Securities and Exchange Commission Historical Society
Interview with Stephen Friedman
Conducted on February 18, 2009, by Kenneth Durr

KD: Interview with Stephen Friedman, February 18th, 2009, in New York City by Kenneth Durr. I want to jump into things with a little bit of background.

SF: Sure.

KD: You did law school at Harvard. Is that right?

SF: I did. Yes.

KD: Any influential professors at that point?

SF: Well, I guess the most relevant thing to the SEC is that I never took a course in securities law.

KD: I've heard that before. Funny how that works out. So you had no idea that this was a path you might follow?

SF: No. Well, I thought of myself as headed toward being a corporate lawyer. And, obviously, securities law is an important part of that. But at that time, I saw little connection between what I was going to practice as a lawyer and what I did in law

school. I might tell you that, as a law school dean, I have exactly the opposite view. [Laughter].

KD: So you tell people, "Don't do what I did, figure out what you want to do later in life."

SF: Yes, precisely.

KD: And then you went to work for Justice Brennan as a law clerk. Was that right out of law school?

SF: Yes. Actually Iwas a year out first. I was in the Army for six months, and then worked at Debevoise, what was then Debevoise, Plimpton, Lyons & Gates for six months, and then clerked.

KD: Okay. So you were doing corporate law for Debevoise, Plimpton?

SF: No, I was doing what a first-year associate does, and in 1963, that was pretty much everything. So not so much during that six-month period, but later when I started, I did corporate law, I did tax law, I did litigation, I did labor law.

KD: Any inkling at that point that you were heading toward an interest in securities?

SF: Not during those six months.

KD: Okay. How did you end up with Justice Brennan?

SF: At that time, all of Justice Brennan's clerks were recommended by Paul Freund, who was a professor at Harvard Law School, and Paul recommended me, which was an extraordinary thing.

KD: Yes. Had you been on the *Law Review* at Harvard?

SF: Yes.

KD: Okay. What was the one thing that you picked up working for Justice Brennan that you took with you through your later career?

SF: That it takes five votes to win. I'm actually not joking because, at that time, it was a relatively short period in the court's history when the so-called liberal group had a majority. Arthur Goldberg was on the court. And that group would do almost anything to keep their five votes. And prior to the time that Goldberg was on the court, a critical role that Justice Brennan played was as a bridge between the liberal and conservative group. He was, in those days, a master at finding narrower grounds that both sides could support.

KD: So focusing on getting those five votes.

SF: Yes. It sounds strange to say that for someone who had spent their time reading opinions, but the internal workings of the court have a profound effect on the shape of the opinions.

KD: It's ultimately politics, I guess.

SF: Well, politics demeans it, I think. There is a process of collective decision making that sometimes revolves around high principle, and sometimes revolves around the quirks that justices have. I remember Justice Black refused to join any opinions that had Latin words in them [laughter]. Many justices had quirks like that, but those things don't determine the outcome of cases.

KD: Yes. How long were you there?

SF: One year.

KD: Is that customary?

SF: Yes. There are occasional exceptions, but all of Justice Brennan's clerks served there for one year.

KD: And did you go back to Debevoise at that point?

SF: No. After that, I became special assistant to the maritime administrator for a year, which was a wonderful year. It was my first experience in the Executive Branch, and strangely enough, that agency was, and I assume still is, in the business of subsidizing American shipping and ship construction. So it was my first exposure to deregulation, which was a major objective of ours. The maritime administrator was twenty-nine; I was twenty-six. He was a brash young lawyer.

KD: How did you end up in that situation?

SF: His name is Nick Johnson, I met him at a party. And, you know, the typical course for a Supreme Court law clerk those days in Washington was to work as a special assistant to an assistant attorney general. I was really more interested in pursuing the non-legal side of the government. And there were a couple of jobs I was interested in that I didn't get. And this came along. Nick Johnson, who was the maritime administrator, was a very iconoclastic person, and I thought it would be fun to spend a year with him, and it was great.

KD: I guess that would've been a fairly hidebound organization at that point, the Maritime Administration?

SF: Well, the rest of the organization was pretty hidebound. We were not, and the clash was, fascinating.

KD: So you were attempting to do some deregulation.

SF: We made a lot of changes, yes. And that was – President Kennedy was killed the year I clerked, so my year at the Maritime Administration was President Johnson's first year. And I think this has been lost in history, but that was an extraordinarily exciting year. The Kennedy legislative program had really stalled, was going nowhere. And when Johnson came in, the emotional momentum of the assassination gave him tremendous power, so there was a huge legislative agenda that was going forward, the Voting Rights Act, Civil Rights Act, the OEO—Office of Economic Opportunity, and it was a very exciting time. So it was, even at the Maritime Administration, it was a very exciting time. And the Maritime Administrator was a kind of protégé of the president's. The president had met him somewhere and liked him a lot, and appointed him head to this agency at 29, which is pretty extraordinary.

