EUGENE ROTBERG

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"When I left the SEC, people said, 'My God! He's ruined the securities industry. What's he going to do to the world's financial system?' "

Eugene Rotberg has never ducked controversy. As associate director for regulation of the Securities and Exchange Commission's trading and markets division in the mid-1960s, Rotberg fought to break down the New York Stock Exchange's commission rate schedule and set in motion the forces that ultimately led to Mayday in 1975. But by the mid-1970s Rotberg was involved in a new challenge: expanding the resources of the World Bank. Under his leadership, the institution has become the largest and most innovative borrower in the world, tapping new markets with new instruments at a breathtaking rate. This month Rotberg is leaving the bank for Merrill Lynch.

My career at the SEC started in the early '60s, and at that time a friend of mine, Fred Moss, and I were somewhat puzzled that stocks would double in price within minutes of coming to market. So we stuck a name on that — called them "hot issues" — and tried to figure out, quite unsuccessfully, why a stock price would double. We wrote a short memo to Barney Woodside, who at the time was director of corporate finance, and said we wanted to do sort of an investigatory study of hot issues. At about the same time, another colleague, Dave Silver [now president of the Investment Company Institute], was doing a study of what was going on in the American Stock Exchange with Jerry Re. Our studies progressed to a point where we were opening up things that hadn't been opened before. We

Ted Kappler

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began to write memoranda; and then that led to the special study of securities markets, which was a two-year study of perhaps nine volumes that opened up a lot of issues that are still with us — automation in the over-the-counter market, member firms going public, the unfixing of commission rates, to name a few.

In all fairness, I think the driving force behind the resolution of some of these issues was really the staff at the SEC. Manny Cohen and Irv Pollack at the commission level supported it, but it's hard to think of any others. The staff at the SEC recognized that regulatory agencies, particularly the SEC, were not likely to make fundamental, structural changes affecting the competitiveness of an industry. And that is why we felt that the way to implement change was to let basic industry competitiveness work.

It was quite a group at the SEC in those days: Milton Cohen, now an outstanding lawyer in Chicago; Ralph Saul, who subsequently became president of the American Stock Exchange and the head of Cigna. Fred Moss was there — he subsequently became president of the Boston Stock Exchange and later a principal at A.G. Becker; Bob Birnbaum, now president of the New York Stock Exchange; Art Fleischer of recent merger and acquisition fame; and Harvey Pitt. I hired Stan Sporkin. I feel somewhat self-conscious naming them simply because there were so many others who were of similar caliber.

The theory we all held at the time was very straightforward: The only way to regulate an industry as strong and effective and with so many bright people as the securities industry was to let competition work, as distinguished from regulation. We basically were not comfortable with regulation; we didn't trust how it could be turned or corrupted. We also thought we had better learn as much or more about the way the securities business operated as those who were actually in it. So we spent days, months, cross-examining people in private: "Tell me what you do in the morning and how you do it." In the end we had a reasonably good understanding of how the markets worked.

What we were doing was no great secret. We said: "Look, fellows, you have a system going. We're going to see how we can change it, and then you're going to change it for us." When I left the SEC, people said: "My God! He's ruined the securities industry. What's he going to do to the world's financial system?"

I wrote the chapter in the special study on the over-the-counter market and the "issue" chapter. One problem was how to handle the volume of paperwork and the recording of the transaction. This led me to recommend a whole series of changes which in effect led to the creation of NASDAQ. Before that was done, however, the industry was able to make presentations. I'll never forget the presentation made by the law firm representing the National Securities Traders Association. They said that the opening line of the first printout of the first trade would state as follows: "This transaction, this opening quotation, will record the death knell of the over-the-counter market." They believed any computer system that would tell you what your bid was and asked was — let alone the best bid and asked — would so narrow spreads that it would make the business quite unprofitable.

Well, it was right after those public hearings in 1968, after Nixon was elected, that I left the SEC. Nixon had issued a letter to Wall Street saying he was going to get rid of all these young, Kennedy-type lawyers, and I, for some strange reason, thought he was talking about me. So I left and came to the World Bank sometime between the time he was elected and inaugurated. I had intended to go to one of three firms: with Don Regan to Merrill Lynch — heaven knows where I would have been if I had done that! — with Leon Levy at Oppenheimer or with John Gutfreund at Salomon Brothers. One of the first people I talked with about whether I should go to the World Bank after my initial interview there was Gutfreund. He suggested, not entirely facetiously, that he was willing to make a switch — I take his job and he comes here. Now *that* would have produced an interesting scenario.

