of the Sunshine Act was that since you couldn't talk to more than one other commissioner at the same time about policy matters, the legal counsel for each of the commissioners would meet. They would hash things out together and then go back to their commissioners to tell them what problems had been identified. For the most part the commissioners would deal with the problems by having one-on-one talks, giving instructions to their legal counsel, and suggesting new drafts of rules. Eventually we would come to some conclusion. But Ed had this habit of not revealing his positions until the public meetings. He was always very persuasive and would force me to reply in a public setting.

When I came to the Commission I sometimes didn't know what my policy positions would be until I was faced with real problems. I turned out to be much more regulatory than I had thought I would be, and I think more than the Reagan people thought I was going to be. Ed was more conservative.

WT: Well, that's kind of the thing that I guess I wanted to get to, is I know that the Executive Branch—I don't know if it started under Reagan or if it was the Bush administration—that they made things very difficult for you. I don't really know the details of that, but this is what I've heard.

DR: Difficult?

WT: Ultimately that, in a sense, you were compelled to resign in 1989. I don't know if they asked you to, or if just in general they made it known.

DR: That process was fascinating. After Bush the First was elected and he had his transition team in place, an article appeared in *The Bond Buyer* that said I was not going to be reappointed. I was concerned about not knowing whether the article was correct, so I went to the White House to talk to the head of the President's transition team. He told me the President was going to replace the heads of all of the administrative agencies except for Wendy Gramm, head of the CFTC. He didn't phrase it as personal to me. Of course, Wendy Gramm was the wife of Senator Phil Gramm, and replacing her was politically not a very wise choice.

I had been in office for a year and a half, and being chairman had been very much more strenuous than I'd expected. I thought that if I really fought for reappointment, I might be able to stay. But I asked myself what I would be buying into if I stayed. I would have to commit to four more years of the tension and stress that I'd been having. I decided I did not want to make that commitment.

WT: Sorry, when was your term supposed to end?

DR: The President doesn't appoint the chairman as such. He has the power to select the chairman from among the five commissioners. It's usual that the incoming chairman is assured that when he's appointed as a commissioner he will be chairman. Theoretically, the President could change his mind, but that doesn't happen. However, I knew that a new President has the power to select a new chairman from among the commissioners and that I could be replaced as chairman by President Bush.

I told the transition team that when the President had appointed my replacement, I would resign. But I did not send in my letter of resignation. I did not resign. I did nothing. Interestingly the Administration didn't appoint my replacement until October of the following year, so I ended up serving as chairman for 26 months. I never knew whether they couldn't find anybody to replace me, or whether I was so good that they just decided to leave me in office.

WT: Just in general, their decision to replace heads of agency, I mean, was that just because they wanted their own people in there?

DR: I suppose.

WT: You think? Because, I mean, of course eventually you were replaced by Chairman Breeden, and he was one of their people.

DR: Interestingly enough, I did not have any interference or suggestions from the White House during the whole time I was chairman. Nobody called to tell me I was not doing things right, or that I should do this or that. That restraint may have been in part because this was the end of the Reagan presidency and The White House didn't really have a strong agenda at that point. I felt quite independent. I thought I was doing a good job. And of course, that's for history to decide. But we did do a lot of things, and the market eventually got better.

I told my wife that I thought the nomination process would be finished by February or March and that we would surely be home by April. In mid-April I finally sent a letter to the President saying that I agreed to resign as commissioner and chairman at such time as my successor as chairman had been confirmed, and was or would be in office. I didn't leave until a week before Chairman Breeden was sworn in, in early October.

One of the reasons that I didn't leave early was that I found that it was very difficult for the Commission to function without a real chairman, with just an acting chairman. And I think particularly when you have a chairman who's more independent of the political process than others, as I was, it is useful to continue in office. More important, I did not want the Commission to be in the kind of disarray that it was when I came in.

