S. HRG. 107–266

SAVING INVESTORS MONEY AND STRENGTHENING THE SEC

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION

ON

THE "COMPETITIVE MARKET SUPERVISION ACT" (S. 143) WHICH SEEKS TO REDUCE EXCESS USER FEE COLLECTIONS MADE BY THE SECURITIES AND EXCHANGE COMMISSION (SEC), PLACE SEC FUNDING ON A STABLE BASIS, AND PROVIDE FOR PARITY OF SEC SALARIES WITH FEDERAL BANK REGULATORS

FEBRUARY 14, 2001

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C O N T E N T S

WEDNESDAY, FEBRUARY 14, 2001

WITNESSES

Additional Material Supplied for the Record

SAVING INVESTORS MONEY AND STRENGTHENING THE SEC

WEDNESDAY, FEBRUARY 14, 2001

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 2:30 p.m., in room SD–538 of the Dirksen Senate Office Building, Senator Phil Gramm (Chairman of the Committee) presiding.

OPENING COMMENTS OF CHAIRMAN PHIL GRAMM

Chairman GRAMM. Let me call the Committee hearing to order. We have the Acting Chairman of the SEC, Laura S. Unger. I want to thank you, Madam Chairman for coming today.

We have a bill before us that does two things. First, it seeks to change the law to assure that we always have enough money to fund the SEC but that the fees on new stock issues and transactions do not become a general revenue source for the Federal Government. Second, we want to establish pay parity, where we are paying people at the SEC wages that are competitive with financial regulatory agencies. I think this is very important. While there are few people who love Government less than I do, I believe that if you are going to do things in Government—and Government does have a role in a free society—then you need to have the best people performing those functions, and having more competitive pay is very important to accomplishing that goal.

Our plan today is to hear from Chairman Unger, to pose a question or two and then go to our panel, which is somewhat depleted, because the airport is closed due to fog, but we still have a good representation of people.

Madam Chairman, we would be very happy to hear from you.

STATEMENT OF LAURA S. UNGER
ACTING CHAIR
U.S. SECURITIES AND EXCHANGE COMMISSION

Ms. UNGER. Thank you very much, Mr. Chairman. It is an honor to appear before this Committee today regarding your proposed legislation. And hello to Senators Reed and Miller. I want to express my appreciation for this legislation, the Competitive Market Supervision Act of 2001, and to the cosponsors of the legislation for their leadership in developing this important bill.

As you described, the Competitive Market Supervision Act addresses two critical issues facing the Commission today. One is the excess collections of securities fees, and the other is our need to match the pay of the Federal banking regulators.

The bill, as I understand it, aims to improve the current system of SEC fee collections. As you know, the Federal securities laws direct the Commission to collect three types of fees: Registration fees, transaction fees, and fees on mergers and tender offers.

The SEC's fee collections have been a subject of concern since 1983, when we first began contributing more to the Treasury than was required to actually fund the agency's operations. Congress revised this fee schedule last in 1996. Obviously I let it slip, having worked on the legislation, which was an honor. The National Securities Market Improvement Act, as you recall, I am sure, provided for a significantly reduced transaction and registration fees with the expectation that these reduced fees would result in collections more in line with the cost of funding the agency's operations.

As you described, that has not turned out to be the case. As our markets have continued to expand over the last couple of years, so too has the amount of fees collected. At the time NSMIA became law, the Dow hovered near 6,000; the Nasdaq composite had just reached 1,200, and about 900 million shares changed hands on the New York Stock Exchange and Nasdaq on an average day. Today, our market indices have roughly doubled with the share volume on the NYSE and Nasdaq averaging 3.5 billion shares a day. As a result, the aggregate fees collected have increased from $774 million in 1996, which at the time was 2.5 times the amount of our budget, to $2.27 billion in fiscal year 2000, which is more than 6 times the amount of our budget.

The Competitive Market Supervision Act responded to this situation by significantly reducing the amount of fees that would be collected in future years. And I thought I would just mention a couple of ways it does this.

First, the bill reduces fees in a comprehensive manner. By targeting all three types of fees that the Commission collects, the bill not only reduces costs to investors and other market participants, but also the costs to the capital raising process itself. I recall you, Mr. Chairman, calling it a tax on capital formation—so it would address that concern. It also has the effect of spreading the costs of regulation among those who benefit from the activities of the Commission.

Second, the bill creates a mechanism to adjust that transaction fee on a yearly basis and to cap the collections each year, which addresses many of the difficulties in trying to predict or project future market growth. Although we have certain technical concerns with this particular mechanism, I do think it would result in more stable and predictable fee collections in the future.

Third, the bill preserves the ability for the appropriators to fund the SEC's operations from offsetting collections. It does this by shifting the fee collections from general revenue to offsetting collections, increasing the likelihood that we will receive adequate funding in the future to protect investors and promote the integrity and efficiency of our Nation's market.

I again want to commend you and the bill's other sponsors and the Committee's staff for the thought and the effort that went into developing this bill. And again, as I mentioned there were some technical concerns with the bill. In particular, one of them was the status of the CBO's projections, which I understand is being adjusted to reflect more current numbers. This critical improvement will reduce the possibility of a funding shortfall in future years. We look forward to continuing to work productively with the Committee and its staff on this bill.

More important to the agency, Mr. Chairman, is the component of the bill that addresses pay parity and that addresses our staffing crisis. Currently, attorneys, accountants, and examiners at banking agencies earn anywhere from 24 to 39 percent more than their counterparts at the SEC. This has had a significant impact on our staff's morale, not to mention their pocketbooks. The pay discrepancy makes little sense for a number of reasons.

First, with the Gramm–Leach–Bliley Act of 1999, the Commission staff will be working toe-to-toe with many of the bank regulators in examining and regulating complex financial firms.

Second, the demographics of our markets have changed dramatically. I gave you some numbers in terms of volume and the level of the Dow indices, but the number of investors has changed as well. Twenty years ago, only 5.7 percent of Americans owned mutual funds. Today, there are 88 million shareholders, representing 51 percent of U.S. households, holding $7.4 trillion worth of mutual funds. This is more than double the amount of what is on deposit in commercial banks and $2 trillion more in assets than are held at commercial banks. Clearly, we need to have sufficient staff and resources to carry out our mission of ensuring fair and efficient markets and adequate investor protection.

Finally, we believe that pay parity is simply good public policy. The issues that the Commission faces today are more complex and difficult than ever. No single business has been transformed more by technology than the securities industry. New technology, new market entrants, and new financial products are reshaping our markets. No less important, our markets today are becoming increasingly global—a trend that most expect to accelerate in the coming years.

At such a pivotal time in our markets' development, we cannot afford to have a serious staffing crisis. I know all Government agencies have to struggle to hire and retain professionals in a world where base salaries for first-year associates at top area law firms average $125,000, but our attrition rate is nearly double the rest of the Government average. Over the last two fiscal years, we have lost 30 percent of our attorneys, accountants, and examiners, including a number of our most experienced and skilled professionals who have left for better paying jobs. If this trend continues because of our inability to pay employees the money they fairly deserve, the Commission's mission will be severely threatened.

The Commission greatly appreciates the Committee's recognition of the staffing crisis that we currently face. Together with the authorization and appropriation levels sufficient to make pay parity a reality, the bill should go a long way to ensuring that the Commission can continue its tradition of excellence as our securities markets enter the 21st Century.

In conclusion, this legislation is an important step toward reducing and reasonably allocating fees on market participants. It also attempts to ensure stable, long-term funding for the Commission, including pay parity for the Commission's staff. We look forward to working with the Committee and its staff on the bill, and I appreciate your indulging me a few extra minutes, Mr. Chairman.

Thank you.

Chairman GRAMM. Well, Madam Chairman, let me thank you for your testimony. I have a chart over here on the left that shows the same thing you said, and that is, as you see the changes in the slope, on several occasions we have had legislation to try to limit the growth of fees to what we need to fund the SEC.

This is a classic user fee. We tell people that these fees are going to be used to fund the SEC's operations from which they will benefit, so they are paying for what they get.

But what has happened—as a result of the dramatic changes we have had in the market—is that while there has never been any question about the intent of Congress, these fees have become a general revenue source. The problem is we are now collecting six times as much as we need to fund the SEC, and this has become a tax on every saver, every investor, every mutual fund, every teacher retirement in the country.

I have been trying to come up with figures to use as an example. Although it is virtually impossible to get inside mutual funds and look at this, just take some averages that might be applicable to a college professor or to an auto worker, say, who has an investment account and contributes to it each month for 45 years. Given that they are paying an average share of these excessive fees on trying to build up a retirement, they would pay $1,304.55 during their working lifetime in excessive fees that intended to fund the SEC but, in fact, now have become part of the general revenue stream of the Government.

If that individual teacher invested that extra money at 6 percent instead of paying these fees, they would have at retirement an additional $5,800.39. Or for a couple, if you had two teachers who were married who used a savings program, that would be worth $11,600 to them at retirement. So the point is, these fees, not on any individual transaction, but over time, become a fairly substantial tax burden as people try to accumulate wealth.

Finally, I would argue that if you define the efficiency of a tax as the amount of money you collect relative to the cost you impose on society, this has to be one of the most inefficient taxes, because you are taxing the initial issue of stock, you are taxing transactions.

We have pay parity for economists at the SEC. And I did not warn you in advance, so you may not have it. If you don't, just send it to me. But it would be interesting to compare the retention rate of economists at the SEC relative to lawyers.

Ms. UNGER. You are correct. I have everything but that. I have attorneys, accountants, and compliance examiners.

Would you rather have Mr. McConnell, our Executive Director, answer that?

Chairman GRAMM. Why don't you just send it to me?

Ms. UNGER. Okay.

Chairman GRAMM. The point is, we have an anomaly in that the SEC actually has pay parity in one area but not in others. I think it is very important, as I told Chairman Levitt, this is something we do strongly support. Senator Sarbanes and I tried to put pay parity in our end-of-the-year bill in the last Congress. But there was an objection in the House, so it did not happen.

I think it is good to pair pay parity in this bill along with a mechanism to guarantee we always have the money needed to fund the SEC, but not have a system which generates these huge, unintended levels of revenues and fees.

I look forward to working with you, and I appreciate your support of this bill.

Ms. UNGER. Thank you.

Chairman GRAMM. Senator Miller.

COMMENTS OF SENATOR ZELL MILLER

Senator MILLER. I am also proud to be a cosponsor of this bill. You have mentioned the two main parts of the bill that I think are very worthy goals, and I am glad that I can support it.

You touched on this in your remarks, but I wish that you would amplify a little bit about the ramifications from an international perspective that you are concerned about that a lack of pay parity raises.

Ms. UNGER. We have a surplus of vacancies, and we cannot attract the people that we need to take care of our domestic agenda. And as technology brings us to a more global marketplace, we need some expertise and some very specialized people to consider more closely those global issues. We do have some limited staff persons devoting time to that now, but we don't really have sufficient resources to spend as much time on that as I believe the agency needs to, and as much of the rest of the world would like.

Senator MILLER. Thank you. I know you could talk a lot about this—but briefly, could you just sum up how you think this bill protects the integrity of our securities markets?

Ms. UNGER. I was a staff person at the SEC right out of law school. At that time, pay parity was an issue. I guess it was 12 or 13 years ago. So it has been something that has been discussed for a long time.

People don't work at the SEC because of the money, obviously, but we see people leave every day because they cannot afford to work there any longer. To the extent that we have compromised the level of people we can attract and retain at the Commission, it compromises our ability to carry out the function of the agency and the mission of the agency, which is to ensure investor protection and a fair and efficient marketplace.

We are being challenged daily by what is going on in terms of technology and how it is impacting our market, market structure, retail online trading. . . . There are a whole host of issues—such as the global marketplace which was mentioned earlier—that we need to tackle today. Yesterday would have been even better.

And so, to the extent we can be fully staffed and have the best people we possibly can to do that, everybody will be better off. As I mentioned, there are a significant number of households that are invested in the U.S. securities markets.

Senator MILLER. Thank you.

Chairman GRAMM. Senator Reed.

COMMENTS OF SENATOR JACK REED

Senator REED. Mr. Chairman, Ms. Unger, I want to thank both of you. There has always been an issued raised up here to what extent that these fees are passed through to the ultimate consumers, and as a result, to what extent the relief will be passed through to ultimate consumers. Can you comment on that or any studies you have or any anecdotal evidence?

Ms. UNGER. I have what I think is a combination of anecdotal evidence and industry statistics. I am not exactly sure of the source other than it was cited last year at this hearing. The percentage that was cited is that 87 percent of the Section 31 fees on New York Stock Exchange transactions are passed on to the individual investor, and approximately 82 percent of Section 31 fees on Nasdaq securities are passed through to the individual investor.

I read all of the testimony for the witnesses that follow me today, and the Securities Industry Association testimony spent most of the time discussing the cost to the investor of these fees and the fact that reducing the Section 31 fees would result in significant savings to investors. I presume, then, that the industry intends to pass this cost savings, should the bill become law, on to retail and other investors.

Senator REED. You are more familiar with the fee structure than I am. But typically, this is not itemized, any type of fee that is charged to a consumer, is it? I have heads shaking yes. Maybe I should wait for the industry representatives to come up here.

Ms. UNGER. They are behind me. I cannot see them.

Senator REED. There is a lot of head twitching going on in the audience.

Ms. UNGER. On the confirmation statement, there is a line that says "SEC fees paid." So there is some disclosure.

Senator REED. Another quick question. There are provisions in which the fee schedule has to be adjusted based upon covering your revenues as we go forward. We will estimate how much is required, et cetera. The SEC is involved in that readjustment process?

Ms. UNGER. Well, my understanding is the estimate is based on the CBO's projections and the cap and floor have a role in determining exactly what the level is. The only thing that is uncertain is what happens after 2011, because we are capped at I think it was $884 million. I think that is right. Is that right? $884 million. So the question then will be whether our fees will be the exact amount of our appropriation. I think we would like to be involved in that very much.

Senator REED. Thank you.

Thank you, Mr. Chairman.

Chairman GRAMM. Senator Stabenow.

COMMENTS OF SENATOR DEBBIE STABENOW

Senator STABENOW. Thank you, Mr. Chairman.

Commissioner Unger, you have spoken about I think and made a very compelling case for allowing the SEC to better compete for qualified professionals. And I notice that in your recommendations, you have laid out the need for $71 million per year in order to be able to accomplish your goals. I wonder if you could tell us how you reached that number and in this tight labor market whether or not, in fact, you feel that will allow you to reach the goal?

Ms. UNGER. Well, certainly we would take more if offered. But my understanding is that the number is based upon achieving pay parity agency-wide as is done at the FDIC. But those are where the numbers are in terms of the projections of the $70.9 million cost.

Senator STABENOW. It is your feeling based on experience at this point in reaching out and recruiting that would solve the problem?

Ms. UNGER. I think it would help substantially. I sent an e-mail to the entire Commission when I was designated Acting Chairman, and as part of that, being a former staff person who is now in a position to perhaps help, I mentioned that I would continue to work for pay parity, and I cannot tell you how big a stack of e-mails I have gotten in response. It is something that is very much talked about, especially since this legislation made it seem that we were getting very close to its being a reality. And it is something people would be very, very happy with.

It doesn't sound like a lot of money, but when you are talking about the difference between being able to afford your children's school tuition and staying at a Commission where you love the work, it is a huge difference.

Senator STABENOW. Okay, thank you.

Thank you, Mr. Chairman.

Chairman GRAMM. Thank you.

Senator Bayh.

COMMENTS OF SENATOR EVAN BAYH

Senator BAYH. Thank you, Mr. Chairman. I had thought briefly about creating a stir today by announcing that Bayh agrees with Gramm on tax cuts.

[Laughter.]

But I did not want hearts to start palpitating around the Capitol.

Chairman GRAMM. Well, you can go ahead.

[Laughter.]

Senator BAYH. I will, however, say——

Ms. UNGER. Valentine's Day.

Senator BAYH. That is right.

Senator SCHUMER. It would be a better story if Gramm agreed with Bayh on a tax cut.

[Laughter.]

Senator BAYH. Thank you. I agree with that, Senator Schumer. I will say that I agree with you when it comes to reducing fees for the SEC, Mr. Chairman. And Ms. Unger, I want to thank you for your testimony today and for your good work for the Commission and just say it seems to me as if this is an opportunity to have a win-win situation. It is good for consumers, not only because it will reduce their cost of transactions, but also increase the protection afforded to those transactions.