KD: I want to know a good bit more about the next thing you went to, which was Deputy Assistant Secretary for Capital Markets.

SF: Yes, but I practiced law in between. I went to Debevoise in 1965. Started as a general associate, migrated into the corporate department, and became a partner in, I think, 1971, something like that, or '70. And at one point during that period, I was asked to teach the seminar in advanced securities law at Columbia Law School, which is really how I learned the securities laws [laughter]. I was a practicing securities lawyer. But I remember when I started preparing for this course, it was the first time I had ever read the

Securities Act from beginning to end. And I remember thinking, "Hmmm, now I understand how it really works," [laughter].

KD: So you just kind of picked it up in the course of doing your work, securities.

SF: Well, but that's the way it worked. Sure. But I learned a huge amount from teaching because, as you know, one, you have to understand it; and two, you have to organize it in some meaningful conceptual structure.

KD: And stay ahead of the students.

SF: And stay ahead of the students, who were a smart group. In addition to which, I had in my seminar financial journalists who were an extraordinarily skeptical group of people. And if you know what a Chinese Wall is, well, I remember the scorn with which these financial journalists treated the idea that a Chinese Wall would actually work. So it was really, in terms of actually learning securities law, that and my service as a commissioner was very…

KD: How long did you teach at Columbia?

SF: I taught in two periods. I taught securities law for, I think, four or five years. And then I went to the Treasury and the SEC. When I came back, I taught a seminar in regulation of financial institutions, which is just broader than securities law. I had become a kind of

willy-nilly expert on the Glass Steagall Act, and in the regulation of investment companies. I covered banks, investment companies and securities firms.

KD: When did you become the expert on the Glass Steagall Act? Was that teaching?

SF: Well, really at the Treasury. And then later at the SEC. But it was at the Treasury, well, let me put this in chronological context. In 1978, which was the beginning of the Carter Administration, I joined the Treasury as the deputy assistant. And I used to tell people that your importance in Washington is inversely proportional to the length of your title. And my title was Deputy Assistant Secretary of the Treasury for Capital Markets Policy.

KD: As long as you can get.

SF: But I was in charge of an office that formulated policy on financial markets, financial regulation. It was the beginning of the thrift crisis. It was the period when the International Banking Act was adopted, which was a major change in the regulatory structure for international banking. And there were major movements in amending the Glass Steagall Act, which ultimately culminated a few years after I left.

KD: So you were primarily interested in banks at that point?

SF: Yes. A lot of it was banking policy and thrifts. But we did a number of studies and took major positions on Glass Steagall, which was really the divisional function between securities firms and banks.

KD: Was this the first time that people had started re-evaluating the Glass Steagall distinction?

SF: No, it had really been going on for years, at least ten or fifteen years. Because what happened was, you know, the regulatory system—and we're seeing the ultimate result of it now—the regulatory system was premised on the notion that there were discreet kinds of financial institutions that did different things, operated in different markets, and could and should be regulated differently. And it was largely the inflationary pressures that came, really stemmed from spending in the Vietnam War during the Johnson Administration, but culminated in the late 70s and the early 80s. Remember, Volcker became Chairman of the Fed in, I guess, '80 or '81.

Those financial pressures totally changed the financial markets. It put everybody in everyone else's business. For example, I spent most of the first year on deregulation of interest rate controls, which sounds very boring. But the banks and thrifts were not allowed to pay market rates and interest. So at a period when there was huge inflation and very high interest rates, the prime rate at one point was 17 percent, banks and thrifts were paying 4 and 5 percent. And thrifts, in order to protect the savings and loans, were paying a little more.

That's the reason money market funds were invented because retail investors were being denied the right to get market rates in interest. Put your money in a bank savings account, I think it was actually 3 1/2 percent, it was some preposterous amount. And so money market funds were invented as a way to give market rates to ordinary people. And so at that point, the securities firms got into the banking business. At the same time, in investment management, institutional investment management, that is management of pension funds, had really been dominated by the banks, starting after the Second World War, because they had trust powers. And the securities firms and insurance companies, life insurance companies, tried to get trust powers. Congress wouldn't give it to them. So they started to invent instruments.

That was the growth of the investment advisory industry, big growth in institutional investment companies, mutual funds. And the insurance companies started to develop insurance products for both institutions and individuals. They were, basically, securities products. They were investments in pools of securities. So and all of this was really driven by inflationary pressures and the fact that everyone was competing for the same pools of capital, and everyone had their unique set of regulatory constraints that were that were totally inappropriate for the time. Market conditions, economic conditions had changed radically.

So there are all these, what had become very weird provisions that made a great deal of sense, but the original premise no longer made any sense at all. So as this process developed during the 70s, there were increasing efforts to change the regulatory structure.