The World Bank approach started when I got this strange call from [then World Bank head Robert] McNamara. I had not known him before. He said he had heard I was leaving the SEC and asked me if I knew anything about international finance. I said no. He asked me if I'd ever studied accounting. I said no. Finance? No. I'd studied for the most part English literature and history; I was a trial lawyer and far more adversarial than I am now. He then asked me what I thought about investment bankers, and I told him the truth — which was that I was trying to indict most of them under the Sherman Act. He asked me what I thought of commercial bankers, and I said I thought they sailed around in little ships on Long Island Sound in the summertime and wore white buck shoes. He asked me what I thought about problems of poverty, and I said it was one of those things where one could spend one's life and not succeed. Then he asked me if I wanted to be treasurer of the World Bank.

I came here essentially because I have always believed in public service, first, and second because the job as described by Bob McNamara was very rewarding in the sense that you knew that the lending operations of the World Bank could make a difference in people's lives: higher caloric content in the food they would eat, more schools, more electricity, higher standards of living, a sense of survival — and with that, hopefully a more stable world. He said he had come here to lend for high-quality purposes. He said he needed someone to find where the wealth existed in the world and to get it.

I haven't the vaguest idea why he chose me, although I suspect that he didn't want anyone who was excessively burdened with too much knowledge of how difficult it might be. Not that it turned out to be all that difficult, but if you wanted to lend $1 billion, you had to borrow $1 billion. And the bank hadn't done anything like that. Nor was I particularly burdened with great knowledge of the traditional forms of borrowing money. So in that sense I was at a great advantage, because when deregulation, competitiveness and a breakdown of international barriers occurred, I was not — and my staff certainly wasn't — locked into traditional ways of tapping the world's flow of wealth.

In the first week or two, when McNamara said, "Do you think we can raise $1 billion a year?," I said, "Sure, why not?" We now borrow $10 billion a year. We were fortunate because both Germany and Japan had begun to develop very substantial foreign exchange reserves and were therefore able to export capital. Then OPEC began to develop substantial resources, and we were able to attract those; we borrowed several billion dollars — $6 or $7 billion — rather quickly.

Bob always had very clear objectives. He would set those out and say, "Borrow the money we need at as low a cost as possible, because any mistakes you make will be borne by the poorer countries in the world." As a result, I found myself going to Japan very frequently in 1969 and 1970 with the expectation that Japan would have explosive growth and would maintain a high savings rate. They had no bond market, but we had lent Japan very large amounts after the Second World War, and therefore emotionally they were prepared to allocate those savings through the opening up of their markets to the World Bank.

I had been told that in negotiating transactions in Japan there's a lot of ritual, that everything's very formal. I knew the cost of borrowing was going to end up at

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about 7 percent, and I didn't want to spend two months drinking tea until we got down to that point. I started off the meeting by saying: "Look, I know we're going to end up at 7 percent — that's already been decided by our betters, the Ministry of Finance. So let's just shake hands, say you've been delightful, and that's it." There was this impassive response: "Come back tomorrow." The next day, I come back and I'm told: "We've heard very much what you said; we know you don't want to negotiate or bargain. We know you believe that rates are arbitrarily set in Japan and we respect that. We can assure you that it's a fair price. The cost is 12 percent." I said, "Fine, we can pay 4 percent." Two weeks later, after a lot of tea, we ended up at 7 percent.

OPEC members are among the most professional I have ever dealt with. They made a clear policy decision in the mid-'60s and later that as their financial resources were increasing they would not take those resources and recycle them to countries in deficit. They would put them in the hands of strong intermediaries — money center banks — or lend them to very high-quality issuers, like the World Bank. Those funds are still in our debt portfolio. The terms and conditions were always on the market. I did not see them demanding or asking for better-than-market terms. Indeed, I found myself going to Iran and negotiating transactions directly, and to this day we still pay interest on those loans to Iran. And to this day, Iran still pays the World Bank interest on the loan we made them in the early 1970s. And Lebanon, too. Lebanon in recent times has been in great turmoil. Their central bank does its best to meet its obligations. The world doesn't stop functioning because of changes in government.