I know I probably reflect the experience of all of us up here when we hire good, dedicated staff people. And it is so difficult to see them have to choose between doing right by their families and continuing to serve the public that they love. So if we can help to make your task a little bit easier in that regard, I think we should.

Mr. Chairman, I, too, am pleased to be a cosponsor of this legislation. I hope we can get it passed. I think we can do it in a way that is fiscally responsible and achieves two important public policy ends for the people of our country.

Ms. UNGER. Thank you.

Senator BAYH. Thank you for your presence.

Chairman GRAMM. Thank you, Senator Bayh.

Senator Sarbanes.

STATEMENT OF SENATOR PAUL S. SARBANES

Senator SARBANES. Thank you very much, Mr. Chairman. First, I want to welcome Laura Unger back before the Committee now as the Acting Chairman of the SEC. And as I have done in the past, remind all of the staff that are sitting behind us here that one day they can be the Acting Chairman of the SEC.

[Laughter.]

Ms. UNGER. I might prefer to be behind you. Thank you.

Senator SARBANES. We remember your work here on the Committee with great appreciation. I am delighted to see you.

As Chairman Gramm indicated, we worked together in an effort to get the pay parity for SEC employees, and I strongly support it, and I think the SEC ought to have it.

I don't want to rain on the parade, and I know where the parade is going because it is marching through here at a rapid clip. But I think out of an abundance of responsibility, if that is the way to put it, I should point out that these SEC fees are going to be reduced by about $1 billion in 1 year, $8 billion in 5 years, and $14 billion over 10 years. So it is not an inconsiderable sum of money.

I appreciate the argument that says, well, they were put into place under a certain rationale and we should not drift away from that. But Jack Lew, the OMB Director, pointed out to the Committee last year that, and I quote him:

> Any additional reductions in SEC fees will necessarily come at the expense of strengthening Social Security and Medicare, providing tax relief to middle-income families, funding critical initiatives, and paying off the debt.

I just simply want to note for the record, this is not cost free. And since it will in effect impact the fiscal situation, we need to recognize that.

Now, of course, the individual cost of these transactions is tiny, although you can accumulate them over time and come to a figure that in and of itself is not tiny. I don't think it is deterred stock market activity. In fact, according to the CRS, in 2000, pretax profits in the securities industry reached $20 billion, which was an increase of 59 percent from a year earlier when pretax profits totaled $12.6 billion, and 1999 was a 26 percent increase over 1998. I know the industry doesn't want these fees and they are obviously going to be markedly reduced. But the industry seems to be doing quite well, if I may make that observation.

I have two substantive things I want to pursue. One is the statute which lays down the benchmark about these fees, which provides that the Commission shall in accordance with this subsection collect registration fees that are designed to recover the cost to the Government of the securities registration process and costs related to such process including enforcement activities, policy and rulemaking activities, administration, legal services, and international regulatory activities.

I understand that there are a number of Federal agencies with which the enforcement division of the SEC cooperates on their investigations, which themselves therefore incur costs in meeting this statutory mandate of the costs related to such process including enforcement activities. Is that correct?

Ms. UNGER. Yes.

Senator SARBANES. So if we were really trying to define on a straight pass-through, as it were, those costs probably need to be entered into the calculation.

Ms. UNGER. The costs of cooperating with the other agencies?

Senator SARBANES. No, not your cost. The cost of the other agencies from cooperating with you and carrying out your enforcement activities.

Ms. UNGER. Well, I think one of the agencies we cooperate with most extensively is the Justice Department, which comes out of the same Commerce–State–Justice pool of money. They generally conduct a criminal investigation, whereas we conduct a civil investigation. If we had criminal authority, certainly we would be pleased to conduct both investigations. But in point of fact, generally they pick the most egregious cases, and there has been a lot of competition among the different attorneys general, State and Federal, in terms of who has jurisdiction over the securities cases, particularly in New York.

Senator SARBANES. But if the rationale of the fees, which is now argued we should adhere to as provided in the statute, so we do not make it a source of money for the general fund—if the rationale for the fees is to recover the cost to the Government—not to the SEC, to the Government—and I am reading from the statute, of the securities registration process and costs related to such process, including enforcement activities, wouldn't it be reasonable to calculate the costs which these cooperating agencies incur in order to help the SEC carry out its responsibilities?

Ms. UNGER. With all due respect, I don't think I agree with that. The SEC is a law enforcement agency. I think we are equipped to carry out our enforcement actions with or without the Justice Department. Again, we have different remedies available to us. So to the extent that we use our full array of remedies, we are carrying out our responsibility as charged by Congress in the 1934 Act, which is where we come from, which is where we were chartered.

To the extent the Justice Department has taken a keen interest in prosecuting white collar crime cases to make a bigger point and provide greater deterrence and have a greater array of cases and expertise in their offices, we do work together. We give the Justice Department in New York a substantial sum of money in order to carry out our enforcement activities. So, I think what you are talking about already takes place.

Senator SARBANES. Now, that is an interesting point. Are you asserting that the other agencies are reimbursed by the SEC for any activities they carry out in the course of costs related to the enforcement activities related to the registration process? Is that your standard practice to reimburse all these various agencies? Not just Justice, but Treasury, FTC, and so forth and so on?

Ms. UNGER. For the entire time I worked in the enforcement division and the entire time I have been a Commissioner, I have the list that I think you are referring to. I have not seen a large number of cases where we have cooperated with these agencies to the extent where they would need to be reimbursed. Again, we are a law enforcement agency. We have a different mission than the bank regulators who are protecting safety and soundness.

Senator SARBANES. Does the SEC think that their budget is where it should be, or does the SEC think that your own budget should be larger?

Ms. UNGER. I think we had requested $567 million for our budget this year, and I believe we are getting in the area of $438 million, possibly $467 million. There is always room for expansion.

But to the extent that we can, back to your other question, work with the Justice Department in delivering our efforts against fraud and making our point stronger, then we have devoted resources to that in terms of our budget.

Senator SARBANES. Mr. Chairman, let me just make this observation and I will close.

Chairman GRAMM. Sure. Go ahead.

Senator SARBANES. First of all, I think you had left the room. I see where the parade is going, and I appreciate that despite Jack Lew's warnings and others about the broader fiscal impact that, you know, this is proceeding down that course. However, I do think that if the rationale for doing that is to adhere to this link-up, that two things need to be very carefully considered. First, what is an appropriate level of budget for the SEC itself if we are going to drop the fees so we don't go down so far that we are not able to meet providing an appropriate SEC budget? Second, the extent to which we need to factor in other costs incurred by the Government in order to meet the charges or the responsibilities set out under the statute.

Both of those I appreciate are a much lower order of magnitude with respect to the bigger question. But nevertheless, they both go to effectively carrying out the securities laws, and I think we need to keep that very much in mind in terms of what levels we go to.

Chairman GRAMM. Senator Sarbanes, I think that is something we should look at and we will try to look at it. Let me just ask a quick question related to this. Now the SEC imposes fines?

Ms. UNGER. That is correct.

Chairman GRAMM. Where does that money go?

Ms. UNGER. Into the general revenue.

Chairman GRAMM. I think that in terms of law enforcement, we have to look at the fines and try to get a measure. If you are paying the U.S. Attorney in New York for their participation, that is covered. To the extent that it is not covered, I think it is a legitimate question to look at. But we also have to take into account fines that you are collecting as part of the process.

Ms. UNGER. Just for a point of clarification, though, we do not generally refer cases to these agencies. They refer cases to us. We are the ones who carry out anything relating to the Federal securities laws. It would not be the Food and Drug Administration or anything like that.

To the extent that they have a lead or a tip or something that they think we should pursue, yes. And to the extent that they might have some particular expertise in a case, then I would assume yes also. But it is really the exception more than the rule. We have tried to work more with the States and the SRO's to avoid duplicating enforcement cases and to make everybody's resources more effective.

Chairman GRAMM. I assume you would do the same. That if you saw something that looked criminal outside the securities laws.

Ms. UNGER. Absolutely.

Chairman GRAMM. It would be helpful to the Committee if you would get for us an annual, maybe go back 10 years of what the aggregate level of fines have been on an annual basis. I think that would help us.

Senator Schumer.

STATEMENT OF SENATOR CHARLES E. SCHUMER

Senator SCHUMER. Thank you, Mr. Chairman. And I am part of the parade as the lead democratic sponsor on this bill. I would just make an observation about the bill before I ask a question.

It is true what Jack Lew says in terms of money going to one fund or another. But if we wanted to tax securities transactions directly, then we should do it. In these days of international competition, where we really run into danger that the place where securities is traded ends up in London or Frankfurt or Hong Kong, or somewhere else, I think we should be really careful about that. That is one of the reasons I support this bill.

I think later Mr. Forney will testify that he believes that this could be a real albatross in terms of our American market's renewed competition against foreign markets. And that is another reason to be for this proposal.

I have one question on a somewhat tangentially-related matter, to be honest, but I would like your view while you are here. I have heard a lot of griping on Wall Street among traders, specialists, et al., about decimalization. In fact, I think the New York Stock Exchange is having a meeting to discuss it Friday. I, for one, was never sold on the great merits of decimalization, given some of the problems it might create.

Are you content with how the implementation is going? Do you see any problems, particularly with finding sticking points? Is the consumer benefiting from decimalization the way he and she were supposed to?

Ms. UNGER. I am not sure if they are benefiting the way they were supposed to, and I think certainly there needs to be a little more time before we can definitively say what the impact is.

There are two things that I have observed in the course of the implementation of decimals or decimalization. One is the multiple price points that decimals produces could result in higher transaction costs, I believe, for a retail investor. The other is what institutional investors are calling being pennied. That their orders are being stepped in front of by specialists or market makers at only one cent, when it is a lot cheaper to do than it was in the sixteenth environment.

I think those are two issues that I will continue to look at closely. We have had a number of roundtables on decimals, and we are planning to have another one, when it is an appropriate time, probably after Nasdaq implements their decimals program, and we will report back to you.

Senator GRAMM. If the Senator would yield, I just want to tell my colleagues, we do have a vote on. It is my understanding from the cloakroom that this is going to be an extended vote; that they are holding it for people who are off the Hill. I would suggest that we have the two Members who have not questioned go ahead and do their questioning. Senator Corzine, you will be the last questioner on this panel. Then what I would like to do is just recess the Committee at that point and I would have Senator Corzine do that, and then our second panel can come up, and as soon as I get back, we will start that second panel.

Senator SCHUMER. I want to do one follow-up, Mr. Chairman.

I guess it is fair to say right now that decimalization or decimals, I guess is the easier way to put it, is not a smashing success. There are some questions out there about how it is working?

Ms. UNGER. Again, I think we need to take more time to see exactly what the impact will be. I don't know how smashing a success it was; it would depend on your expectations, I believe. I think it is fine, and there are some issues that we need to look at closely to make sure it is better.

Senator SCHUMER. Thank you, Mr. Chairman.

We are paralyzed.

Ms. UNGER. Who's in charge?

Senator CARPER. Why don't we pass something while we are here, Jon?

[Laughter.]

Ms. UNGER. This bill would be okay.

COMMENTS OF SENATOR THOMAS R. CARPER

Senator CARPER. Some of us are newer Members around here than others. In your testimony, you speak of your gratitude to the Committee for their understanding of the challenges that you face with respect to compensation and being able to attract and retain qualified staff. I am new on this side of Capitol Hill, and would appreciate it if you would just take a minute or so, for my benefit, and talk to me about the difficulty you have had in attracting and keeping good people.

Ms. UNGER. I mentioned in my oral testimony that while most of the Government has experienced about a 7 percent attrition rate, the SEC has experienced a substantial amount more, and I do have a chart actually, which if you want me to can be made a part of the record.

Senator SCHUMER. Without objection.

Ms. UNGER. I would be happy to.

For fiscal year 2000, we lost 17.47 percent of our attorneys while the rest of the Government lost about 6.7 percent. Again, we are seeing a large number of the attorneys who are specialized in the area of securities law move sometimes to other governmental agencies, which are paying, as I said, 24 to 39 percent more. Certainly it is also hard to compete with what a lot of the law firms are paying for first year salaries.

I did say that I do not think people work at the SEC for the money, and obviously, no one who works in the Government works for the money. But, when there is such a disparity as exists between the SEC and the rest of the Federal financial regulators, not only do we have a hard time attracting the talented and qualified people that we need, there is a morale problem with the people who are at the agency in terms of seeing what their colleagues elsewhere are making, and I wouldn't say they are feeling like second class citizens, but, you know, we feel that we are a very qualified agency and that we have a very important mission to fulfill. And so to be compensated accordingly would mean a great deal to these individuals who are there now, and also it would really help attract additional talent. We have a number of vacant positions open now for that very reason, and I have the number here. We have a total of 3,037 full time employees, but we have 3,285 slots. We are having a hard time filling those slots.

Senator CARPER. Help me again with the numbers in terms of the impact on the budget, revenues to the Federal Government that the passage of this bill would create. Did I hear someone say $14 billion over the next years? Did someone say that?

Ms. UNGER. Senator Sarbanes was talking about the fact that, right now, the offsetting collections that the Commission generates are substantial, and we are funded out of offsetting collections. A portion of our fees go into general revenue, and a portion go into offsetting collections. At the end of this bill cycle, we will be fully funded from offsetting collections, and none of the fees will be going into general revenue. And so we are going from substantial amounts of money into general revenue to eventually zero.

But that is at the out years of this bill. This bill goes through 2011, and I did mention to Senator Sarbanes, after 2011, we will be fully funded at an authorization level set by this Committee that would equal the amount of offsetting collections, so we would have to set our fees according to our authorization.

The objection is that the money, the excess fees that we have been producing since 1983 will no longer be going into the general pot of money for Commerce–State–Justice that have been used to fund, in part at least, some other programs.

Senator CARPER. Right. I don't recall exactly how many other Committees there are, but there must be a dozen or so Committees, and if every Committee would pass legislation that would change, really net the revenue to the Federal Government by $14 billion over the next 10 years, that would be $140 billion.

My sense in listening to the questioning of some of the other Members is that this bill's likely to be adopted, and likely to be passed. My hope is that we are the only Committee that tries this because, if not, we are going to have a much smaller piece of pie to use for a tax cut than a lot of people are talking about. That is not your worry here, but that is something that needs to be said on the record.

Ms. UNGER. It is a concern. I think the optics of the bill from that perspective make it somewhat difficult but if you consider that this is a tax on capital formation and investors, then it is a tax cut in a different way. If you go back to the statutory language that sets our fees to cover the costs of securities transactions and preventing fraud and everything else, then there is certainly an equity argument to be made.

Senator CARPER. If even eight Committees were to pass legislation that had a similar kind of impact, ironically, that would add up to the same amount of money that we are talking about using on these extenders, the R&D tax credit and a variety of others that need to be extended that are about to expire, so it adds up to be real money, we have to be mindful of it.

Ms. UNGER. I wonder how many other agencies bring in so much in terms of revenue?

Senator CARPER. I honestly don't know. Good question. That having been said, you mentioned that most people don't work here in Government for the salary. This guy does. And we are delighted that he is here.

STATEMENT OF SENATOR JON S. CORZINE

Senator CORZINE. Let me just say this is like most of my meetings at Goldman, Sachs. Everybody just left.

Also I will be recusing myself on this because there might be the perception of misinterpretation of why I might be voting for something. In addition, I want to make a couple of observations and make them quickly, because we have to go vote.

I embrace this pay equity element enormously. I think the kind of turnover rates that you cited, 16 and 17 percent and the number of vacancies is a real potential tax on investors from the lack of ability to fulfill the mission of the SEC, which I have great admiration for.

I think the point that Senator Sarbanes was drawing out with regard to the appropriate level of the budget to fulfill the SEC's mission effectively for investor protection and to make sure that you carry out all the various missions, I think could be questioned whether we have that set right, the $100 million that you talked about relative to your request versus appropriations and whether there is timely and effective ability to deliver on the mission just because of the lack of resources.

Some of it because of parity, some of it just because of maybe there is not as broad an investment in the role of the SEC that I think might be necessary.

Occasionally I felt that when audits or other things were going on from firsthand experience.