And on the bank and thrift side, all the money was flowing out of something called disintermediation, which basically means money was coming out of the banking system and going into securities products so people could get current rates of interest. So there were constant attempts to change the regulatory structure through legislation. And that really went through the early 80s.

I've forgotten the name of the statute that effectively ended a lot of the Glass Steagall Act, but then there were a series of regulatory changes that legitimized all these new products in each industry. So it was a great job. I learned a huge amount, and I came to understand the capital markets in a way that, as a lawyer, I hadn't begun to.

KD: So your job was, essentially, to study all these things that were happening?

SF: Well, it was to formulate the administration's policy, usually on legislation that was going on. Or to the extent it was an administration initiative, there was, for example, an administration bill to deregulate the regulation of interest rates, there were administration bills on changing the regulatory structure for the financial markets. And so we would, this office did the analytical work, made a recommendation, in effect, to the secretary, and then that would go to the president. And then that would be reflected and either bills were presented or testimony that I or someone else – I testified a lot.

KD: Oh, really?

SF: I spent a lot of time on the Hill.

KD: You were still pretty young at this point too, I would guess.

SF: Yes, I think I was forty. Something like that. Seems young now [laughter], not to the guys in this administration. So it was really an intellectually explosive experience for me.

KD: And so that put you right on the threshold of the point at which you were tapped for the SEC, I guess.

SF: What happened is I actually left the Treasury and went back to my law firm. And I went back in June, and I took off three months. I was going to write something, which I never finished. And on my first day of work, as I was walking out the door, the phone rang, and my wife said, "It's Harold Williams," who was then chairman, and who I'd gotten to know. And Harold told me that Roberta Karmel was leaving the Commission and asked me if I were interested. I remember saying, "Harold, this is my first day at work." And about six months later, I left to go back to the SEC.

KD: So you did take Roberta Karmel's slot.

SF: Yes, I had her, I think it was hers, her unexpired term.

KD: So you had met Harold Williams earlier, and that was –

SF: When I was at the Treasury. I, at one point, was helping the fellow whose title was Director of White House Personnel. It's basically the office in the White House that's in charge of presidential appointments. And as you know, the Commission has a mandatory political split. John Evans's term had expired. He was a Republican, and the Carter White House asked me to help them find a nominee for that seat who was a Republican, and was a person they would be comfortable with, which meant a pretty liberal Republican. And we were, ideally, looking for someone who was not a lawyer, who was a capital markets economist or practitioner. And after a great deal of work, we couldn't find someone and John was reappointed. And when I was later a commissioner, he and I were good friends and I liked him a great deal. This was not a personal thing. But during that period, I got to know Harold Williams very well.

KD: How much did your job with Treasury intersect with the SEC?

SF: Some, but not a lot. I would say 80 percent of it was banking, banking and the thrift industry.

KD: All right. So you had come to the attention of the folks at the White House who might be looking around.

SF: Yes. So I was back at my firm for about six months. And as you know, it's a lengthy process, even then, in filling out these forms and going through the clearances. And then I rejoined the Commission, I think, in June or July, something like that.

KD: Did you talk to President Carter before you went in?

SF: No. I only met President Carter once, other than shaking his hand at some event, and that was when at the very end of the administration, my term was extended beyond the end of the administration, but at the end of his administration, I got word that I was to come to the west wing entrance to the White House at a certain time, and I showed up, and there was a long line of presidential appointees who were there. I mean, this stretched for a block. And my part of the line was over with all the regulatory agencies, and we were lined up to have our picture taken with President Carter. So when I finally got to the door, they said, "Walk down that hall. You'll see a room with a bright light. Go in there."

So I walked in, and there was a room with a bright light, there was the president. We shook hands. He gave me a big smile, they took a picture. It looks as though we are the closest of friends. I walked out, and that was the end of my relationship with President Carter. [Laughter]. I mean, I dealt a lot with the White House staff, and I wrote memos and recommendations that the president read and initialed and approved or didn't approve.

KD: I guess I'm wondering, as you were being vetted and when you got the word, "Are you interested in this position," was there any discussion of what Carter's vision was for the SEC?

SF: No. Well, I don't recall any. I mean, no. I don't recall any.

KD: Okay. Well, how about Harold Williams?

SF: Harold and I talked a lot about what the Commission was doing, and some of the challenges it had. The day I was sworn in, I think it was a Tuesday, and Harold said, I've never forgotten this, Harold said to me, "I'm really glad you're here. We have some very important issues to deal with on Thursday." And on Thursday, I think this is right, I don't know if it was that week or the next week, we adopted the shelf registration rule. I have to say that the Commission had no idea of the implications of this rule.

This was, as I said, a period of very high interest rates, extreme fluctuations in interest rates. And the CFOs tried hard to do their public financing during a downdraft in these fluctuating interest rates. And the Commission tried hard to process registration statements very quickly so that they could take advantage of these windows. And they got the processing period down to something like 24 hours. And the CFOs said that wasn't fast enough because rates were fluctuating so quickly. So the shelf registration rule was adopted really to speed up the ability of a credit-worthy borrower to hit the markets at just the right time. They viewed it as almost a mechanical step.