I have been involved in private placements in the past where McNamara asked to break off the transaction where the cost to us was too low, where unexpected changes occurred between the agreement and the actual signing. These were transactions that were adverse to the other side and beneficial to us. We've always believed — under [former World Bank chief A.W.] Clausen as well, and I'm sure Mr. Conable — that the only transactions that are worthwhile are those where, at the end, all parties feel it's a reasonable deal at the time it is done. And that's it.

Our investment banks give us very, very effective, expert service — service in the best sense. They tell us where the market is vulnerable or fragile, where on the yield curve it's strong, where the buying power is coming from. And it's rare that we get investment bankers more than two basis points apart from each other. No one is fooling us; no one is saying that they have something when they don't. Nor do firms give us suicide bids — knowing the market's 8 percent for a given currency but telling us, "Say, look, Gene, we'll do this for you at 7⅞." There's a lot of mutual respect. We don't deal with people who either don't know where the market is or do know but want to lose a lot of money.

What one must focus on is who has wealth, how fast it is accumulating and what kind of instrument do the controllers of wealth want in order for you to take it. Do they want equity? Do they want to be liquid? Long? Short? Leveraged or not leveraged? Fixed or floating? That is essentially what every government, private corporation and quasi-public institution has to figure out worldwide. And once you know that, creation of the instrument is child's play. All you need to do is ask what the market wants and can you afford to pay it. The stuff in the middle — investment banking, merchant banking, commercial banking — is simply the vehicle you use to tap into that ultimate saver or investor.

Ninety-five percent of our borrowings are at fixed interest rates. Although our loans are floating, they are floating on the basis of a pool of fixed-rate loans. When interest rates dropped from 14 percent to 7 percent, we became almost 100 percent a fixed-rate borrower for twenty- and 30-year maturities. We do not believe that the way to cope with high interest rates is to borrow at floating rates. The way to resolve high interest rates is not to borrow. The way not to borrow is to have $20 billion in cash, then let it drop until you get through the cycle. A floating rate is society's proxy for discontent; it means, "I don't want my future to be fixed." So short-term borrowings at floating rates are not bad per se; they simply reflect the unease of a culture. We borrow at fixed rates and borrow more than we have to, because when the fixed-rate market really and truly disappears, you can have a breathing space and not borrow at all if you have liquidity.

I think I helped create an environment where my colleagues could raise $100 billion for poor people and where we could attract those funds from institutions that do not ordinarily lend, directly or indirectly, to that constituency. And we were able to do so through the formation of a very sophisticated institution, using the most sophisticated financial tools, by building the bank on the asset and investment side so that they would have confidence in leaving their funds with us. Otherwise, we would not have been able to attract private sector funds.

I guess I once said that Robert McNamara is Martin Luther out of the Harvard Business School. And that's meant to be a compliment, a pretty strong one. He is a great humanitarian — driven, committed, a very vulnerable human being. It is simply a great pleasure to talk with someone who, at the age of 70, retains the motivation, the drive and the liberalism that he still does. Clausen and Conable are quite different from each other and quite different from McNamara. They both have great skills — excellent analytical skills, personal skills and management skills.

I think Tom Clausen got a bad rap and unfavorable publicity simply because the world expected this institution to be a magic one that could resolve the debt crisis or at least prevent the world from having one. That's an unfair burden to put on him or the institution. It's a complicated world out there, and there are many things that occur which are outside anyone's control — let alone one institution that functions out of Washington, D.C. We might have a great deal of money and a great deal of wisdom, but you can't prevent earthquakes from happening or high interest rates or a recession in the West or protectionism. Yet these are variables that will affect the way the world is held together. It's a little naive to think that the president of the World Bank or the bank itself can intervene to move things or prevent these things from occurring. And the better part of wisdom — and I think both Clausen and Conable have that wisdom — is to understand that while we are an ethical spokesman for what *should* happen, we really can't make major changes or prevent the untoward. There are a lot of constituencies in the world, and we're just one of them. What we have that the others don't is objectivity. I hope we can retain it.

The rhetoric will change; the bank will not. There will be changes in the margin of the kind of lending we do. But the bottom line, when you cut through it all, is, What kind of advice can you give to facilitate a country's growth? And will that occur within one year, two years, ten years? External capital flows into these countries is beyond our control. Our job is to try to raise the level of comfort and confidence. But ultimately, the country has to decide the way it's put together.

This is an apolitical institution. I hope it remains one. That's one of its beauties. And as McNamara said when I came to the bank, "This sure beats the hell out of selling automobiles." ii

Editor: Margaret A. Elliott