If I look at that chart, it looks like some of the budget projections I also think I have seen at an old firm that I worked at and I would have called that a trees grows to the sky chart. I question because if you look at where SEC fee collections are relative to the budget, up until about 1995, some gap, but not the kind that produce $14 billion over 10 years, we have had an extraordinary period in securities markets both in the underlying transactions and the new issue market mergers. And one could wonder whether we have gauged this properly for a more normalized event, and I certainly wouldn't plan my business looking at a chart like this without wondering whether historical relationships might be more appropriate and looking at the 1995 issue might be one of those.

Finally, just for all of those that would make the case that sort of what it is turned into, a transaction tax is an albatross, I wonder why we have had so much volume occur in the marketplace, and whether there is sometimes stretching of what the argumentation would be.

As I said, I am recusing myself, and I probably would come out very favorably in that, but I do think there are some observations in here about carrying out the mission that go beyond the parity question.

And if you don't mind——

Ms. UNGER. Do you want me to respond to any of that?

Senator CORZINE. I would love to except they tell me I am going to miss a vote. Then I won't be back here to hassle you the next time.

Ms. UNGER. Certainly if you have any questions that you want to submit, I can send you a written response.

Senator CORZINE. Right. I really do think you need, if I had the time to be here, I would like to deal with, we have gone through a clearly attractive period in securities markets and is the adjustment, does it take into account the consideration that you might have a dramatic falloff in volume which might not be supported over a longer period of time, which I think any practical business approach to this would want to see one do, not just collect the dough for the general revenues.

Ms. UNGER. The short answer is yes. There is a mechanism built in to take care of that.

Senator CORZINE. Good.

Ms. UNGER. Thank you.

Senator CARPER. The Committee is in recess. We did it together.

Senator ENZI [Presiding]. We will begin again, and I will begin by welcoming the second panel. We will change the order just a little bit because of airline connections.

First will be Mr. James Burton, who is the CEO of California Public Employees Retirement System. Then Mr. Marc Lackritz, who is the President of the Securities Industries Association and then Mr. Leopold Korins, who is the President and CEO of Security Traders Association.

Mr. Burton.

STATEMENT OF JAMES E. BURTON CHIEF EXECUTIVE OFFICER CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM (CalPERS)

Mr. BURTON. Thank you, Mr. Chairman and Members of the Committee.

My name is James Burton. I am the Chief Executive Officer of CalPERS. I do appreciate the opportunity to testify before the Committee today. We are the largest public pension fund in the United States with assets of $165 billion. Our plan has 864,000 active workers and 356,000 retired employees. We pay approximately $4.8 billion in annual CalPERS retirement benefits.

We administer this plan on behalf of 2,480 governmental entities in California. We have a well-diversified portfolio and we are represented in every conceivable asset class.

I am here to support S. 143, the Competitive Market Supervision Act. We believe this measure would benefit large and small investors alike by reducing the cost of securities transactions that both types of investors must pay. We also support S. 143 because it would enhance the ability of the SEC to attract and retain expert staff that is responsible for protecting investors and ensuring accountability and integrity in our markets.

We understand that the Commission staff turnover rate is considerably higher than that of other financial regulatory agencies. The Committee heard testimony last year that the attrition rate at the SEC is about 13 percent, while the Federal Reserve Board and others only lose about 5 percent of their staff each year.

Today, Acting SEC Chair Laura Unger told the Committee that the Commission has lost 30 percent of its attorneys and accountants over the past 2 years. As a large institutional investor, CalPERS is troubled by this kind of turnover of the SEC's professional staff. As a CEO, I can understand the added pressure it places on other staff members who must pick up the slack, even as essential responsibilities are unmet. CalPERS is pleased to support a measure that would help the SEC solve this problem.

We also urge the Committee to be certain that there is a stable funding source for the SEC. This, too, is crucial for the agency to attract and retain talented people.

Next, I would like to address the securities transaction fees reduction element of S. 143. Our internally managed U.S. equity portfolio turnover rate is approximately 10 percent a year. This lower-than-average rate is based on our passive investment strategy which seeks to replicate the Wilshire 2500 Index.

We also allocate a portion of our U.S. equity portfolio to external managers whose turnover rate is much higher. Because we do not trade as frequently as mutual funds, or even as often as other public pension plans, our savings and transaction fees from S. 143 won't be as great as others. It will be about $342,000 annually. But what is important to us is that this becomes essentially reduction in taxpayer costs.

Let me explain. CalPERS' actuaries make a number of projections to determine how much the plan needs in contributions today in order to pay beneficiaries in the future. While employee contributions remain constant, employer contributions are adjusted based on actuarial estimates. To the extent CalPERS' administrative costs are reduced, through fee reductions, for example, actuarial guidelines require employer contributions to be decreased. Dollars not spent on administrative costs are invested. For California taxpayers who fund State and local public agencies, these savings translate into a smaller tax burden.

Mr. Chairman, the CalPERS' Board of Administration passed a resolution in support of last year's bill and remains strongly supportive of both transaction fee reductions and SEC pay parity.

I am pleased to testify in support of S. 143 and urge the Committee to move the bill as quickly as possible. Thank you.

Senator ENZI. Thank you for providing your testimony. I know that you do have to leave. We appreciate the effort that you have gone to, to help us build this part of the record, which is a crucial part of getting any of the bills passed.

I am sure that there will be some questions for you, but we will get those to you, if you would respond to them and get them back to us, we would appreciate that so that they can be a part of the record.

Mr. BURTON. Yes, sir. Thank you for the accommodation and we will respond fully for the record.

Senator ENZI. Thank you.

Mr. Lackritz.

STATEMENT OF MARC LACKRITZ, PRESIDENT SECURITIES INDUSTRY ASSOCIATION

Mr. LACKRITZ. Thank you, Senator Enzi.

If I could start off by borrowing a line from the old broadway play, "I am Not Rappaport," and I am not Gorman. Unfortunately our witness today was going to be our Vice Chairman of SIA, Lon Gorman, who is a Vice Chairman of Schwab and President of Schwab Capital Markets, and is an expert in trading and market structure. He is our Vice Chairman and also a Cochairman of our Market Structure Committee. With the closing of the airports, unfortunately his plane was diverted back to New York, so he sends his apologies. Unfortunately, you don't have the varsity in front of you today, but I will do the best I can to testify in terms of our position on this.

We strongly support S. 143, the Competitive Market Supervision Act of 2001, which was recently introduced by Senator Gramm and Senator Schumer. We believe the time has come for Congress to reexamine the issue of SEC fees, because the basic assumptions underlying the current fee structure have changed dramatically. The fees were implemented several years ago to fund the cost of regulating the securities markets—essentially to ensure that the SEC had enough funding to adequately perform its regulatory duties, hire and retain the best staff, and cover the agency's operating expenses. Today, of course, the fees collected exceed that cost by 500 percent or more. It is time to bring securities transaction fees back in line with the cost of regulation.

Whenever an individual sells shares, the brokerage firm puts a line item on the trade confirmation for securities transaction fees. As you know, the fee is charged on sell transactions, so that every time an investor sells shares, a debit appears on their confirmation reflecting the amount of the fee. To the individual investor, the fees may seem relatively insignificant—on a small trade, they can amount to just pennies, maybe a few dollars on a larger trade. But do they ever add up, Mr. Chairman. Last year, so-called Section 31 fees and other securities transaction fees provided an estimated $2.27 billion in revenue to the Federal Treasury. The budget of the SEC, however, was $377 million, meaning that investors paid $1.9 billion more in fees than was necessary just last year.

The securities industry strongly supports adequate funding of the SEC. Our U.S. capital markets are the envy of the world, in no small part because we have the most sophisticated and professional regulatory system in the world. Proper oversight of the securities markets is absolutely critical to investor confidence. The industry agreed several years ago to pay additional transaction fees in order to provide Congress with a more reliable source of funding for the

SEC. But no one expected the staggering growth in market activity in the years since 1996 legislation that established the current fee system. Trading volume on the New York Stock Exchange and on the Nasdaq has roughly doubled in the last 4 years, sending transaction fees skyrocketing. These securities transaction fees should continue to be collected to the degree necessary to ensure that the SEC is fully funded and able to carry out its very important responsibilities.

But it is clearly not in the interest of investors for these fees to so grossly surpass the cost of regulation. These fees drain capital from the markets, and from the pockets of individual investors. Last year, that surplus amounted to $1.9 billion that could have been reinvested to stimulate economic growth and create jobs. It is money that could and should remain in the hands of investors.

It is important to point out that a reduction in securities transaction fees will benefit the broad spectrum of investors. As recently as 1992, about one-third of all U.S. households owned stock, either directly or indirectly. Last year, that number had risen to roughly half of all U.S. households invested directly or indirectly in the markets. Every single American who owns stock, directly or indirectly, through their investments in mutual funds and pension funds pays these fees, as was pointed out earlier. Regardless of their investment choices, reducing the fee would benefit investors of all types.

Mr. Chairman, this legislation is really the right answer. It brings the fees more in line with the actual costs of regulation, and ensures that investors are not taxed beyond that which is necessary for that purpose. It ensures that the SEC will have adequate funding, not only this year, but into the future, to perform its critical functions. And, importantly, it ensures that the SEC can recruit and retain the best-qualified regulators by creating pay parity between the SEC and Federal financial regulators. The SEC is losing top staff at an alarming rate to the private sector, as well as to other financial regulatory agencies that can offer much better pay. Experienced and well-qualified, competent and sophisticated regulators are critical to the long-term stability of our financial markets. By bringing SEC pay in line with other agencies, such as the Federal Reserve Board and the FDIC, we can be certain that talented professionals will continue to offer their skills and experience to the SEC. So we strongly support pay parity for the SEC staff, and always have, Mr. Chairman. We support preserving fee revenues from Nasdaq transactions as offsetting collections up to the latest CBO baseline numbers. We strongly endorse S. 143, and urge Congress to move quickly to pass this important legislation.

Finally, we are all keenly aware of the impact the current economic slowdown has had on our capital markets and on the American public in general. The market's downward move has had a profound impact on the savings of the vast majority of investors. After several years of unprecedented growth, the current situation is particularly frustrating to the millions of investors who have come into the markets in just the last 3 or 4 years, and, in fact, have not seen a downturn like this. By returning to investors some of the $1.9 billion in excess fees that were collected last year on transactions, Congress can help alleviate at least a small portion of the losses of the current market situation.

Passing the Competitive Market Supervision Act is the right thing to do, and we urge this Committee to move the bill to the Senate floor at its earliest opportunity.

Again, Mr. Chairman, thank you very much for the opportunity to testify.

Senator ENZI. Thank you for the excellent job of standing in on short notice.

Mr. LACKRITZ. Thank you.

Senator ENZI. Mr. Korins.

STATEMENT OF LEOPOLD KORINS
PRESIDENT & CHIEF EXECUTIVE OFFICER
SECURITY TRADERS ASSOCIATION

Mr. KORINS. Senator Enzi and Members of the Committee, thank you for the invitation to testify before you today on SEC's transaction fees. I am Lee Korins, President and CEO of the Security Traders Association. I appreciate this opportunity to present the views of the STA, and I applaud all of you for scheduling a hearing on this important issue in the first weeks of the 107th Congress.

I have also submitted a longer written statement for inclusion in the record.

I wanted to thank you, Senator Enzi, and the other cosponsors of S. 143 for your efforts to enact legislation to provide meaningful and equitable fee relief. STA supported S. 2107, the Competitive Market Supervision Act, last year, and was heartened to see that you, the Chairman, and Senator Schumer reintroduce the bill this past month.

In 1996, the Congress enacted the National Securities Market Improvement Act, NSMIA, which modified the SEC fee structure—including extension to Nasdaq trades of the transaction fees imposed by Section 31. NSMIA was supposed to reduce the amount of SEC fees collected. Unfortunately, however, the 1996 legislation has not functioned as intended, as the fees generate about six times the SEC's funding needs and continue to increase.

Actual fee collections have significantly outpaced NSMIA's projections because the Congressional Budget Office and the Office of Management and Budget used very conservative estimates of stock market growth that were relied on by this Committee and Congress in drafting NSMIA.

In fiscal year 2000, actual collections from all sources grew to $2.27 billion, over six times the SEC's budget, as has been mentioned. The latest CBO estimate shows runaway growth in the fees from $2.47 billion in fiscal 2001 to $3.76 billion in fiscal 2005. In other words, total SEC fees are projected to raise over $15 billion over the next 5 years, while the SEC budget will require only a fraction of that amount over the same period.

In my written testimony, I have included a chart that illustrates this trend, showing how the fees will collect over $16 billion in excess of what Congress intended in NSMIA over just the 7 year period of fiscal 2001 to fiscal 2007.

Another defect in the NSMIA's fee structure is that it fails to accommodate changes in the securities markets. For example, unless

Congress restructures SEC's fees this year, the pending Nasdaq conversion to an exchange will redirect to the general fund a significant portion of the fees that are currently made available to the appropriators to fund the SEC. Thus, we face the possibility of a fee structure that generates billions of dollars in unanticipated collections while at the same time creating a funding crisis for the SEC.

Clearly, this is not the scenario the Committee intended when it fought to redesign the SEC's funding structure in 1996, and reduce the amount of the fee surplus.

I want to emphasize here that the issue is not SEC funding. Indeed, Mr. Chairman, the legislation that has been sponsored with the Senators that have cosponsored it, protects and enhances the SEC's funding.

For the record, let me state unequivocally, that the industry and all investors consider it their duty to continue the funding of the SEC. The discussion here is over the amount of the fees, not whether we should have user fees.

Section 31 transaction fees operate as a tax on the gross trading revenue of securities professionals. One STA member firm which makes markets in about 100 Nasdaq stocks estimated that its Section 31 fee payments amounted to 40 percent of its net OTC trading profits before the allocation of overhead. Another firm found that its Section 31 fee payments were twice the amount of its rental payments for the building, housing, and trading activities. Section 31 fees operate as a gross receipts tax, meaning that fees are paid before Federal and State taxes, before salary, and before all other allocations for overhead. This is a perverse scenario, an onerous burden on the very traders who provide liquidity in the markets for hundreds of stocks.

A letter I received today, that will be entered into the record, comes from Coastal Securities, a Nasdaq market maker in Dallas, Texas. I will just read a portion of it. They indicate that:

> The burden of the Section 31 fee on Coastal Securities is clearly reflected in its financial numbers. For the 4 years the fee has been in effect, approximately 6 percent of our gross equity trading revenues have been paid to the U.S. Government under the guise of this charge. Even more dramatic, this fee amounted to approximately 29 percent of our net Nasdaq profits before allocation for such things as compliance, human resources, accounting, etc. The Section 31 fee is in all practical respects an additional tax that broker-dealers in the Nasdaq market must pay. . . . The effective Federal Income Tax rate for Coastal Securities is approximately 63 percent after considering the Section 31 fee.

But ultimately, it is the investing public that shoulders this burden. Section 31 fees are a tax on personal savings and investment in the form of lower returns. And as more Americans invest, more people pay this tax. Indeed, the percentage of households owning equities, as has been mentioned, is now up over 50 percent in the year 2000.

It is important to note that Americans of all income levels are increasing their savings through equity ownership. According to some of the most recent statistics, 29 percent of households with incomes between $15,000 and $25,000 per year own stock. Therefore, this is not just a tax on the wealthy. It is paid by the smallest, as well as the largest market participants.

Section 31 fees also hurt those who participate in pension plans, including public pension plans. For example, over a 5 year period, the many State public pension plans will pay millions of dollars in Section 31 fees. Some examples are New York, over $13 million; New Jersey, over $2.5 million; Connecticut, over $1 million; Michigan, nearly $5 million; and Pennsylvania, approximately $6.5 million. At a time when the Government is encouraging savings, we think it is inconsistent to levy this pernicious tax on investment.

Finally, as Chairman Levitt explained during testimony last year, 87 percent of the transactions on the New York Stock Exchange, which include this fee, are paid by individuals, not traders or firms. This clearly illustrates who ultimately bears the burden of excess fee collections.

The STA strongly supports S. 143. This legislation provides meaningful fee relief while ensuring that the SEC continues to have the resources necessary to supervise and regulate securities markets. Indeed, the fee level set in S. 143 will accommodate the recent significant increases in the SEC's budget and will pay and will include pay-parity provision as part of this legislation.