In fact, it totally changed the whole nature of public debt financing in America. It radically changed the relationship between issuers and underwriters. What had been, often, a long-term financial advisory relationship became commoditized. CFOs would ask firms, in effect, to bid on a deal. There was almost no time to do due diligence because they would go to market immediately. It's fascinating. There are a number of examples of small steps. Particularly, you see it a lot in the financial markets, small steps that radically changed things in a way that no one had anticipated. Shelf registration rule is one example.

The creation of mortgage-backed pools, which simply took mortgages that were already guaranteed by the Federal Government, and put them in a pool and made a public security out of them, created what was the most revolutionary change in financing probably in the last century. There were all these tiny changes that have profound effects. This was certainly one of them.

KD: So shelf registration was in the works when you showed up.

SF: Yes. It may not have been the next week. It was very fast.

KD: You talk about this sort of being considered process and not understanding the implications. Wasn't this part of a broader effort to integrate the whole disclosure process that was going on at that point?

SF: No. When shelf registration was being extended to equity securities, it was being done as part of an effort to have what I think was called company registration. The idea behind that was a continuous disclosure process. That came much later. This was really debt financing, and was focused on this time period. I'll tell you an interesting story.

When you become a commissioner, there's a sort of series of obligatory visits to the major offices, both departments and geographical offices. And I remember talking to, I've forgotten his name now, the fellow who was head of the office that processes registration statements and reviews them. And a question I used to like to ask people, because it's a difficult issue both for government and non-profits generally, which is if you don't have profits as a measure of success, how do you know when you're doing a good job? How do you measure your success?

So I said to this fellow who was in charge of the office of disclosure policy, or whatever it was called then, how do you know when you're doing a good job? And his response was all about processing time. He had really been able to process registrations so quickly. And I remember thinking how ironic it was that here the group whose function in life was to review the quality of disclosure was measuring itself by the speed with which it did it. So, you know, the interest rate fluctuations and all these inflationary pressures just had a tremendous effect on everybody.

KD: There was some ideological impetus to deregulate at that point too, at the end of the Carter Administration.

SF: The Carter Administration was making a major deregulatory effort—the CAB, and there was a fellow in the White House who was an economist whose name escapes me now, but who was leading this effort. Deregulation is important. It's hard to say that today. I mean, our regulatory system has failed so badly. But, basically, the description I gave you a minute ago of the way the regulatory system became obsolete because of changes in the market, that's the reason deregulation is important. It's not that regulation is bad. It's that you have to make sure you're regulating the right things. And I think that all of being a regulator is about the search for balance between enforcement and regulation. Regulation is inherently rigid because it applies to everyone equally, way beyond the core of stuff you're trying to limit, or prohibit or constrain.

And so on the other hand, enforcement often doesn't send the message to the whole market that you want to send. You're constantly looking for the right balance. At the Commission, that was played out really at the Commission table because the Enforcement Division, of course, thought that the right way to do everything was through enforcement, and there were discussions from time to time about should we proceed by rule? Should we proceed prospectively? And that's really the kind of discussion a well-functioning regulatory agency needs to have all the time. Sometimes it's better not to have rules because it prohibits so much legitimate conduct. A rule-based system

prohibits so much legitimate conduct. And sometimes it's actually necessary, you have to. And often, rules become obsolete. You need to get rid of them.

KD: Was this something that you and Harold Williams were in accord on at that point?

SF: Yes, I think so. Harold and I were, I think, close, certainly as members of the Commission.

KD: You said this played out at the Commission table. Did it play out in the sense that ideas, such as the ones you're talking about, were contested by others?

SF: Yes. Sure. There was a bigger discussion. I wish I could give you examples. I think it's hard for me at this point. And it would often be sparked by an enforcement action. Stan Sporkin and I were very good friends. It was fascinating. It was a great relationship because we saw the world, really, through very different eyes. But we liked each other a lot, I think, and had a lot of respect for each other. Stanley would sometimes try to accomplish what was, essentially, regulatory result through an enforcement proceeding. And sometimes he did that inadvertently.

I give you one of my favorite examples. The enforcement division came to the Commission with a proceeding against a broker who had sold a Treasury security that didn't exist. So the first question was whether you could violate the securities laws. You know, the 10(b)(5) was a fraudulent statement in connection with a purchase or sale of a

security. And if there was no security, how can there be a violation of 10(b)(5)? So we had a long discussion about that, and I remember Stanley said, "Don't worry. I'll take care of it," or something like that. It was a wonderful, a typical Stan Sporkin reaction. That was the technical legal issue. And then I remember asking what the effect of an enforcement proceeding would be on the repo market and Treasury securities.