WT: Right. So then after that, you've served in a number of capacities on a number of different boards, beginning I think with the NASD.

DR: Yes. The day my appointment became public, the head of public affairs at the White House told me my life would never be the same. Shortly after I left the SEC I became a member of the NASD board at the request of Joe Hardiman head of the NASD at that time. I believed that the automation in the NASDAQ market was much more likely to produce a successful market than the way that New York was trading.

And then Arthur Levitt, who had been two years behind me at Williams College, asked me if I would help to start the SEC Historical Society, which I did. I organized a group of people to start the Society. Harvey Pitt, Paul Gonson and I were instrumental in getting it really going. Then we hired Carla Rosati, which was a great decision. Since then the Society has had its own life. We were quite concerned for a while that there wouldn't be the financial support for the Society that there is now.

WT: Arthur Levitt recruited you for a couple of other positions.

DR: He then recruited me to be an independent member of the Financial Accounting Foundation. That is the foundation that oversees the FASB.

WT: Right. He had just been in kind of hand-to-hand combat with them.

DR: He had been pressuring them. I found that there was a lot of unhappiness about him at the FAF because he had insisted that a majority of the FAF trustees be independent. When I was at the FAF, I became chairman of the FAF International Committee. I began to be concerned about the effort of the International Accounting Standards Committee in London to create international accounting standards. I was worried that there was a collision coming between GAAP and international accounting standards. I was a representative of the FAF at IASC for a couple of years. I served on the IASC's Strategy Working Party, created in order to recommend changes in the IASC constitution. We were in existence for two years and finally produced a report that recommended a new structure for the IASB. The report was then adopted by the IFAC, the international association of accountants, which controlled the IASC. Then I believe Chairman Levitt was responsible for my appointment as one of the new trustees of the IASCF Foundation, now called the IFRS Foundation.

And then while Arthur was still at the SEC, I received a call one day from Paul Roy, Director of the Division of Investment Management asking me whether I would be willing to organize an educational organization for independent directors, which I did. That organization is now a not-for-profit corporation called the Mutual Fund Directors Forum. I served as the Forum's chairman for ten years. I'm still an emeritus board member. That was a lot of public service.

WT: I know, exactly.

DR: And I've continued here at Northwestern to administer the San Diego Securities Regulation Institute and the Ray Garrett Jr. Corporate and Securities Law Institute. After I left the Commission, Bob Mundheim called to ask me if I would serve as vice-chairman of the San Diego Institute for three years, and then serve as chairman for three years. The year that I became chairman, the University of California said it did not want to administer the Institute anymore. So Northwestern became the administrator.

WT: So you've seen a number of the more controversial issues up close in your time in these various organizations. For example, the SEC's effort to put in independent directors of mutual funds, you were involved with that from the Mutual Fund Directors Forum. Can you tell me about that, or about I guess some of the accounting issues. What springs to mind is that you were working on the accounting of derivatives, right, with the FAF?

DR: At the FAF, we had a couple of issues that had to do with the independence of the FASB. Some members of Congress wanted to have all of the FASB GAAP rules be approved by Congress. Business people were supporting that approach and we spent quite a bit of time fighting that idea. At the IASB, the Board adopted new international accounting standards, including a provision dealing with accounting for derivatives. The European Union adopted the IAS standards, but with a carve-out for the valuation of derivative instruments. The carve-out changed the way banks valued those instruments.

Subsequently I have become very concerned about the effort to try to have IFRS, International Financial Reporting Standards, used by U.S. issuers. I'm not happy about having the IASB, whose governing body may eventually be controlled by the European Union, deciding what our GAAP standards should be. My view is that the original focus was on having comparable standards, not standards that are exactly the same.

WT: It seems like in a lot of cases, one sees the same issues come up again and again. Is it a case of the issues evolve, like you have these annual meetings and you make a little bit of progress at a time, or are there long periods of frustration before activity, you know, finally manages to get through and there's agreement?