Furthermore, S. 143 addresses concerns raised by Members of the Appropriations Committee by ensuring that they will continue to receive the same level of fees designated as offsetting collections as included in the most recent budget baseline. Indeed, without a change in current law, the conversion of Nasdaq to an exchange will automatically deprive these appropriators of nearly all the offsetting collections they now receive.

We applaud the inclusion of the fee cap and the floor in Section 5 that ensures against the unintended over-collection of fees, while protecting the SEC from any shortfall. Given the recent track record of budget projections, this is a prudent safeguard to ensure that the legislation fulfills its intent.

In sum, S. 143 would move the fees collection system toward its original purpose—providing a stable source of funding for the SEC, derived from a constituency that benefits from its oversight and regulation. The STA applauds the scheduling of this prompt hearing on an issue of great importance to our members across the United States.

Thank you very much for your interest, and I will be happy to answer any questions.

Senator ENZI. Thank you.

We want to thank both of you for your excellent testimony. I am glad that we were able to have a hearing this early on this important issue. We are talking about a revenue surplus again. That means an overcharge. Any time we have an overcharge, we want to stop the overcharge and give it back to the people that overpaid.

We are nearing Abraham Lincoln's birthday right now, and he is legendary in his efforts to return money that was not his. I think that is the case that we have here, too, and, while we are doing it, we are being responsible for, not only reducing the excess fees paid by the investors, but at the same time we are providing an adequate level of funding for the SEC and providing for an ability to attract and retain quality employees. And I am pleased with the unanimity of the testimony that has gone into the record today.

I do have a couple of questions for either or both of you, and this relates to our international competitiveness. We do want to assure that the U.S. markets do remain competitive. Could you explain how the existing fee structure compares to those of other international markets? Do other countries assess a similar fee? And do either of you have any knowledge?

Mr. KORINS. It is difficult to assess the fee structure from one country to another, because of the various expenses of transacting business in different countries. For instance, the clearing costs in most European countries are much more significant than the clearing costs of transacting business here in the United States because of things like centralized depositories and things that we have put in place over many years.

But as far as transaction fees, per se, I do not know of any country that exacts an actual tax on each transaction going through its exchange. There are some other countries that levy a securities transaction excise tax. It is not to fund the regulators, for the most part. It is a tax. In fact, most of them are repealing those taxes, because they realize that it is disadvantaging them from an international competitiveness point.

Your point about international competitiveness, I think, also goes to the SEC pay-parity issue, which is that, as the markets become globalized, it is really critical that we have the most competent professional and understanding staff at the SEC. To the extent that they are losing staff at the rate of 30 percent a year, that is not good from the standpoint of the sophistication that is necessary to deal internationally with other regulatory agencies.

Senator ENZI. Thank you.

Former SEC Chairman Levitt stated last year that 82 percent of the fees collected on Nasdaq market transactions and 87 percent of the fees collected on the New York Stock Exchange transactions are paid directly by the investors.

I am the accountant in the Senate, so one of the things that I was interested in was who pays the remaining 18 percent or 13 percent of the transaction fees collected. Even if this fee is not paid directly by the investor, will it not be passed on to the investor in some fashion?

Mr. LACKRITZ. Mr. Chairman, the remaining part is paid by either market makers or specialists who are the intermediaries in the transactions. As you know, costs—money is fundable, and so costs get passed on that way. Absolutely.

Senator ENZI. Can you quantify the loss to investors from what they would otherwise receive in returns because of the fees? This 82, 87 percent?

Mr. LACKRITZ. Lee may want to address that. What we can quantify is the amount of surplus that has gone into Government as a result of the fees being too high. You can, obviously, back that up and do some calculations and do the compounding and the discount back to present value to come up with some number. If you think about how much investments have appreciated in the last couple of years up until 2000, it would be an addition to that. For example, in 2000, the Nasdaq index was down 39 percent for the year. That was the worst performance Nasdaq had had since 1971. The Dow was down 6 percent, which was the worst performance it had

had since 1981. The S&P 500 was down about 10 percent, so, obviously, any part of those returns or those fees that are going back to investors would help ameliorate that loss that they experienced this last year.

Mr. KORINS. I think there was some testimony entered into the record to the effect—and the Chairman indicated it—that a member of a public pension plan who had over a thousand dollars exacted in fees would, in fact, with a normal rate of return, that money would end up being over $5,800 during the period for an individual. This is a very meaningful amount of money that is going out of public investors, as well as private investors.

Senator ENZI. That is what I was hoping for.

Mr. KORINS. Yes, it was entered into the testimony earlier.

Senator ENZI. A little harder to put a handle on. Mr. Korins, in your testimony, you mentioned the drain that excessive fees have on the market and the way it reduced liquidity, and that the major impact falls on small companies. Could you expound on that a little bit more for me?

Mr. KORINS. As market makers, and to some degree specialists on an exchange, find that their expenses of staying in the market keep increasing, that leads them to be more attentive to the more liquid securities, which, of course, are the larger issues that they trade. As a result, a certain amount of capital is drained away from making markets in the smaller, less active issues, because those require, usually, capital commitments over an extended period of time. The typical small issue does not turn over every hour or even everyday. It sometimes means that you are tying up capital for an extended period of time.

As people lose the ability to have an effective return from the capital that they commit to these areas because of the expenses that they incur, then it is detrimental to the smaller issues. They will concentrate their capital and their talent on the larger issues where the liquidity is.

Senator ENZI. I want to thank each of you for providing this testimony and building the record for us and your attentiveness in spite of the delay and the vote that we had that created quite a disruption. We appreciate the testimony and hope that that will wrap things up to get this bill expedited.

There may be additional questions provided in writing. We ask that you answer those as quickly as possible.

Mr. LACKRITZ. We would be happy to.

Mr. KORINS. We would be happy to respond.

Senator ENZI. We would appreciate it, and so we will keep the record open.

[Whereupon, at 4:10 p.m., the hearing was adjourned.]

[Prepared statements, response to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF SENATOR PHIL GRAMM

The Competitive Market Supervision Act of 2001, S. 143, was introduced January 22, would reduce the fees collected on securities registration and transactions while assuring adequate funding for the operation of the Securities and Exchange Commission. The bill would also allow the SEC to bring the pay of its employees in line with the pay of other Federal financial regulators.

The bill we have before us does two things. First, it seeks to change the law to assure that we have a system whereby there will always be enough money to fund the SEC, but the fees on new stock issues and transactions won't continue to be a general revenue source for the Federal Government.

Thanks to the growth in the economy, these fees are now generating six times as much as we need to fund the SEC. And these fees, over time, become a fairly substantial tax burden as people try to accumulate wealth. I have been trying to come up with figures that would help us understand the problem. By taking some estimates that might be applicable to a college professor or an auto mechanic, saving for retirement, we find that they will pay $1,304.55 in excessive fees over their lifetimes. And if that money were invested for retirement over a 45 year working lifetime, with a conservative 6 percent return, that grows to $5,800, or $11,600 for a two-wage family. That shows that the fees are a very heavy tax on people who try to build up savings, to send their children to college, to retire, or to provide for their future.

The second thing we want to do is establish pay parity for the SEC, giving the SEC the ability to pay wages that are competitive with what we now allow in financial regulatory agencies. I think this is very important. There are few people who love Government less than I do. But I believe that if you are going to do things in Government, and Government has a role in a free society, then you need to have the best people you can get performing those functions, and having more competitive pay is very important.

PREPARED STATEMENT OF SENATOR JIM BUNNING

Mr. Chairman, I would like to state my strong support for S. 143, the Competitive Market Supervision Act.

I am a cosponsor of S. 143, and commend you, Mr. Chairman and the Ranking Member of my Subcommittee, Senator Schumer, for your hard work on this important issue. User fees should be used only for the purpose for which they were collected. They should not be used to balance the budget. The budget is not only balanced, but also we are running a surplus. We are currently collecting way too much money in user fees—more than the Securities Exchange Commission (SEC) needs to offset its budget. This backdoor tax on capital is an unfair burden to investors and brokers. I think it would be a nice Valentine to the American investor, both large and small, to pass S. 143 in an expeditious manner.

With more and more people investing in the markets, fee collections have boomed to outrageous levels and these fees are passed on to investors in terms of higher investment costs. Many of these folks are small, first-time investors. Although the fees are a small percentage and that percentage will decrease over the next 8 years, the SEC is still collecting much more money than it needs. We tried to move this legislation last year, but we were unsuccessful. It is time to cut this tax. This money belongs to the taxpayers and should be given back to them.

I also support the pay parity provisions of the bill. If we are going to continue to have a strong SEC to ensure our markets remain the envy of the world, the SEC must be able to hire and retain good people. This bill will help ensure we keep good people to oversee our securities markets. It will put their salaries in line with those paid by the Federal Reserve and other Federal agencies. It won't pay what Wall Street does, but it will help us keep those people who have chosen to serve the public to continue in their jobs.

Again, I thank the Chairman for bringing this important legislation before us.

PREPARED STATEMENT OF LAURA S. UNGER

ACTING CHAIR, U.S. SECURITIES AND EXCHANGE COMMISSION

FEBRUARY 14, 2001

Chairman Gramm, Ranking Member Sarbanes, and Members of the Committee: I appreciate the opportunity to testify before you today on behalf of the Securities and Exchange Commission ("SEC" or "Commission") regarding S. 143, the proposed "Competitive Market Supervision Act of 2001" (the "CMSA" or the "bill").

The CMSA addresses two issues of great importance to the Commission. First, the bill aims to improve the current system of SEC fee collections. The Congressional Budget Office ("CBO") estimates that fees required to be collected by the SEC from all sources will total over $2.47 billion in fiscal 2001.[1] This represents more than five times the SEC's fiscal 2001 appropriation of $422.8 million.[2] The Commission shares the Committee's concerns regarding these excess fee collections.

The CMSA attempts to rectify this situation by significantly reducing fees for investors, market participants, and companies making filings with the Commission, while preserving offsetting collections that will be available to our appropriators to fund the agency in coming years. It also spreads the costs of regulation among those who benefit from the activities of the Commission. We commend Chairman Gramm, Senator Schumer, and the bill's other cosponsors for this effort to achieve significant fee reductions in a comprehensive manner.

Second, the CMSA addresses what is perhaps the greatest challenge facing the Commission today: The SEC's severe difficulties in attracting and retaining a sufficient number of qualified staff. The CMSA addresses the SEC's staffing crisis by giving us the much-needed ability to match the pay and benefits of the Federal banking agencies. In the wake of the historic Gramm–Leach–Bliley Act of 1999, pay parity is more imperative than ever. The Commission greatly appreciates the Committee's recognition of the ongoing staffing crisis we currently face. The CMSA, together with authorization and appropriation levels sufficient to make pay parity a reality, should go a long way to ensuring that the Commission can continue to carry out its statutory mandate of protecting investors and maintaining market integrity by remaining an institution that can attract and retain dedicated professionals.

Given the complexity of the issues involved in fee reduction, we will first briefly review the current fee collections required by the Federal securities laws and their relationship to the SEC's funding before addressing the specifics of the bill. We will then address our need for pay parity. Although we have several technical concerns with the fee reduction portion of the bill's impact on the stable, long-term funding of the agency, we are confident that we will be able to continue to work together with the Committee to resolve these issues. We look forward to a thorough and inclusive dialogue with you and other interested parties.

Current Fee Collections and SEC Funding Structure

In previous testimony before the Securities Subcommittee, we gave an overview of the history of SEC fees, the fee agreement contained in the National Securities Markets Improvement Act of 1996 ("NSMIA"), the impact of the Budget Enforcement Act on the fee debate, and the SEC's own efforts to reduce fees.[3] Today, we would like to focus on the current fee collections situation and its relationship to the SEC's funding structure.

The Federal securities laws direct the Commission to collect three different types of fees:

- Securities registration fees required to be collected under Section 6(b) of the Securities Act of 1933 that are paid when companies register their securities with the Commission ("Section 6(b) fees").
- Securities transaction fees required to be collected under Section 31 of the Securities Exchange Act of 1934 ("Exchange Act") that are paid when securities are sold on exchanges and in the over-the-counter ("OTC") market ("Section 31 fees").
- Fees on mergers and tender offers (and other significant transactions) required to be collected under various provisions in Sections 13 and 14 of the Exchange Act that are paid when transaction documents are filed with the Commission.

The majority of the fees collected from these three sources—a large portion of Section 6(b) fees, Section 31 fees on transactions involving exchange-listed securities,

[1] CBO January 2001 Baseline.

[2] Pub. L. No. 106–553, 114 Stat. 2762 (2000).

[3] *See* Testimony of Arthur Levitt, Chairman, U.S. Securities and Exchange Commission, Concerning Fee Collections, Before the Subcommittee on Securities, Senate Committee on Banking, Housing, and Urban Affairs (March 24, 1999).

and all fees collected on mergers and tender offers—goes to the U.S. Treasury as general revenue. The remaining portion of fee collections—a small portion of Section 6(b) fees and Section 31 fees on Nasdaq transactions—goes to "offsetting collections."

The distinction between the general revenue portion and the offsetting collections portion of fee collections is central to understanding the SEC's funding structure. Because our appropriators use offsetting collections to fund SEC operations, offsetting collections are crucial to full and stable long-term funding for the SEC. The SEC has *not* received an appropriation from the general revenue portion of fee collections, which CBO projects to be more than $1.5 billion in fiscal 2002,[4] for the last 5 years.

Although some anticipated that NSMIA would lead to gradual increases in general revenue funding for the SEC, this has not occurred.[5] Because the tremendous growth in transaction volume and market capitalization we have witnessed in the last few years has far exceeded the 1996 estimates on which NSMIA was based, current fee collections are well in excess of original estimates.

The following chart shows current CBO estimates of SEC fee collections broken down between those that go directly to general revenue and those that go to offsetting collections:

Estimated SEC Fee Collections[6]

(BY FISCAL YEAR, IN MILLIONS)

	2001	2002	2003	2004	2005	2006	2007
General Revenue:							
Section 6(b)	804	820	836	873	935	999	357
Section 31	571	638	672	779	885	998	463
Mergers and Tender Offers	84	89	93	97	99	100	101
Total General Revenue	1461	1547	1601	1749	1919	2097	921
Offsetting Collections:							
Section 6(b)	220	160	117	39	23	0	0
Section 31	797	989	1215	1505	1827	2191	1110
Total Offsetting Collections	1017	1149	1332	1544	1850	2191	1110

As the chart illustrates, total fee collections are currently projected to increase through fiscal 2006, and then fall sharply in fiscal 2007. This is because under current law both the general revenue portion of Section 6(b) fees and all Section 31 fees will be reduced dramatically in fiscal 2007—the Section 6(b) fee rate will be reduced from the current $200 per million of the aggregate offering price of the securities to $67 per million and the Section 31 fee rates will be reduced from their current 1/300th of 1 percent of sales to 1/800th of 1 percent. In addition, the offsetting collections portion of Section 6(b) fees are gradually being eliminated over a

[4] CBO January 2001 Baseline.

[5] NSMIA contemplated that the increases would be gradual because of the practical realities of the budget process—it is difficult to maintain full and stable funding for the SEC in the context of a sudden shift to general revenue.

[6] The numbers in this chart are based on the CBO January 2001 Baseline.

ting collections portion of Section 6(b) fees are gradually being eliminated over a multiyear period ending in fiscal 2006.

"Competitive Market Supervision Act of 2001"

The proposed "Competitive Market Supervision Act of 2001" achieves meaningful reductions in fee rates in a comprehensive manner. It significantly reduces the burden of excess fees not only on investors and the Nation's securities markets, but also on the capital-raising process. By targeting all three types of SEC fees for reduction, the bill spreads the benefits of fee reduction among all those who pay for the costs of regulation. Specifically, the bill would further reduce the Section 6(b) fee rate on the registration of securities from the scheduled reductions under current law. In fiscal 2002, the Section 6(b) fee rate would be reduced by 73 percent—from the current $250 per million to $67 per million. The bill would reduce this rate by another 50 percent in fiscal 2007—to $33 per million.

The bill imposes similar rate reductions on the fees associated with merger and tender offers. Specifically, the fee rate on mergers and tender offers would be reduced by 67 percent in fiscal 2002—from the current $200 per million to $67 per million. The bill also reduces this rate by another 50 percent in fiscal 2007—to $33 per million. The collections resulting from the Section 6(b) fees and the fees on mergers and tender offers are reclassified as offsetting collections that would be available to the SEC's appropriators to fund the Commission.