Now that's something I knew something about because I'd been at the Treasury. And this was a market in which billions and billions of dollars were traded all the time. And no one at the Commission knew anything about it. And it was a phenomenon that I think has been true, that one sees at the Commission over long parts of its history, which is that the staff knows a great deal, a huge amount, about what they know about, and extraordinarily little about what they don't know about. And I remember being struck by the fact that here is this truly monster market. It would dwarf the equity markets.

KD: The repo market.

SF: Yes. Which was, essentially, a secured lending mechanism between brokerage firms, and banks, and all sorts of financial institutions. And really, no one knew anything about it. And so the question is, "Well, if you have this enforcement proceeding, what is its effect?" And you treat it as, in effect, an assertion of jurisdiction by the Commission. What's the effect on this market, which doesn't know the Commission from a whole in the ground. So those kinds of issues that arose out of enforcement proceedings were a

constant subject of discussion. You know, should we proceed by rule? Is it really fair to do this? So forth.

KD: That's not terribly surprising, I guess, given what Stanley Sporkin had established and the vigor of the enforcement arm in those years.

SF: Well, what's interesting about Stanley, I said we viewed things with very different eyes. I mean, I viewed people—my default position was usually that these were people who were, basically, trying to do the right thing, and may have stepped over the line. Maybe even stepped over the line intentionally. But they were, fundamentally, businessmen and women who were trying to do their business, and trying to comply with the rules. And Stanley's default position was one of seeing fraud in the same circumstances.

And much of the financial community, and certainly the international financial community, because this was after the Foreign Corrupt Practices investigations, viewed him as this colossus. And he viewed himself and the staff as five little guys in a rowboat adrift in a sea of fraud [laughter]. Truly. Because he saw all these problems. And I have to say that one of the things that struck me when I joined the Commission, is really a measure of my own naiveté, is how much real fraud there was, how much real fraud there was, how much garden-variety fraud there was. How many plain old old-fashioned crooks there were [laughter] in this business. Because in my law practice, I really didn't see that.

KD: They didn't come to Debevoise.

SF: No, they didn't [laughter]. Exactly.

KD: Okay. Well, I wanted to talk about some of the priorities and some of the things that, you know, really looked like they were going to be on the agenda when you came in. And you went right to shelf registration and talked a little bit about enforcement, which are some obvious ones. Other things that are going on. National market system? Things like that?

SF: Let me mention one other thing. I'll come back to the national market. I mean, in many ways, I felt that one of the most important things I did, there were a couple things. One was I represented the Commission in testifying in negotiating the Small Business Investment Act, which was basically the creation of venture capital funds with special exemptions from the regulatory regime, and the Investment Company Act regulatory regime. And that really combined a lot of what I had done at the Treasury, which was dealing with congressmen and senators and their staffs and various interest groups, but representing the regulatory interests of the Commission. The second thing was the Carter and Johnson opinion. Do you know what that is?

KD: Yes, I've heard of that.

SF: Carter and Johnson were partner and associate in a large New York corporate firm like mine who had a client that probably was not a crook, but didn't really believe in disclosure. It was a computer leasing company that had huge upfront financing requirements. As their financing dried up, they didn't disclose it. They did that over the objection of Carter and Johnson, their counsel. But Carter and Johnson stayed with them. And they were the object of an enforcement proceeding. And this was a cause celebre in the securities bar because it was a so-called 2(e) proceeding, which was a proceeding, in effect, to disbar them from appearing before the Commission.

There was an Administrative Law Judge opinion that upheld the 2(e) proceeding against them. And there was an appeal to the Commission, a majority. And my recollection is it was a one vote majority, decided not to – I don't remember whether it was a reversal. I've forgotten the procedural posture, whether it was a reversal or simply not accepting the recommendation of the Administrative Law Judge. And Harold asked me to write an opinion. Now usually, the Commission didn't write opinions. And there was also an opinion writing group which wrote opinions when the Commission did write opinions, and they had done a draft which Harold didn't like.

KD: These were staff people?

SF: Yes. It was a little staff unit called the opinion writing group, it was, I think, in the general counsel. So my office wrote the opinion, which was a long attempt – it both dealt with the legitimacy of a 2(e) proceeding against lawyers, and attempted to establish a set

of standards of conduct for lawyers who found themselves in this position. I thought, and I think Harold thought, it was a tremendously important decision. The staff hated it because it gave lawyers more protection to be wrong, not intentionally wrong, but simply wrong in the advice they were giving, than they thought appropriate. And, in effect, it disappeared.

KD: What was the opinion arguing? What were the grounds?