DR: Things basically don't move very fast unless there's a crisis. In the mutual fund area, there have been independent directors for a long time. The question has been how to change the environment so that the directors feel empowered to protect the shareholders, as opposed to cooperating with the advisors. The Mutual Fund Directors Forum that we've created is independent of the advisors and has, I think, been very important in helping to induce a gradual increase of responsibility by independent directors.

The most interesting comparison one can make right now has to be with what happened in the '87 market crash and what's happening with high frequency trading. You may, if you look at my piles of books here, see that I have *Flash Boys*, *High-Frequency Trading*, *The High Frequency Game Changer*, and other books which are related to the computerization of the stock markets. I've been fascinated with the developments in that area now, as compared to what we were looking at in 1987. Until recently I was very concerned that the Commission wasn't doing enough about potential market breakdowns, but its new Regulation SCI is moving in the right direction.

WT: For all the thematic similarities, is it a completely different set of issues with all the different technologies that one has now, or is it a case of going back to the history of, say, the '87 market crash?

DR: The markets have changed. Mary Schapiro had me appointed to the Joint CFTC-SEC Committee on Emerging Regulatory Issues, which issued a report dealing with the 2010 Flash Crash, so I have become re-engaged with the technical issues. Particularly in the last six or eight years, the technical issues have changed dramatically. But fairness to retail and institutional investors, protections against volatility, problems of market efficiency, and problems of possible market breakdowns are all still with us. It's just that the mechanics are very different.

WT: Analogous problems, but with specific solutions.

DR: Specific solutions.

WT: Different and specific.

DR: The other important matter is the question of dealing with big data. As you may know, the Commission is now faced with huge information dumps in the trading environment. Another question now is how to deal with EDGAR information in a rational way. I have just finished being co-chairman of a group talking about the future of the Securities and Exchange Commission in a changing world. The idea for the conference originated with Rod Hills, a former SEC chairman. He enlisted Harvey Pitt, also a former chairman, and me to help him create the conference, and then unfortunately he died. Harvey and I undertook to hold the conference in Rod's honor, and to talk about the role of the Commission in a changing world, which is a very, very difficult question.

WT: You were also involved with the PCAOB?

DR: Yes. When Bill McDonough was the first chairman of the PCAOB, he started a PCAOB Advisory Committee consisting of a high-level group of people. I had known Bill when he was a bank executive here in Chicago. Then he became chairman of the New York Fed. When he became chairman of the PCAOB, he appointed me to the first advisory committee to the PCAOB. I'm now an emeritus member, but I still attend when I can.

WT: I guess you joined in 2004, which is a couple of years into it.

DR: It was the first year for the committee.

WT: Oh, it was the first year.

DR: Yes.

WT: Oh, I see.

DR: But there's a technical advisory committee that worries about what the rules say. We try to give advice about the broad scope of the PCAOB's activities.

WT: Was that a difficult organization to get going?

DR: The PCAOB?

WT: Yeah.

DR: Very hard. It took quite a bit of time before it got its sea legs, but I think it's functioning very well now.

WT: What were some of the key issues in those early times that you dealt with?

DR: Congress solved the important funding issue when it created the PCAOB. An initial issue for the PCAOB was how it should go about adopting auditing principles. Recently the PCAOB has been concerned with the question of the role it should have with regard to audit committees and the way they function.

Those are very difficult areas, but as you know the PCAOB is very closely monitored by the SEC. The FASB is not so directly controlled. The Commission has delegated to the FASB the right to create GAAP. It could always withdraw that power, but it's unlikely it would ever do that.

So my life has changed. I've been very happy with my association with the SEC and people in it. I'm a great admirer of the SEC people I've known.

WT: Well, I don't have any more questions myself, and it seems like a good place to wrap up.

DR: A good place to stop. I have to leave here shortly.

WT: Well, very good then. Thank you.

DR: You're welcome.

[End of Interview]