The bill proposes a more complex approach to reducing Section 31 transaction fees. The bill puts in place a mechanism by which the Congress would set the Section 31 fee rate on a yearly basis. The rate would be determined by taking a fixed dollar amount specified in the bill for that year and dividing it by the estimated dollar volumes of transactions on the exchanges and in the over-the-counter market for that year. The fixed dollar amount for each year is calculated by taking the total amount of offsetting collections available to the Commission's appropriators under CBO's December 1999 baseline and subtracting the anticipated Section 6(b) and merger and tender offer fee collections for that year under the reduced rates discussed above.

In fiscal 2002, this mechanism could result in a Section 31 fee rate of approximately $14 per million—less than half the current rate of 1/300th of 1 percent (or $33 per million). Moreover, by resetting the Section 31 fee rate on a yearly basis, the bill should avoid the potential for excess collections or shortfalls inherent in an activity-based fee. Instead, this approach should cause the amount of total fees collected to approximate those in the CBO's December 1999 baseline projection of offsetting collections through fiscal 2010.[7] The bill also designates all of the fees collected under this mechanism as offsetting collections.

The CMSA reduces fees by eliminating the general revenue portion of collections, which currently accounts for the majority of all SEC fees and is estimated to reach more than $1.5 billion in fiscal 2002,[8] and redefining the make-up of offsetting collections. Going forward, all Section 31 fees, all Section 6(b) fees and, for the first time, merger and tender offer fees are shifted to offsetting collections. Because our appropriators fund agency operations out of offsetting collections, these changes ensure that the costs of Federal securities regulation are shared more evenly. These changes also should help to preserve the ability of our appropriators to fund SEC operations out of offsetting collections, and, therefore, increase the likelihood that the SEC will receive adequate funding in the future.[9] We appreciate your efforts to

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[7] The bill currently uses CBO's baseline projections from December 1999. We understand from the Senate Banking Committee staff that these numbers will be updated with CBO's most recent 10-year projections. We encourage this amendment as it will lessen the possibility of shortfalls in offsetting collections in fiscal 2007 and after fiscal 2010.

[8] While we understand that there are rather complex Pay-As-You-Go ("PAYGO") budget scoring rules that may affect the ability of Congress to reduce the general revenue portion of fee collections, the Commission believes that it would be difficult to achieve truly meaningful reductions in fees, as well as to provide full and stable long-term funding for the SEC, without addressing the general revenue portion of fee collections. We take no position on the larger tax policy issues raised by the bill.

[9] We are concerned, however, with the long-term impact on our funding of the fixed dollar cap on Section 31 fee collections, as well as the overall fee cap and floor, after fiscal 2010. By freezing the transaction fee cap after fiscal 2010, the bill does not allow offsetting collections to continue to grow in tandem with the Commission's budget needs. In addition, it is unclear how the overall fee cap and floor, which are both based on the Commission's authorization level, would work in years after 2010. Historically, this level has not been set, if at all, until the latter part of the appropriations process. This creates a potential timing problem because, under the bill, the authorization would, in fact, be needed at the beginning of the legislative process to allow CBO to estimate available collections. We hope to continue working with the Committee

Continued

take into account SEC funding issues when crafting this bill. By taking this approach, your bill facilitates the Commission's continuing efforts to protect investors and promote the integrity and efficiency of the Nation's securities markets.

The bill also eliminates the possibility of drastic excess collections or shortfalls in one year by setting an overall fee cap and floor and by creating a mechanism to make intra-year adjustments in the Section 31 fee rate to steer collections to a level between the cap and floor. The Commission believes the concept of a cap and floor on fee collections provides a workable way of avoiding the shortcomings of previous attempts at fee reductions. The Commission does have some concerns with the way the floor is set in the bill's current version. The Commission believes a change to the way the floor is set will allow the floor to continue to approximate the minimum necessary for the Commission to operate. Revising the floor should also prevent future CBO projections of offsetting collections from being skewed downward, which would have the effect of reducing the amounts actually available to our appropriators to fund the agency.

In addition, as a practical matter, the feasibility of this bill's approach depends on the Commission receiving an up-front appropriation each year that would be reduced by offsetting collections as they are collected. The Commission would need such an up-front appropriation purely for cash-flow reasons; it will not "cost" anything in terms of general revenue. It is our understanding that most Government agencies receive such an up-front appropriation and, until the last few years, the Commission received one as well. Although we do not believe that this ultimately will be a problem, the need for an up-front appropriation underscores the need for an inclusive dialogue on these complex issues.

Finally, we note that the bill should be modified to reflect Congress's recent adoption of the Commodity Futures Modernization Act of 2000 ("CFMA"). As the Committee is aware, the CFMA for the first time allows the trading of a new class of securities—futures contracts on single stocks and narrowly based stock indices. The CFMA provides for "assessments" on these security futures products comparable to the Section 31 transaction fees payable on stock option transactions. We would be pleased to work with the Committee's staff in making the technical changes necessary to include these CFMA assessments in the bill's fee reductions, as well as to avoid any unintended negative impact on the bill's funding structure.

Pay Parity with Banking Regulators

The second issue that the CMSA addresses is the Commission's severe difficulties in attracting and in retaining a sufficient number of qualified staff. At present, the Commission is unable to pay its accountants, its attorneys, and its examiners what their counterparts at the Federal banking agencies earn. Since all of the Federal banking regulators are not subject to the Government-wide pay schedule, they are able to provide their staffs with appreciably more in compensation and in benefits than we can.

This disparity is a significant drain on morale. It is difficult to explain to SEC staff why they should not be paid at comparable levels, especially when they are conducting similar oversight, regulatory, and examination activities. It is one thing for staff to make salary comparisons with the private sector, but quite another for them to see their Government counterparts making anywhere from 24 to 39 percent more than they are.

This is particularly true in the wake of the landmark Gramm–Leach–Bliley Act of 1999 ("GLBA"). As this Committee is well aware, the GLBA demands that the Commission undertake additional examinations and inspections of highly complex financial services firms both to fulfill our own oversight responsibilities and to provide the Federal Reserve and other banking agencies with the information and analyses needed to fulfill their missions. Moreover, by allowing securities firms, banks, and insurance companies to affiliate with one another, the GLBA requires increased coordination of activities among all the financial regulators. Even more so than in the past, Commission staff will work side-by-side with their counterparts from the banking regulatory agencies, including the Federal Reserve, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation. However, we cannot match the salaries that these regulators pay.

The Commission has already seen several staff leave to take positions with these agencies, primarily because of pay. Unless we are put on equal footing, this trend will continue and most likely intensify. Given the complexities of our markets and the new business affiliations we are likely to see, the SEC does not believe it is at

on these issues and believe they can be addressed without undermining the stated benefits of the bill.

all beneficial to have the financial regulators poaching from one another based on pay. Instead, we should be working together from the same starting point.

Pay parity will help resolve the Commission's staffing crisis. Since 1996, our attrition rate has been increasing, particularly among our more senior professionals. Over the last 2 fiscal years, the Commission has lost 30 percent of its attorneys, accountants, and examiners. These losses are adversely affecting the Commission's continuing efforts to protect investors and promote the integrity and efficiency of the Nation's securities markets. The Commission is losing staff before they become fully productive because we cannot pay them enough. In a world where first-year associates are making six-figure salaries in Washington, DC law firms, the salaries the SEC can provide are simply not competitive to attract and to retain a sufficient number of talented professionals to reduce high turnover and fill open positions. We recognize that the SEC cannot completely match the higher salaries offered by brokerages, law firms, self-regulatory organizations, and other securities-related businesses. Something needs to be done, however, to close the pay gap and reduce the turnover problems we face.

Recruitment

The lack of pay parity creates enormous difficulties in recruiting attorneys and accountants. We have used recruitment bonuses where possible, but have not met with much success. A typical first-year associate in a top-tier New York or Washington, DC law firm makes double, if not more, than a comparable staff attorney at the SEC. The costs of 3 years of law school leave most graduates entering the job market with significant amounts of student loan debt. It is not difficult to understand why the private sector looks so appealing.

Our problem is even worse for accountants, who need to be experienced when they walk in the door. Experienced accountants are difficult to find and expensive to hire because their ability to analyze complex financial statements is highly prized. We do not have the luxury, if you can call it that, of being able to take someone directly out of school. The Commission has attempted to ameliorate this problem by developing an "in-service" placement program that allows certain Securities Compliance Examiners to be reassigned as accountants if they meet specific criteria, but even this effort has fallen short. In fact, in fiscal 1999 only 46 percent of our available positions for accountants were filled. This hiring rate is not sustainable. The Commission needs the ability not only to keep staff longer, but also to bring them to the Commission in the first place.

Retention Efforts

The SEC has also lost far too many of its most talented and experienced staff. Over the past several years the Commission has explored virtually every available approach to keeping staff longer. In 1992, we petitioned and received from the Office of Personnel Management ("OPM") the authority to pay the majority of our attorneys and accountants approximately 10 percent above their base pay. While special pay was a step in the right direction, it proved to be a short-term solution. This is because staff that receive special pay do not receive the Government-wide locality increase each year, which means that their special pay becomes less valuable over time and hence becomes less effective as a retention tool. Our appropriation last year included funds to reinstate special pay rates for certain employees.[10] While this should help, based on our experience, we know this is at most a temporary and partial remedy to the SEC's staffing crisis.

The Commission has also used retention allowances and economist special pay to help alleviate our retention problem. While these tools have proved somewhat effective when targeted to specific staff and situations, we believe they are incapable of providing the broad relief that we need to combat the Commission's losses and treat all staff fairly.

The Agency and Its Staff

Our inability to attract qualified staff and the current level of turnover is threatening our ability to oversee the Nation's securities markets and to respond in a timely manner to the changing events and innovations in our markets by:

- Hampering our ability to bring cases to trial and disrupting the continuity we need when pursuing cases.
- Hindering us from responding to changing markets in a timely fashion, including through targeted deregulatory efforts.

[10] We submitted our special pay justification package for certain attorneys, accountants, and examiners to OPM on December 21, 2000 and are waiting their approval of our proposed special pay rates.

- Limiting our institutional memory, which is a crucial component of our long-term effectiveness as a regulator.
- Lowering employee morale, which in turn reinforces the staffing crisis.

SEC staff work hard to handle the Commission's increasing, and increasingly complex, workload. The time that our managers and senior staff have to devote to this workload is, however, reduced by the time it takes to recruit and train new staff. The SEC conservatively estimates that it takes approximately 2 years for new staff to become fully productive. During this period, new staff is somewhat of a drag on the efficiency of the agency because they are still moving up the learning curve. If these staff leave just as they become fully productive to the agency, we do not break even on our investment in training them. That is a loss not only for us, but also for the investing public and our markets.

The SEC should be a place where highly motivated people come to hone their skills and perform public service, both before entering the private sector and after a stint in the private sector. Such career paths speak highly of the Commission's professionalism and the industry's regard for the agency and its staff. However, the Commission should be able to keep staff for a minimum of 3 to 5 years. The SEC can ill afford to have its future walk out the door. We need to ensure that the Commission has the staffing resources to meet the regulatory challenges that lie ahead as technology in general, and the Internet in particular, continue to reshape our markets.

The Need for Commensurate Authorization

Resolving the Commission's staffing crisis requires the statutory changes contained in the CMSA that would allow the agency to pay its employees outside of the Government-wide pay scale, and it also requires Commission authorization and appropriation at a level that allows the agency to implement pay parity. Without the authorization to be appropriated sufficient funds to implement pay parity, having the authority to provide our employees with pay parity will do little to address the staffing crisis we face. By our estimates, implementing pay parity with the banking regulators, as the CMSA proposes, would require a net funding increase of approximately $70.9 million in fiscal 2002, with yearly adjustments for inflation thereafter.[11] Although this is a significant amount of money, it is crucial for the Commission to have the resources it needs to fulfill its mission. The most vital resource we have, ultimately, is our highly professional and well-regarded staff. This is the one area we can least afford to jeopardize.

Conclusion

The proposed "Competitive Market Supervision Act of 2001" addresses two important challenges to the Commission's continuing efforts to protect investors and promote the integrity and efficiency of the Nation's securities markets. First, the bill achieves significant reductions in excess fee collections, while preserving offsetting collections that can be used to continue to fund SEC operations. While the Commission does have technical concerns with the bill, as noted above, we hope that we can continue to work with the Committee and its staff to iron these out. Second, the bill addresses the SEC's serious staffing crisis by providing the SEC pay parity with Federal banking regulators. We appreciate your recognition of these challenges and commend the comprehensive manner in which you address them. We look forward to continuing a thorough and inclusive dialogue with you and other interested parties on this bill.

PREPARED STATEMENT OF JAMES E. BURTON

CHIEF EXECUTIVE OFFICER

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM (CALPERS)

FEBRUARY 14, 2001

My name is James E. Burton and I am the Chief Executive Officer for the California Public Employees' Retirement System (CalPERS).

CalPERS is the largest public pension system in the United States with an investment portfolio of more than $165 billion, held in trust for its 1.2 million members. Among the members are 864,000 active duty police officers and fire fighters, college professors and school custodians, and other public employees. And some 356,000 retired public employees receive $4.8 billion in annual CalPERS retirement benefits.

[11] This assumes full-funding of special pay and no new staff in fiscal 2002.

In short, CalPERS provides retirement plan administration for the State of California and most of its cities, counties, and special districts. In all, CalPERS administers the retirement system for 2,480 governmental entities.

Our $165 billion in assets are allocated among fixed-income instruments, equities, real estate, and other investments. Our investments in domestic equities are currently valued at some $67 billion.

I am here to support S. 143, the Competitive Market Supervision Act. We believe this measure would benefit large and small investors alike by reducing the cost of securities transactions that both types of investors must pay. We also support S. 143 because it would enhance the ability of the SEC to attract and keep expert staff that is responsible for protecting investors and ensuring accountability and integrity in our markets. This is a matter of great significance to all Americans.

According to the testimony of SEC Chairman Levitt last year, the Commission staff turnover rate is considerably higher than that of other similar regulatory agencies. I believe he estimated the attrition rate for the SEC at about 13 percent, while the Federal Reserve Board and others only lose about 5 percent of their staff per year. The pay parity provisions in the bill would put the SEC on par with the Federal Reserve Board and other regulators. We also urge the Committee to be certain that there is a stable funding source for the SEC. This, too, is crucial for the agency to attract and retain talented people.

We have worked with the SEC and we know that when key personnel leave, they take their institutional knowledge with them. This results in inefficiencies as replacement staff go through learning curves. S. 143 will give the SEC the flexibility it needs to bring salaries in line with other financial regulatory agencies.

Next, I would like to address the securities transaction fees reduction element of S. 143 and how it will affect the 2,211 public employee retirement systems in the Nation. The Federal Reserve Board says that these plans own approximately $2 trillion in equities.

Wilshire Associates, a pension plan consulting and research organization, estimates that the average annual turnover of equity portfolios of public pension plans is 30 to 40 percent. This totals $600 billion to $800 billion annually. Based on these estimates, the fee reduction formula in the bill would save public pension plans approximately $10 million per year in transaction fees.

CalPERS' domestic equity portfolio turnover rate is 10 percent per year. This lower-than-average rate is based on our view that the long-term investor performs better. The following table illustrates our historical rates of return since 1991:

Year	**Through June**
1991	6.5 percent
1992	12.5 percent
1993	14.5 percent
1994	2.0 percent
1995	16.3 percent
1996	15.3 percent
1997	20.1 percent
1998	19.5 percent
1999	12.5 percent
2000	10.5 percent

Because we don't trade as frequently as mutual funds—or even as often as other public pension plans—our savings in transaction fees from S. 143 won't be as great as others. It will be about $342,000 annually. But what is important to us is that this becomes essentially a refund to taxpayers.

I will explain. CalPERS actuaries make a number of projections and assumptions to determine how much the plan needs in contributions today in order to pay the beneficiaries in the future. While employee contributions remain fairly constant, employer contributions are adjusted based on actuarial estimates.

To the extent CalPERS' administrative costs are reduced, through fee reductions for example, actuarial guidelines require employer contributions to be decreased. Dollars not spent on administrative costs are invested. For California taxpayers who fund both the State and the local public agencies, these savings translate into a smaller tax burden.