SF: Well, it explored a couple things. It explored when a lawyer became a wrongdoer, and the opinion conceded that there was a point at which a lawyer became part of the problem, in effect. But that was a point much further down the line than the staff was comfortable with. And it also emphasized the fact that it was not desirable to impose liability on a lawyer, the result of which would be that he or she would give the most conservative disclosure advice, which is what the staff felt was appropriate, that a lawyer's obligation was to give the best advice he or she could give on the merits. And that it was, in effect, a violation of the lawyer's obligation to his client to give the most conservative advice. And that sometimes, that advice was wrong. Just because it was wrong, or wrong in retrospect, or just wrong, if it were given in good faith after careful consideration, that it wasn't appropriate to make that lawyer the object of an enforcement proceeding.

And there was a majority of the Commission, what we did is we announced a prospective standard, which I confess I would have to look at the opinion to tell you what it was.

And what the staff did, I think, was noticed some kind of a rule-making proceeding for the standard, which ultimately went nowhere. But for me, it was a very important exercise. The opinion crops up from time to time in enforcement proceedings.

KD: Yes. This is one of the important early lawyer and accountant type cases.

SF: Yes.

KD: Had the phrase gatekeepers come up at any point yet?

SF: Sure. Well, Stanley always used that term gatekeepers. Yes. But the typical gatekeeper case is the case involving White & Case, for example, and National Student Marketing, where the gatekeeper act is the delivery of an opinion. This was a much more complex thing. This had to do with the ongoing relationship between a securities lawyer and his client. As you go through the process, you make a decision over the course of lots of events over a long period of time, months, as to what has to be disclosed when, how much has to be disclosed, how you put it. And I think the reason Harold wanted me to write this opinion is because that's something I had spent a lot of time doing, and I had a better sense than some of the other commissioners of what actually happens. Now the dispute was about whether what actually happens is what should happen or shouldn't happen. But as a factual matter, I was really, I think, the only member of the Commission then who had done that.

The national market system, I don't remember the precise national market system issues. I mean, the commissioner was, at that point, bent on a course of trying to create competition among markets. And I was, frankly, never persuaded that that was going to produce the results that its proponents thought. But it was an area where I had no expertise at all. I learned a lot. But I don't remember taking strong independent positions on it. Markets and trading is an extraordinarily complicated business. And it's extremely hard to understand if you haven't done it.

I've been on the board of the NASD. I've been on the board of the Chicago Options Exchange. And I've done a variety of things. And now I'm on the board of New York Stock Exchange Regulation, and I still feel at a disadvantage considering technical trading issues.

KD: And they've gotten a lot more complicated since 1980.

SF: They've gotten a lot more complicated. And the more I learn, the more complicated they get [laughter].

KD: How about internationalization? Was that starting to be a factor for the SEC at this point?

SF: Yes. But the SEC's view was, the kind of party line as it were, is that we had the best financial markets in the world, and there was no reason where we should change anything

to accommodate others. Not long after I left, the Commission began to shift that position. And I remember thinking that one of the dynamics that was really at work here was that admitting that a system, a different system didn't create threats undermined the integrity of everything.

So, for example, this was a period when the additional disclosure about executive compensation, in great detail, was growing and growing. But in Germany, they didn't do that. And, you know, the issue was if it worked so great in Germany, why was it so important for us to disclose it here.

The point I'm raising has nothing to do with the substance of that disclosure question, which I happen to think is important, but it was a dynamic at work in all of the discussions about the extent to which we should accommodate other accounting systems, other regulatory systems, which is there was an implicit threat there, which is that if the other markets worked all right, or as well with a different rule system, why were these rules so important? And that was an issue that was very seldom discussed, but I thought it was implicit in all of the discussions.

KD: Well, there would've been the other threat, being that if these other systems work so well and ours is so cumbersome, might there be a time when issuers will go somewhere else?

SF: Yes. And people are worried about that. The New York Stock Exchange, I think perhaps by then, if not soon after, really felt it had run out of large companies. This was before

the technology boom. And its major marketing efforts were international companies. They were afraid of U.S. Securities liability, and worried about accommodating to an accounting regime. The U.S. markets were so dominant in terms of depth and breadth of capital and other things, but foreign companies achieved some of their ends without registering, so that no one worried that much about it. It was discussed, but at least at the Commission, no one believed that it was a serious problem.

KD: How did your relationship, how did the Commission change over time that you were there? Was it reconfigured at any point?

SF: Well, the end of my term, John Shad became chairman. That was a fairly short period. And Barbara Thomas, I think, joined before I left.

KD: And were you there when Irv Pollack was there?

SF: Yes. Irv was there, John Evans, Harold, myself and—gee I can't think of his name. He was a fellow who was older at the time, and he'd been at the Commission a long time. He retired. Barbara may have succeeded him.

KD: Okay. How were relations among the commissioners?

SF: Close, and cordial. More than cordial. I think everyone was, it was very different from, I think, the period when Roberta Karmel was on the Commission and there was so much

stress. I liked everyone on the Commission. I got along well with everybody. I don't think I was viewed as a corporate nose under the tent. I think people thought I dealt with issues on the merits. I think we all got along very well. I remember when we were—it may have been the Carter and Johnson opinion, I sent one of my legal assistants to listen to an argument that had occurred a couple of years before in an earlier stage in whatever case it was, and I remember he came back and he said, "You can't believe what this discussion was like." And people were shouting at each other. But none of that was true when I was there.