Mr. Chairman and Members of the Committee, the CalPERS Board of Administration passed a resolution last year in support of S. 2107, last year's version of the

Competitive Market Supervision Act. This action followed a presentation to the Board on the merits of S. 2107 by Geof Gradler, your very capable Committee economist. We want you to know that we appreciate Mr. Gradler's assistance.

Finally, we are pleased to testify in support of S. 143. We urge the Committee to move the bill as quickly as possible.

Thank you.

PREPARED STATEMENT OF MARC LACKRITZ

PRESIDENT, SECURITIES INDUSTRY ASSOCIATION

FEBRUARY 14, 2001

Chairman Gramm, Senator Sarbanes, and Members of the Committee, I am Marc Lackritz, President of the Securities Industry Association, which comprises nearly 750 securities firms, including investment banks, broker-dealers, and mutual fund companies. SIA deeply appreciates the opportunity to present the views of the securities industry on the issue of securities transaction fees.

Mr. Chairman, we strongly support the Competitive Market Supervision Act of 2001, which you recently introduced with Senator Schumer. We believe that the time has come for Congress to re-examine the issue of SEC fees, because the basic assumptions underlying the current fee structure have changed dramatically. The fees were implemented several years ago to fund the cost of regulating the securities markets—essentially to ensure that the SEC had enough funding to adequately perform its regulatory duties, hire and retain the best staff, and cover the agency's operating expenses. Today, of course, the fees collected exceed that cost by 500 percent or more. It is time to bring securities transaction fees back in line with the cost of regulation.

Whenever an individual sells shares, the brokerage firm puts a line item on the trade confirmation for securities transaction fees. As you know, the fee is charged on sell transactions, so that every time an investor sells shares, a debit appears on their confirmation reflecting the amount of the fee. To the individual investor, the fees may seem relatively insignificant—on a small trade, they can amount to just pennies, maybe a few dollars on a larger trade. But do they ever add up. Last year, so-called Section 31 fees and other securities transaction fees provided an estimated $2.27 billion in revenue to the Federal Treasury. The budget of the SEC, however, was $377 million, meaning that investors paid $1.9 billion more in fees than was necessary last year.

The industry strongly supports adequate funding of the SEC. The U.S. capital markets are the envy of the world, in no small part because we have the most sophisticated regulatory system in the world. Proper oversight of the securities markets is absolutely critical to investor confidence. The industry agreed several years ago to pay additional transaction fees in order to provide Congress with a more reliable source of funding for the SEC. But no one expected the staggering growth in market activity in the years since the 1996 legislation that established the current fee system. Trading volume on the New York Stock Exchange and on the Nasdaq has roughly doubled since 1996, sending transaction fees skyrocketing. Securities transaction fees should continue to be collected to the degree necessary to ensure that the SEC is fully funded and able to carry out its important responsibilities.

But it is clearly not in the interest of investors for these fees to so grossly surpass the cost of regulation. These fees drain capital from the markets, and from the pockets of individual investors. Last year, that amounted to $1.9 billion that could have been reinvested to stimulate economic growth and create jobs. It is money that could—and should—remain in the hands of investors.

It is very important to point out that a reduction in securities transaction fees will benefit the broad spectrum of investors. In 1992, about 37 percent of all U.S. households owned stock, either directly or indirectly. Last year, that number had risen to roughly half of all U.S. households. Every American who owns stock either directly, or indirectly through their investments in mutual funds and pension funds, pays these fees. Regardless of their investment choices, reducing the fee would benefit investors of all types.

Mr. Chairman, the legislation you and Senator Schumer introduced last month is the right answer. It brings the fees more in line with the actual cost of regulation, and ensures that investors are not taxed beyond that which is necessary for that purpose. It ensures that the SEC will have adequate funding, not only this year, but also into the future, to perform its critical functions. And, importantly, it ensures that the SEC can recruit and retain the best-qualified regulators by creating pay parity between the SEC and the Federal financial regulators. The SEC is losing top staff at an alarming rate to the private sector, as well as to other financial regulatory agencies that can offer better pay. Experienced and well-qualified regulators are critical to the long-term stability of our financial markets. By bringing SEC pay in line with other agencies, such as the Federal Reserve Board and the FDIC, we can be certain that talented professionals will continue to offer their skills and their experience to the SEC. Finally, we support preserving fee revenues from Nasdaq transactions as offsetting collections up to the latest CBO baseline numbers. We strongly endorse S. 143, and urge the Congress to move quickly to pass this important legislation.

Finally, we are all keenly aware of the impact the current economic slowdown has had on our capital markets and on the American public in general. The market's downward move has had a profound impact on the savings of the vast majority of investors. After several years of unprecedented growth, the current situation is particularly frustrating to the millions of investors who have come into the markets in just the last 3 or 4 years. By returning to investors some of the $1.9 billion in excess fees that were collected last year on transactions, Congress can help alleviate at least a small portion of the losses of the current market situation.

Passing the Competitive Market Supervision Act is the right thing to do, and we urge this Committee to move the bill to the Senate floor at its earliest opportunity.

Thank you very much for the opportunity to testify today.

PREPARED STATEMENT OF LEOPOLD KORINS

PRESIDENT & CHIEF EXECUTIVE OFFICER
SECURITY TRADERS ASSOCIATION

FEBRUARY 14, 2001

Introduction

Chairman Gramm, Members of the Committee, thank you for the invitation to testify before you today on the subject of the Securities and Exchange Commission (SEC) transaction fees. I appreciate this opportunity to present the views of the Security Traders Association (STA), and I applaud you for scheduling a hearing on this important issue in the first weeks of the 107th Congress.

I also want to thank you, Mr. Chairman, for your efforts to enact legislation to provide meaningful and equitable fee relief. STA supported S. 2107, the Competitive Market Supervision Act, last year, and was heartened to see you, Mr. Chairman, and Senator Schumer reintroduce this legislation as S. 143 last month. S. 143 is a balanced and workable proposal, which I will discuss later in my testimony.

I am Lee Korins, President and CEO of the Security Traders Association—the STA is composed of 30 regional affiliates and over 7,000 individual members throughout North America and Europe. It is the largest group of its kind in the world. Our membership represents all facets of the securities industry. While many members are traders for securities firms and institutions, others are partners, specialists, floor traders, proprietors or registered representatives—all of whom are charged with the responsibility of executing orders at the fairest prevailing prices. The fact is that no one speaks for individual professionals in the securities industry with more credibility than STA.

Today, I want to briefly discuss:

- The history and evolution of SEC fees.
- How the fee collections have consistently and substantially outpaced budget estimates, Congressional intent, and the SEC's funding needs.
- How the fees act as a tax on savings, investment, and capital formation.
- STA's support for S. 143, which fairly reduces the fees while preserving adequate funding for the SEC and maintaining offsetting collections for the appropriators.

History of the SEC's Funding Structure

In 1996, Congress enacted the National Securities Markets Improvement Act (NSMIA) reforming regulation of the securities and mutual fund markets. NSMIA also modified the SEC's fee structure—including extension to Nasdaq trades of the transaction fees imposed by Section 31 of the Securities Exchange Act of 1934. The SEC reauthorization was the result of a complex deal worked out between House and Senate authorizers and appropriators, the Office of Management and Budget (OMB), and the SEC, following years of Congressional wrangling over a new SEC funding mechanism. Unfortunately, however, the 1996 legislation has not functioned as intended.

Background

Since the 1930's the Federal Government has levied SEC fees on the regulated community, including registration fees authorized by Section 6(b) of the Securities Act of 1933, and transaction fees authorized by Section 31 of the Securities Exchange Act of 1934. These fees were deposited in the Treasury's General Fund as general revenues. The SEC received no credit for collected fees and could not directly use the funds, but rather was funded through an annual appropriation. Since 1983, the SEC has been a net contributor to the Treasury, collecting far more fees than necessary to cover its budget.

In 1990, budget rules were significantly changed. Specifically, the 1990 Budget Enforcement Act set limitations on specific spending categories and created "pay-as-you-go" procedures to require offsets for decreases in revenue or increases in entitlement spending. These rules put severe restraints on discretionary spending, forcing appropriators to choose among competing programs. The SEC was thus forced to compete for discretionary funding with the Departments of Commerce, Justice, and State, which are funded in the same annual appropriations legislation as the SEC.

Beginning in 1990, the appropriators decided to respond to the problem of insufficient resources to fund competing programs by imposing annual rate increases in the Section 6(b) registration fee in each year's Commerce, Justice, and State Appropriations Bill. The amounts attributable to such increases were credited against the agency's appropriation account as an offsetting collection. Offsetting collections are deposited in special appropriations accounts, as opposed to the General Fund, and are available to appropriators to finance agency activities. This funding mechanism increased the overall funds available to the Appropriations Committees. This practice eventually led to objections by various Members of Congress on both jurisdictional and policy grounds. Since the agency was collecting far more in fees than its budget required, opponents argued that the annual SEC fee increases contained in appropriations bills constituted a tax. Members began to call for a new SEC funding structure that allowed the Government to cover the costs of the SEC's regulatory activities without artificially inflating the cost of raising capital in the markets. In 1993, the House Energy and Commerce Committee, under the leadership of then-Chairman Dingell and Representative Bliley, crafted a bill which would have established a mechanism by which the SEC would set and collect fees solely to recover the costs of its regulatory activities. The House unanimously passed this bill.

During that same year, the House and Senate again passed an SEC appropriations measure which raised registration fees and credited the amount as an offsetting collection. Both House Ways and Means and House Energy and Commerce Committee members lodged complaints, and language was included in the conference report on the Commerce, Justice, and State Appropriations Bill indicating that the practice would be ended.

Funding Crisis

When the Commerce, Justice, and State Appropriations Bill for fiscal year 1995 came to the floor of the House on June 28, 1994, the bill again contained a provision that would have imposed additional registration fees as offsetting collections. House Members succeeded in striking the provision from the House bill on procedural grounds, and subsequently prevailed in an effort to keep the provision out of the conference agreement. This move left the SEC with an appropriation of $60 million, significantly below the $297 million originally provided by appropriators. The agency indicated that it would have to severely restrict its operations beginning in October 1994 absent Congressional action.

This funding crisis prompted Congress, to pass a stop-gap measure (P.L. 103–352), authorizing a registration fee increase for another year, in order to fund the Commission through 1995. House Report 103–739 indicated that this was done as a one-time fix to avert an SEC shutdown, and contemplated passage in the next Congress of an SEC reauthorization that would "eliminate the need for one-year-at-a-time increases in registration fees." The stage was thus set for an SEC reauthorization that would establish a predictable and adequate fee structure to recover funds solely to offset the cost of the Commission's regulatory activities.

Action in the 104th Congress

In 1995, control of Congress shifted to the Republican Party and the legislative agenda was crowded, leaving unaddressed the SEC fee issue. However, in light of the prior year's funding crisis, the Administration's fiscal year 1996 budget proposal stressed the need for a sound, stable, and long-term funding structure for the SEC. The fiscal year 1996 Commerce, Justice, and State Appropriations Bill (H.R. 2076), was vetoed by the President due to unrelated policy disputes, and the SEC's fiscal year 1996 budget was funded by a series of continuing resolutions. Ultimately, Congress and the President agreed to an omnibus spending bill (H.R. 3019) that funded the SEC for the remainder of the year.

In 1996, then-House Commerce Committee Chairman Bliley (R–VA) introduced H.R. 2972, the SEC Reauthorization Act. The bill was designed to end the appropriators' practice of funding SEC activities through the yearly ritual of raising registration fees as offsetting collections. The proposal would have: Reduced Section 6(b) registration fees over a 6 year period; incrementally extended the Section 31 transaction fees to Nasdaq trades; and reduced the rate for all transaction fees beginning in 2002. In total, the package was projected to reduce fee collections by $751 million by 2002. Initially, a portion of the fees was to be deposited as offsetting collections. Beginning in 2002, all fees would be deposited in the General Fund and no fees would be allotted as offsetting collections.

Mr. Chairman, in 1996 you introduced S. 1855, a bill that would have also reduced SEC fees. However, in response to concerns by the Clinton Administration you and then-Senate Banking Committee Chairman D'Amato (R–NY) agreed to postpone consideration of the legislation. The Administration expressed concern that ending the offsetting collections funding practice would require appropriators to fund the SEC's full budget out of the General Fund, subject to the discretionary spending caps, forcing reductions in other programs.

The House passed H.R. 3005, the Securities Amendments of 1996, on June 19, 1996, but not before adding the SEC reauthorization provisions originally embodied in H.R. 2972. The Senate amended and passed H.R. 3005 without the fee provisions on June 27, 1996, setting up a conference in which the SEC fee issue would have to be resolved. The fee issue was highly controversial in conference. Negotiations among House and Senate authorizers and appropriators, the OMB, and SEC held up the bill for weeks and threatened to entirely derail the legislation. An agreement was finally reached on the fee issue and the bill was passed in the closing days of the 104th Congress. H.R. 3005 became P.L. 104–290—the National Securities Markets Improvement Act when the President signed the bill on October 11, 1996.

Under the complex deal worked out in conference, transaction fee rates were fixed until fiscal year 2007, and decreased thereafter. The NSMIA specified that a portion of the registration fee is deposited as General Fund revenue, and a portion is made available to the appropriators as offsetting collections. Transaction fees remain at 1/300th of 1 percent until fiscal year 2007, when they are reduced to 1/800th of 1 percent. Beginning in 1997, Nasdaq trades became subject to the full transaction fee rate. While the exchange transaction fees are collected as General Fund revenue, the Nasdaq transaction fees are deposited as offsetting collections. (However, this will change when the Nasdaq converts to an exchange later this year and those transaction fees will be deposited in the General Fund, and therefore be unavailable to the appropriators.) By pushing general revenue losses into the out-years, the new fee structure minimized budget-scoring concerns.

Current Situation and Impact

Unfortunately, actual fee collections have significantly outpaced the Congressional Budget Office's (CBO) and OMB's conservative estimates of market growth relied on by this Committee and Congress in enacting NSMIA. In fiscal year 2000, actual collections from all sources (including Section 31, Section 6(b), and merger and tender fees) grew to *$2.27 billion dollars*—over six times the SEC's budget of $377 million. The latest CBO estimates show runaway growth in the fees from $2.478 billion in fiscal year 2001 to $3.769 billion in fiscal year 2005. In other words, total SEC fees are projected to raise $15.2 billion over the next 5 years ostensibly to finance an agency that will require only a fraction of that amount over the same period. These excessive and growing fee collections will remain a tax on savings and investment unless Congress takes action.

Thus, today's fee collection surplus was not anticipated because the Government's budget projections used overly conservative estimates of the dollar volume growth in the markets. The markets have experienced remarkable dollar volume growth over the last few years. For example, total volume on the Nasdaq increased from 272.6 billion shares in 1999, to 439.6 billion in 2000. This 60 percent increase in Nasdaq trading volume occurred even as the value of the Nasdaq index plummeted by 50 percent.

With volume growth driving fee receipt growth, it is not surprising that budget estimates routinely fall short of the actual fee collections and must be continually revised upward. A set of fee projections for fiscal year 2001–2007 illustrates this trend, and the constantly expanding fee surplus:

YEAR	NSMIA	1999 CBO	2001 CBO	NSMIA "SURPLUS"
2001	$788	$1994	$2478	$1690
2002	$621	$2200	$2696	$2075
2003	$844	$2442	$2933	$2089
2004	$853	$2732	$3293	$2440
2005	$890	$3132	$3769	$2879
2006	$937	$3547	$4288	$3351
2007	$351	$1735	$2031	$1680
7-YEAR	**$5284**	**$17782**	**$21488**	**$16204**

(numbers in millions)

Looking at fiscal year 2001, the 1999 estimate for fees for that year were two and a half times greater than estimated in NSMIA just 3 years earlier. Now the latest CBO estimate for the fiscal year 2001 shows that fee receipts will be about 25 percent higher than estimated in 1999 and three times greater than the 1996 NSMIA estimate.

Clearly, this is *not* the scenario this Committee intended when it fought to redesign the SEC funding structure in 1996 to reduce the amount of the fee surplus. I want to emphasize that the issue here is *not* SEC funding. Indeed Mr. Chairman, the legislation you have sponsored with Senator Schumer protects SEC funding. Section 5 of S. 143 safeguards against overcollections or undercollections of the fees. This provision is one of the most important in the proposed legislation to avoid repeating the mistakes of prior fee restructuring efforts—it eliminates the need to have absolutely accurate long-term projections of market activities—something that simply cannot be done. Section 5 ensures that the restructured fees will fund the SEC without turning the fees into a general revenue tax—regardless of the accuracy of budget projections.

For the record, I will state unequivocally that the industry and all investors consider it their duty to pay for continued self-funding for the SEC. That has never been in question, the discussion focuses only on the level of collections.

Impact on Securities Professionals

Section 31 transaction fees operate as a tax on the gross trading revenue of securities professionals. One STA member firm which makes markets in about 100 Nasdaq stocks estimated that its Section 31 fee payments amounted to 40 percent of its net OTC trading profits before the allocation of overhead. Another firm found that its Section 31 fee payments were twice the amount of its rental payments for the building housing its trading activities. Section 31 fees operate as a gross receipts tax, with traders reporting rates of 3.5 percent, and as high as 6 percent of gross revenues. As a gross receipts tax, the fees are paid before Federal and State taxes, before salary, and before allocations for overhead. Because of this, market makers and specialists face potential losses in a down market as margins get further squeezed even as their trading volumes and their transaction fees can continue to increase. This is a perverse scenario and onerous burden on the very traders who provide liquidity in the markets for hundreds of stocks.

Impact on the Markets

Excessive fees also reduce liquidity in the market. The major impact falls on the thinly traded stocks of small start-up companies. Therefore, the fees deter capital from flowing to the entrepreneurial, high-technology companies that have driven the new economy and given us the longest expansion in U.S. history.

Impact on the Investing Public

But ultimately, the investing public shoulders this burden. Section 31 fees are a tax on personal savings and investment in the form of lower returns. And as more Americans invest, more people pay this tax. Indeed, recent Federal Reserve data show that the percentage of households owning equities has increased from around 32 percent in 1989 to 41 percent in 1995 and to over 50 percent in 2000. It is important to note that Americans of all income levels are increasing their savings through equity ownership. According to some of the most recent statistics, 29 percent of households with incomes between $15,000 and $25,000 own stock.

What is the impact of these fees on people saving through mutual funds? Take for example two widely held mutual funds, the Vanguard Windsor II Fund and the Vanguard Growth Fund. Each pays close to one quarter of a million dollars annually in these fees—fees paid by investors through reduced earnings. And just as more Americans are owning equities, more people are also saving through mutual funds.

Forty-nine percent of U.S. households, or approximately 50 million households own mutual funds. Seventeen percent of U.S. households with incomes *below* $25,000 owned mutual funds in 2000. This is up from 13 percent of households in that income bracket just 2 years earlier. So this is not a tax on the wealthy. It is paid by the smallest, as well as the largest market participants in the country.

Section 31 fees are not only a drag on savings through equities and mutual funds, they also hurt those who participate in pension plans, including public pension plans. For example, over a 5 year period the following States' public pension plans will pay millions of dollars of Section 31 fees:

- New York—over $13 million.
- California—nearly $18 million.
- New Jersey—over $2.5 million.
- Michigan—nearly $5 million.
- Pennsylvania—approximately $6.5 million.
- Connecticut—over $1 million.

Finally, SEC Chairman Arthur Levitt's testimony last year noted that individual investors pay 87 percent of the fees levied on NYSE trades. This clearly illustrates where the burden of these fees falls.

At a time when the Government is encouraging savings and planning for the future, it is inconsistent for it to levy this pernicious tax on investment.

Conclusion

STA strongly supports S. 143. This legislation provides meaningful fee relief, while ensuring that the SEC continues to have the resources necessary to supervise and regulate the securities markets. Indeed, the fee levels set in S. 143 will accommodate the recent significant increases in the SEC's budget and the "pay parity" provision that is also a part of this legislation. Furthermore, S. 143 addresses concerns raised by Members of the Appropriations Committees by ensuring that they will continue to receive the same level of fees designated as offsetting collections as included in the most recent budget baseline. Indeed, as mentioned earlier in my testimony, without a change in current law, the conversion of the Nasdaq to an exchange will *automatically* deprive the appropriators of nearly all the offsetting collections they now receive.

As I also mentioned earlier, we applaud the inclusion of a fee cap and floor concept that insures against the unintended overcollection of fees while protecting the SEC from any possible shortfall. Given the recent track record of budget projections, this is a prudent safeguard to ensure that the legislation fulfills its intent. In sum, S. 143 would move the fee collection system toward its original purpose: Providing a stable source of funding for the SEC, derived from a constituency that benefits from its oversight and regulation.

In closing, Mr. Chairman, STA applauds you for scheduling this prompt hearing on an issue of great importance to our members across the United States. Thank you, and I will be happy to answer any questions.

RESPONSE TO WRITTEN QUESTION OF SENATOR SARBANES FROM LAURA S. UNGER

Q.1. Section 31 of the Securities Exchange Act of 1934, the statute which authorizes transaction fees, directs the collection of fees "to recover the costs to the Government of the supervision and the regulation of securities markets and securities professionals, and costs related to such supervision and regulation, including enforcement activities, policy and rulemaking activities, administration, legal services, and international regulatory activities." Section 6(b) of the Securities Act of 1933, the statute which authorizes registration fees, similarly directs the collection of fees to recover the costs to the Government "of the securities registration process, and costs related to such process, including enforcement activities, policy and rulemaking activities, administration, legal services, and international regulatory activities."

Please identify the Government agencies, in addition to the Securities and Exchange Commission, that have conducted enforcement activities, policy and rulemaking activities, administration, legal services or international regulatory activities that relate to securities markets, securities professionals, or securities registration.

A.1. The Federal securities laws grant regulatory authority to several of the Federal Government agencies other than the SEC, most notably the Federal banking agencies (the Federal Reserve Board, the Office of Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision), the Department of Justice, including the U.S. Attorneys' Offices, and the Commodity Futures Trading Commission.

While not constituting the "supervision [or] regulation of securities markets and securities professionals" *per se,* a number of other Federal Government agencies, in carrying out their own statutory mandates, engage in enforcement or other regulatory activities that relate, in some way, to the securities markets, securities professionals, or securities registration. For example, the Department of Justice, through its Antitrust Division, has brought civil actions alleging violations of the Sherman Act against securities firms and national securities exchanges. As another example, the Equal Employment Opportunity Commission has brought a civil action against a securities firm alleging violations of the Americans with Disabilities Act.

In some of these situations, these agencies may consult or work cooperatively with our staff in conducting these activities; in other situations, these agencies may conduct these activities without the Commission's involvement or even awareness. Accordingly, we cannot produce a definitive list of the agencies that have conducted these activities. In addition, other Federal Government agencies—for example, the Office of Management and Budget under the Paperwork Reduction Act, 44 U.S.C. Section 3501 et seq. (1998)—have regulatory responsibilities in connection with Federal agency rulemakings, including Commission rulemakings.

Finally, the Commission and its staff provide information to or obtain information from other Federal agencies in the course of the Commission's enforcement and other regulatory activities or as part of routine agency to agency cooperation and information sharing.[1] Arguably, where another agency incurs costs to provide information to the SEC, these costs are "related to the [Commission's] supervision and regulation" of the securities markets, securities professionals, or securities registration.

RESPONSE TO ORAL QUESTIONS OF SENATOR GRAMM FROM LAURA S. UNGER

Q.1. During the Committee's February 14 hearing, Chairman Gramm asked the Commission to submit information on the effect of an existing higher pay scale for economists on our retention rate for economists compared to our retention rate for lawyers.

A.1. The Securities Litigation Uniform Standards Act of 1998 ("SLUSA"), P.L. 105–353, granted the Commission the authority to pay its economists more than permitted under the General Schedule. Although SLUSA does not amount to full pay parity for the reason that is explained below, it does preliminarily appear to be having some positive effect on the Commission's attrition rate for economists.

During fiscal 1999, prior to introduction of the new pay scale, the Commission lost three of the eight permanent economists in its Office of Economic Analysis ("OEA") and hired an additional six, resulting in a total of 11 permanent economists employed in OEA at the start of fiscal year 2000.[2] During fiscal 2000, the first fiscal year the new pay scale applied, three permanent OEA economists left the Commission and eight more were hired. As of the start of fiscal 2001, the Commission employed a total of 16 permanent economists in OEA, none of whom have left as of mid-March 2001.

Given the limited time it has been in effect and the limited number of staff to whom it applies, it is hazardous to attempt to draw any conclusions from this data. Nonetheless, if we were to try to draw conclusions it would appear that while the authority granted by SLUSA has slowed attrition, it has not brought the Commission's economist attrition rate down to an acceptable level. The loss of three of the 11 economists who began fiscal 2000 in OEA constitutes an attrition rate of over 21 percent.

Even with SLUSA's pay authority, the Commission still cannot match the pay and benefits of economists at the Federal banking regulators. Economist pay at the Commission is currently capped at the EX–IV level for base pay, and at the EX–III level for total pay. For IPA fellows, pay is capped at the General Schedule 15/10

[1] As partially reflected in an earlier list provided to Senator Sarbanes's staff of Federal agencies our enforcement division has cooperated with on investigations, the Federal Government agencies that the Commission has been in contact with at least periodically over the last several years include: the Central Intelligence Agency, Commerce Department, Commodity Futures Trading Commission, Comptroller of the Currency, Defense Department, Energy Department, Energy Information Administration, Environmental Protection Agency, Federal Bureau of Investigation, Federal Communications Commission, Federal Criminal Investigative Organization, Federal Deposit Insurance Corporation, Federal Reserve Banks, Federal Reserve Board, Federal Trade Commission, Food and Drug Administration, General Accounting Office, Housing and Urban Development Department, Internal Revenue Service, Justice Department, Labor Department, National Archives and Records Administration, National Credit Union Administration, State Department, Office of Thrift Supervision, Small Business Administration, Treasury Department, U.S. Agency for International Development, U.S. Customs Service, U.S. Geological Service, U.S. Postal Inspection Service, and the U.S. Trade Representative.

[2] As a recruiting tool, OEA also hires a number of Intergovernmental Personnel Act ("IPA") fellows, who typically are university faculty members in finance or economics. Because IPA fellows are temporary employees who work pursuant to contract for a set period of time, they have not been included in these figures.

level. Pay at the Federal banking agencies is not subject to these caps. The Competitive Market Supervision Act would address these problems and therefore better enable the Commission to recruit and retain economists.

Q.2. During the Committee's February 14 hearing, Chairman Gramm asked the Commission to submit the amount the Commission has contributed to the Federal Treasury in the past 10 years through collection of fines imposed for violations of the securities laws.

A.2. The table attached as Appendix A shows, by fiscal year, the total fines collected and contributed to the Treasury in connection with Commission enforcement actions as of February 2001. The chart includes fines collected through settlements and judgments after litigation, but does not include disgorgement.

Appendix B is a chart that was discussed during the hearing and should be included in the record.

Appendix A
FINES COLLECTED BY SEC IN FISCAL YEARS 1991-2000

Fiscal Year	Total Fines Collected
1991	$7,161,021
1992	$5,275,615
1993	$5,156,085
1994	$1,604,645
1995	$182,835,445
1996	$19,433,364
1997	$15,219,230
1998	$26,222,485
1999	$51,002,779
2000	$22,177,409
Ten Year Total	**$336,088,078**

Appendix B
SEC AND GOVERNMENT-WIDE TURNOVER RATES, 1994-2000

SEC TURNOVER RATE, 1994-2000

Fiscal Year	Permanent Employees	Attorneys	Accountants	Securities Compliance Examiners	GS-14s	GS-15s
1994	9.59%	13.90%	6.91%	5.51%	11.27%	11.45%
1995	11.39%	15.15%	9.38%	14.29%	9.61%	12.98%
1996	9.52%	11.32%	8.96%	10.31%	10.50%	9.59%
1997	11.94%	16.01%	12.13%	10.78%	14.82%	15.83%
1998	12.46%	15.19%	12.87%	10.48%	14.77%	11.36%
1999	13.72%	13.50%	13.72%	14.92%	14.35%	14.43%
2000	13.83%	17.47%	13.76%	13.93%	14.75%	11.48%

GOVERNMENT-WIDE TURNOVER RATE, 1994-1999

Fiscal Year	Permanent Employees	Attorneys	Accountants	Financial Institution Examiners*	GS-14s	GS-15s
1994	7.83%	6.51%	6.44%	8.31%	6.93%	8.63%
1995	12.33%	11.95%	8.11%	7.05%	7.84%	8.64%
1996	7.03%	6.66%	6.61%	13.77%	5.60%	7.02%
1997	7.62%	7.41%	7.14%	8.05%	6.21%	7.95%
1998	7.07%	7.05%	8.01%	5.56%	5.59%	7.02%
1999	7.08%	6.78%	6.62%	5.58%	6.08%	7.59%
2000	N/A	N/A	N/A	N/A	N/A	N/A

* The SEC is the only government agency that uses Securities Compliance Examiners. Financial Institution Examiners in other agencies perform similar work to Securities Compliance Examiners.

PREPARED STATEMENT OF ROBERT B. FAGENSON

VICE CHAIRMAN, VAN DER MOOLEN SPECIALISTS USA, INC.
VICE CHAIRMAN OF THE BOARD OF DIRECTORS OF
THE SPECIALIST ASSOCIATION OF THE NEW YORK STOCK EXCHANGE

FEBRUARY 14, 2001

Chairman Gramm, Senator Schumer, Members of the Committee, good afternoon. I am Robert Fagenson, Vice Chairman of the Board of Directors of The Specialist Association of the New York Stock Exchange. I am pleased to appear before you to present the Association's views concerning S. 143—The Competitive Market Supervision Act of 2001. The Association wholeheartedly supports the legislation because it will provide significant relief to all American investors while preserving the high quality of securities regulation by ensuring that the Securities and Exchange Commission ("SEC") is fully funded. I will limit my testimony today to transaction fees imposed by Section 31 of the Securities Exchange Act of 1934 ("Exchange Act") and the registration fees under Section 6(b) of the Securities Act of 1933 ("Securities Act").

The Specialist Association is comprised of 18 broker-dealer firms, which include all of the individual specialists of the New York Stock Exchange. Our specialists are at the heart of the auction market of the world's most active stock exchange. The Exchange's auction trading marketplace is *the* mechanism through which the prices of stocks listed on the Exchange are "discovered" and liquidity is provided to buyers and sellers. We coordinate orderly trading in our respective specialty stocks. We supply liquidity when necessary to the proper operation of the market, acting as buyer or seller in the absence of public demand to buy or sell in those stocks.

Over 260 billion shares of stock were traded on the Exchange in 2000 in more than 221 million transactions. Specialists participated as principal, selling for their own accounts, in 13.6 percent of those transactions, paying approximately $50 million in Section 31 fees last year (an amount we expect to significantly increase this year). A total of $370 million was paid in Section 31 fees in 2000 on NYSE transactions by all NYSE member firms and their customers.

Beginning in the 1930's, the Federal Government, through the SEC, has collected fees on the registration of securities under the Securities Act ("Section 6(b) fees") and on sales of securities under the Exchange Act ("Section 31 fees"). Although these fees were initially intended as user fees to defray the costs of Federal securities regulation, the amounts collected have exceeded the cost of running the SEC since 1983. As discussed below, those collected amounts now are more than six times the SEC's budget. In short, the Section 6(b) and Section 31 fees have become a general tax on capital raising and a tax on American investors. Moreover, as I will discuss in a moment, Section 31 fees represent a tax imposed at a particularly inopportune time in the life cycle of a specialist's or market maker's capital.

Please let there be no misunderstanding. We support continued full funding for the SEC, an agency that has overseen our constantly growing, remarkably fair and efficient markets that raise new capital and serve the public investor, contributing to our worldwide reputation for fairness and integrity. What we object to is misuse of the financing mechanism designed to offset the cost of operating the SEC through over-collection of the fees and application of the proceeds to completely unrelated purposes.

As things stand, the Section 31 fee cannot be viewed as anything but a tax on the sale of securities, a purpose for which it was never intended. Although assessed in relatively small increments—it is currently set at 1/300 of 1 percent of the total dollar amount of securities sold, the tax is creating a drag of over $1 billion per year on the capital markets. This drag on our markets represents a cost paid by all investors, including the huge number of individual participants in mutual funds, pension plans, and other forms of retirement accounts.