KD: Yes. I was wondering if you were familiar with that in the period before you came onto the Commission.

SF: Well, I was familiar with it in principle. I knew there were these divisions, certainly. But what I didn't realize was how emotionally charged some of these discussions were. That was a big surprise.

KD: Other things that might've come across the radar screen. Certainly, insider trading is just starting to raise its profile a little bit.

SF: Well, the Boesky thing, that came later. And Levine came later. I'm sure there are major things that I've just forgotten. There were a couple very important cases where enforcement proceedings were not authorized. And they were interesting because of the role that, I think, Harold Williams played, which had nothing to do with deregulation, and

nothing to do with ideology. It really stemmed from Harold's experience as a businessman. And there was an enforcement proceeding against one of the tire manufacturers which had introduced a new radial tire, and they had all sorts of problems with it. And it ended up in a massive recall, and a big hit to their earnings.

The enforcement division, Stan in particular, felt very strongly that they should've disclosed this right at the beginning. And I remember Harold talking about the way the introduction of a new product works, and the naturalness of the fact that there were always glitches, there are always problems. And one always believes that they'll be solved in the ordinary course. And most of the times, they are. Something doesn't work right, you take it back, you improve the product, you fix whatever the issues are. And, eventually, you end up with all the pieces in place.

What happened with this radial tire is they never got to that point, and they had to recall it. But it was, to me, a graphic example of the value that someone with a business background can bring to the discussion of the application of regulatory principles.

KD: John Shad, how long were you there when he was there?

SF: Oh, it's probably just three or four months.

KD: Okay. Because here you have somebody coming out of a very different background.

SF: Right. And, of course, I ended up at E.F. Hutton, where John had come from. My principle recollection of John really has to do, not so much with the Commission, but the time when he testified very early in his chairmanship. The Reagan White House was using OMB to try to recall the issuance of new regulations. And, of course, the SEC is an independent regulatory commission, so the Democrats who had a majority in the House were wild about this.

And they held hearings to see what the Commission's reaction was going to be by this attempt by OMB to research over an independent regulatory commission. Now there's a time-honored way to deal with this, which is what you say is, "Mr. Chairman, I have total respect for the independence of the SEC, and nothing I ever do will ever compromise that. But I'm in agreement with the deregulatory goal of the administration, and I'll do my best to pursue that without compromising the independence of the SEC." That's the way people in Washington talk at hearings when issues like this come up.

KD: Right.

SF: John could not bring himself to do that. And he ended up looking like, I don't know what. He was excoriated by the panel for compromising the independence of the Commission, and there's no way out of that box if you confront it totally.

KD: Were you still on the Commission at that point?

SF: I was still on the Commission. I remember, I went to the Hill to listen to the argument. I was interested in how he was going to deal with it. I like John, personally. But it was really at the very tail end of my time there.

KD: Were there any issues that were paramount at the end of your time? Had things changed?

SF: Well things, I think, did change. But not so much while I was still there. I don't think there were any significant changes in the operation of the Commission when I was there.

KD: Shelf registration, which you brought up right off the bat, that was going to play out a little bit longer.

SF: Right. The national market system was going forward. Ordinary enforcement actions, including insider trading, were going forward. There were a lot of those cases, but they were fairly standard cases of people doing totally wrong thing, giving tips to friends. The options markets, the Commission was really just starting to get a handle on the options markets. And it was going through this process of learning about a sector of the financial markets that it really didn't know much about. There was an accord. I can't remember whether the accord was John Shad or Harold. But there was an accord with the CFTC about dividing jurisdiction over options, and options on futures.

KD: Right, Shad Johnson.

SF: Shad. It was Shad. That's right.

KD: And, of course, options had been frozen for a little while. I think they were probably unfrozen about the time you came in.

SF: I'd forgotten that. Oh, yes. While they were creating the regulatory, yes. And tender offer regulation was really – just beginning is probably not the right word, but it was still pretty much in its infancy, and didn't present a major set of issues while I was there.

KD: Well, you had gone in knowing that you were just going to serve out the remainder of Roberta Karmel's term…

SF: No. I knew that I was unlikely to be reappointed when the fellow who was in charge of reporting on the SEC for the Reagan transition team, I've forgotten exactly how he described me, but the bottom line was someone who should be replaced [laughter]. And so at that point, it was clear to me that it was unlikely I'd be reappointed. I didn't go there intending to spend only two years. I really have no idea how long we were going to spend. But it became clear pretty early that the Reagan Administration was unlikely to reappoint me.

KD: Okay. Is there anything else from your time on the Commission that we haven't talked about?

SF: I'm sure there's lots that I haven't covered.

KD: But nothing springs to mind?

SF: Occurs to me at the moment.

KD: All right. Well, then, did you go back to practice?

SF: I went back to Debevoise, and I guess it was the Fall of 1981, and I stayed there for five years, and then I left to become general counsel of E.F. Hutton, which had gone through a terrible mess. Again, reacting to these high interest rates, it had an extremely aggressive cash management system that ended up, in effect, kiting checks. And it was handled extremely badly, I think, by their counsel and by the management, and they ended up pleading guilty to something like sixty-three felony counts. So the whole senior management changed.

KD: So what was your job, to go in there and put the thing back together?

SF: I was general counsel. Well, it was to put together the legal and regulatory side, certainly. But the people on the management committee, in the end, there was only one person who'd been there earlier, and that was an extraordinary time. We had a takeover attempt from Shearson three months after I arrived. Then we spent the next ten months in struggle to oust the chairman, and then came the market crash of 1987, and then we

ended up selling the firm to Shearson for $30 a share less than we'd turned down the last time [laughter]. And then after that closing, I became general counsel of Equitable Life. And we went through the first major demutualization. And I say major, the first large company demutualization since the second World War, which was a very challenging and exciting time, and I learned a lot. I knew nothing about insurance regulation at that point.

And then after the demutualization, there's an IPO, and we ended up selling a controlling interest to Oxon the French insurance company. And at that point, it became, it seems like, a much less interesting company. So I went back to the firm in 1993, and I stayed there until 2004 when I became dean at Pace Law School. Then became president in June of 2007.

KD: Well, looking back on your subsequent career a little bit, what did you learn from your experience at the SEC? What kind of perspective did that give you that helped you?

SF: Well, I learned a tremendous amount. I first learned, as I said, how many plain old fashioned crooks there were. I learned a great deal which was valuable to me as a lawyer about what the Commission was interested in and what it didn't care about. For example, and you could see this later as the rule-making process evolved, but it really was primarily interested in protecting individual investors. That seems obvious, at this point, but from the point of view of a New York corporate lawyer and when I started this in the 70s, most of our clients were institutional, and yet, we would spend endless hours

analyzing and parsing the legal implications in situations where there really was almost no legal risk. I mean, that doesn't mean that when I started to practice law again I just ignored the law.

But what it does mean is—and this was also part of my experience as general counsel, I think an important part of a lawyer's role is managing risk. And in a sense, that goes back to the Carter and Johnson opinion. It's simply not a question of disclose everything. One's always making judgments about how to deal with various risks. And the nature of the risks are SEC enforcement proceeding, a civil law suit, and occasionally, financial collapse. But usually, the risk a lawyer is assessing are those two things. And understanding what the Commission and its staff thinks is important, what it thinks its primary role is is very important in assessing how much risk you're really taking.

It's not that you're taking big risk, it's just that there isn't really much risk there. So even in areas where there's not a lot of law, you can't be certain as a lawyer. Typical lawyer's reaction is to be as conservative as possible, but often, that's not necessary. So I learned a huge amount about the regulatory process, and I've never been a regulator before. And that's been a source of endless interest and fascination for me, intellectually—and, of course, as a lawyer, but really more intellectually. And those are the issues we're dealing with today, which is how you regulate markets. It's complex.

I remember when I first joined the Commission, I was in Chicago taking a tour of the floor of one of the commodities exchanges. And they told me that there were more math

PhD's on the floor at this exchange than there were at the University of Chicago. And I saw these guys just sort of standing there, watching things happen and thinking. And I thought, you know, it's likely the regulatory system will never catch up to what they're doing. And understanding why that is and the limitations of regulation and a regulatory agency, I think, are very important as you think about what's possible to accomplish and what you can't.

There were other things, for example, the Investment Company Act was an absolutely draconian solution to a set of serious scandals in the 20s and 30s. And the Investment Company Act started out prohibiting almost everything except the plain vanilla management for a percentage of investments. And it was interesting from two respects. One is the process of accommodating those prohibitions to changes in the marketplace through the exemption process and the rule-making process. And the other was the fact that these very rigid, very draconian provisions worked just fine. This was an area which, until recently, when those restrictions were loosened in a whole variety of ways, was absolutely free of regulatory problems.

There were crooks and there were bad guys doing things they shouldn't have done, but fundamentally, as an industry, it experienced enormous growth, and did so relatively free of any problems. And that's a lesson, I think, people are going to have in mind today as they rethink the regulatory system.

KD: Well in some sense, it gets back to dealing with those legacies. You talked about the Glass-Steagall Act and how structures are built into the regulatory system that you somehow have to learn to live with or learn to adapt to.

SF: Right.

KD: Well, anything else we should cover?

SF: No. I don't think so.

KD: All right. Well, thank you very much for your time. I appreciate it.

SF: I enjoyed it.

[End of Interview]