These fees have consistently grown over years. In fiscal 1999, the SEC's fee collections from Section 6(b) and Section 31 fees (and fees related to mergers and tender offers) mushroomed to $1.75 billion. That is, the SEC's fee collections amounted to more than five times its $337 million budget. In fiscal 2000, the agency collected more than $2.27 billion, more than six times what was needed to fund its operation.

To bring transaction fees back into line with the cost of running the SEC, there have been efforts to cap or reduce Section 31 fees, including Chairman Gramm and Senator Schumer's proposal last year. These efforts are supported by, among many others, Americans for Tax Reform, the National Taxpayers' Union, Citizens for a Sound Economy, the U.S. Chamber of Commerce, the Profit Sharing/401(k) Council, the Security Traders Association, the Securities Industry Association, and all the securities and options markets, including the New York Stock Exchange and our Association.

Also, we expect the trading volume on the Exchange to continue to increase, which in turn will have the effect of increasing the Section 31 tax. In fiscal 1999, the average daily trading volume was 809 million shares. In 2000, it was over one billion shares. And with decimalization now fully implemented, volume will surely increase again by a significant amount (as it did when the standard trading increment was reduced to 1/16 from 1/8).

The Section 31 "tax" is unfair particularly to our members because it in effect imposes a tax on the amount of gross revenue, rather than on profits. Thus, our members must pay this tax regardless of whether their business is profitable. Moreover, the Section 31 tax is imposed at a particularly inopportune time in terms of its ultimate effect on market liquidity. Unencumbered by Section 31 fees, revenue generated by specialists and market makers in securities transactions could be used by these market professionals to make our markets more efficient through investment in technology, provide more liquidity to the market and provide additional benefits to American investors. Thus, investors and the market in general lose more than simply the amount of the Section 31 fees themselves in terms of sacrificed market liquidity and efficiency.

We would also be wise to remember that we have had the benefit of a thriving and competitive bull market for an unprecedented number of years. During such times, the impact of measures placing inappropriate burdens on capital formation and market activity can be softened or blunted. As is often the case with respect to ill-advised policy, it is only when market conditions eventually decline and liquidity becomes more scarce that the full brunt of a cloaked tax such as the current Section 31 fees will be felt by us all. This will be particularly true to the extent that market prices stagnate or decline.

In conclusion, the general tax revenue is the objective of other laws, but not the securities laws. Congressional action to restore the unintended tax now represented by the Section 31 fee to its original purpose—to fund the operations of the SEC, and not for any other type of Federal expenditure—is long overdue. While providing significant relief to investors by reducing the excess fees collected by the SEC, at the same time S. 143 guarantees full funding of the agency by providing it with the authority to adjust fee rates in the event fee revenues are projected to fall below the appropriated amounts. All American investors will benefit from this bill. We applaud your efforts regarding this important matter and we are committed to working with you and this Committee toward the passage of this legislation.

The Association is thankful for this opportunity to express its views on the Competitive Market Supervision Act of 2001. Thank you, Mr. Chairman.

I would be pleased to respond to any questions you, Senator Schumer, or other Committee Members may have.

PREPARED STATEMENT OF LON GORMAN

PRESIDENT, SCHWAB CAPITAL MARKETS
VICE CHAIRMAN, THE CHARLES SCHWAB CORPORATION
VICE CHAIRMAN OF THE BOARD OF THE
SECURITIES INDUSTRY ASSOCIATION

FEBRUARY 14, 2001

Chairman Gramm, Senator Sarbanes, and Members of the Committee, I am Lon Gorman, President of Schwab Capital Markets and Vice Chairman of The Charles Schwab Corporation, a national and global leader in corporate and municipal finance, and in securities sales, trading, and research. I also serve as the Vice Chairman of the Board of the Securities Industry Association ("SIA").[1] I am testifying on behalf of SIA and we appreciate this opportunity to present our views concerning

[1] The Securities Industry Association brings together the shared interests of more than 740 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers, and mutual fund companies) are active in all United States and foreign markets and in all phases of corporate and public finance. The U.S. securities industry manages the accounts of approximately 50-million investors directly and tens of millions of investors indirectly through corporate, thrift, and pension plans. The industry generates in excess of $300 billion of revenues yearly in the U.S. economy and employs approximately 700,000 individuals.

securities transaction fees and the legislation introduced by Chairman Gramm and Senator Schumer.

We believe it is critical that the Congress examine the issue of Securities and Exchange Commission (SEC) fees because the facts and assumptions on which enactment of the current statutory fee structure was based have changed. Fees that were developed several years ago to fund the cost of regulating the securities markets now seriously exceed the Government's cost of regulation to such a degree that they constitute a drag on capital formation, and a special burden on every American investor.

The "Competitive Market Supervision Act" (S. 143), introduced by Chairman Gramm and Senator Charles Schumer, has earned the strong support of the securities industry because of its dual approach that combines a fee-rate cut and a cap on revenue generated by the transaction fees. S. 143 represents the best approach for full funding of the SEC and reducing the burden on capital caused by this excessive fee. If enacted, the Gramm/Schumer proposal would save investors $8 billion over 5 years—funds that would have otherwise been collected as excess fees and remitted to the Treasury General Fund.

Relief for Investors

The U.S. securities markets serve as a strong engine for economic growth and job creation. The securities industry furnishes the seed capital for start-up companies, provides the liquidity that is essential to bringing investors into the market, harnesses investment for growth and expansion for the economy, and creates savings and investment vehicles for millions of Americans. Today, almost 50 percent of U.S. households own stock, directly or indirectly. By the end of this year, the number of individuals who own stock is likely to exceed 80 million.

In fiscal year 2000 SEC fee collections exceeded $2.2 billion, $1.89 billion more than the $377 million SEC appropriation for fiscal year 2000. That is more than six times the Commission's funding level. Fee collections are projected to exceed SEC appropriations by more than $2 billion in fiscal year 2001. In fact, fee collections are projected to exceed the cost to run the Commission by more than $2 billion for each year through fiscal year 2005. If the current statutory fee collection continues American investors will shoulder the burden of more than $15 billion in these fees over the next 5 years. We do not believe it is in the interest of investors—or, of the Nation's capital markets—for these fees to so grossly surpass the regulatory costs incurred. These transaction fees drain capital from the private markets removing it at the very start of the capital-raising process—and divert it into the U.S. Treasury.

Why should the general public care? Aren't these fees being paid by Wall Street? Generally they are not. When brokerages charge an investor for selling shares, they generally pass on the SEC fees to the customers in transaction costs. In fact, most securities confirmations include a separate line item for the SEC transaction fee. Once this fee is reduced, investors will be able to see the savings immediately. The individual investor, not the broker, is paying the vast bulk of the transaction fees. This is money that could help fund retirement savings, fuel economic growth, and create jobs.

We know that our markets have been made better, and fairer, by the presence of a strong and effective Securities and Exchange Commission. And, because it is in our interest—and, more importantly, in the public interest—to have an effective SEC, SIA has always strongly supported full funding for the agency so that it can carry out its important investor protection mission. In the past, SIA has supported full funding for the SEC even at times when budget freezes and budget cuts were being pressed on all Federal agencies. If S. 143 is enacted, the excess fees charged to investors, the industry, and issuers will be reduced; yet will still generate substantially more in revenues than the cost of running the SEC.

Background

Five years ago, the industry was asked to "step up to the plate" and pay additional fees in order to help Congress move to a more reliable funding mechanism for the SEC. We agreed to do so because we believed it was in the long-term interests of the securities markets. The fee structure adopted as part of the National Securities Markets Improvement Act of 1996 ("NSMIA") for the first time assessed transaction fees on the Nasdaq markets. This provision was intended to establish parity between the fees assessed on exchange and Nasdaq markets. While it was expected that, as a result of these changes, the fees paid by investors and the industry would increase in the near term, the ultimate goal of NSMIA's fee provisions was to bring fees collected by the SEC more in line with the actual cost of running the agency.

At the time these provisions were enacted, no one anticipated the explosion of market activity that has taken place over the past several years and continues today. In particular, no one could have predicted the phenomenal influence that online investors would have on the equity markets. In 1996, the transaction fee, already levied on NYSE stocks, was first imposed on transactions of securities traded on the Nasdaq Stock Market.

Since the enactment of the NSMIA in 1996, SEC appropriations have risen in an effort to give the SEC sufficient resources to oversee the markets and enforce the Federal securities laws. However, the increase in transaction and other fees paid by investors, issuers, and the industry has far exceeded the increase in the cost of running the SEC. The following chart sets forth the fees collected by the SEC during fiscal years 1996–2000 and estimated fees to be collected during fiscal years 2001–2005 (including Section 6(b) fees, Section 31 fees, and other fees), compared with the amounts appropriated or requested to be appropriated to the SEC during these years (dollar amounts in millions):

Year	§6(b)	§31	Other	Total	SEC Budget
1996	$575	$134	$65	$774	$297.4
1997	653	274	63	990	305.4
1998	1,034	632	114	1,780	311.1
1999	941	668	148	1,759	338.9
2000	1102	1090	78	2270	377.0
2001*	1,024	1370	84	2478	422.8
2002*	980	1627	89	2696	—
2003*	953	1887	93	2933	—
2004*	912	2284	97	3293	—
2005*	958	2717	99	3774	—

* CBO estimate

In addition to our concerns about these fees as a drag on investment, we are concerned about the potential for these fees to jeopardize market liquidity.

Although transaction volume and market valuations have increased, market maker and specialist revenue on these transactions has declined as a result of lower margins and technology investment to handle the ever-increasing volumes. Section 31 fees thus comprise an increasing share of gross trading revenues, even though the rate of the fee has remained constant. If left uncorrected, these fees will have a significant effect on the ability of market makers and specialists to commit capital to the market. We believe that our equity markets—much admired and envied throughout the world—would operate much less efficiently in the absence of market maker and specialist liquidity.

Unintended Results

This result certainly was not intended by Congress. When Congress adopted NSMIA's fee provisions, its intent was clear. The language of Section 6(b) states that the registration fees to be collected by the SEC under that section "are designed to recover the costs to the Government of the securities registration process, and costs related to such process. . . ."[2] Similarly, the language of Section 31 states that the transaction fees to be collected by the SEC "are designed to recover the costs to the Government of the supervision and regulation of securities markets and securities professionals and costs related to such supervision and regulation. . . ."[3]

[2] Securities Act of 1933, Section 6(b)(1).
[3] Securities Exchange Act of 1934, Section 31(a).

Unfortunately, the fees have far exceeded the cost of regulation. They divert resources which could be used more productively elsewhere in our economy; and they discourage capital investments in technology that could be used to make our equity markets more efficient and attractive to investors. This is real capital that could be used to fund new businesses, to build plants, to create jobs, and to add to the national wealth.

Furthermore, the transaction fee structure creates an uneven playing field. Congress expressly stated that extending the transaction fees to Nasdaq securities was intended to "provide more equal treatment of these organized markets, which are overseen by the Commission." However, when Congress extended the SEC transaction fees to Nasdaq trades, it failed to take into account the structure of the Nasdaq market. In the Nasdaq market, dealers frequently must trade as principals to maintain orderly markets and to provide liquidity to customers on demand. Although many of these dealer-to-dealer trades are being effectuated ultimately to fill a customer order, they are nevertheless subject to multiple fee assessments.

Conclusion

There may be some who believe that since the U.S. stock market has recently had a number of record years, investors, market makers, specialists, and other market participants somehow can, or should, pay these fees. We have demonstrated that we are more than willing to pay the fair cost associated with regulation. But, it simply is not right to charge investors, issuers, and other market participants six times the cost of regulation. At a minimum, a burden of this size, with its potential to adversely affect the structure of the capital markets, should not be imposed inadvertently because of changed circumstances.

The securities industry is faced with a number of challenges currently and in the near future: Converting and expanding quote capacity to accommodate decimalization; further reducing settlement time to T+1; ensuring that investors and issuers benefit from the explosion in technology and electronic commerce; and, meeting the competitive challenges of globalization. All of these challenges have required, and will continue to require, significant financial investment on our part, as well as the time and efforts of our most talented industry professionals. We intend to meet these challenges to maintain and enhance the international preeminence of our capital markets, to help fund the continued growth of the U.S. economy, and to ensure that investors and issuers have even more opportunities in the new century.

We appreciate Chairman Gramm and Senator Schumer's recognition of the disparity between the fair cost of regulation and the costly burden of the transaction fee. This legislation will better align the amount of fees collected with the cost of regulation. We have confidence that Congress, once it reviews the facts, will make a decision that is in the interest of millions of investors. We are committed to working with you and this Committee to find such a solution.

Thank you.

PREPARED STATEMENT OF ROBERT H. FORNEY

PRESIDENT & CHIEF EXECUTIVE OFFICER
CHICAGO STOCK EXCHANGE

FEBRUARY 14, 2001

Chairman Gramm, and other distinguished Members of the Committee, I appreciate your interest in the Section 31(a) fee issue and welcome the opportunity to offer my views on behalf of the Chicago Stock Exchange. The excessive Section 31(a) fees, monies that end up in the general revenues rather than the intended purpose of funding the SEC, are simply a hidden tax on the American people who are working hard to build a secure financial future for themselves and their families. You are to be commended for your efforts on this very important issue.

The Chicago Stock Exchange ("CHX") opened for trading in 1882 and today has become the second-largest stock exchange in the United States. In 2000, over 26 billion shares traded and approximately 65 million trades executed—transactions representing a total value of over $1.2 trillion. We are known as an innovative, low-cost, and high-quality equity marketplace that is a leader in technology. Our automated trading systems provide a significant boost in productivity, capacity, and reliability while reducing our operating costs. Our investment in technology has served us well, resulting in an average annual growth rate of more than 70 percent over the past 5 years. Today, we are able to process over 10,000 trades per minute. The CHX also uniquely benefits the investor by providing the largest auction market for

Nasdaq stocks. These and other aspects of our exchange, such as extended trading hours, automated price improvement, and the ability to trade more than 4,400 issues—more than any other U.S. exchange—distinguishes the CHX.

While we are justifiably proud of our growth, we continue to be an organization mostly comprised of small businesses that fiercely compete with much larger rivals. Excessive Section 31(a) fees are not just an unfair burden on investors, they are also an impediment to small trading firms growing their businesses, providing quality jobs to people in our community, and providing serious competition that benefits all investors.

The Case For Reducing Section 31(a) Fees

Before I lay out the arguments for reducing fees, let me reassure you that the Chicago Stock Exchange supports a fully funded SEC. Investor protection is of the utmost importance—investors have to have confidence in the integrity of our markets. At the same time, these excessive collections must be brought into line with the true budget needs of the SEC.

Section 31(a) Fee Collections Far Exceed Expectations and SEC Budget Needs

When the NSMIA fee structure was established in 1996, no one could have anticipated the explosion in transaction volume that has occurred and the huge increase in fees that are being collected as a result. As SEC Chairman Arthur Levitt noted in 1998:

> [t]he projections made in 1996 when NSMIA was enacted did not anticipate the strength of the bull market we are enjoying today. Collections are currently up across the board—not only for Nasdaq trades. Collections will continue to increase if market activity continues to grow.

They did. The fiscal year 2000 revenue generated by Section 31(a) transaction fees alone (not including other fees, such as registration fees) was $1.1 billion, which far exceeded the SEC's appropriated budget of $377 million. In fiscal year 2001, Section 31(a) fees are again expected to exceed $1 billion because the sharply increasing volume of transactions is expected to continue. For many reasons that include growing investor activity in the United States and around the world, we believe that even if market values decline, transaction volume is likely to continue to grow.

This unexpected growth in securities market transaction since 1996, which at our exchange has averaged more than 70 percent growth per year, provides sufficient reason for Congress to revisit the fee structure established in NSMIA to bring it more in line with the purposes Congress articulated. If left unchecked, the Section 31(a) fee is expected to continue to swell, imposing a back-door tax on capital and limiting the U.S. securities industry's ability to create better products for investors at lower costs and aggressively compete in the global market.

The Section 31(a) Fee Structure Harms Competition in the Industry

Excessive Section 31(a) fees also reduce competition within the industry. The CHX is a regional exchange that trades securities that are listed and also traded on the primary markets (the New York Stock Exchange, the American Stock Exchange, and the Nasdaq). CHX competes for these trades almost entirely based upon speed, quality, and cost of execution. To be successful, it must better the primary markets in these areas.

The CHX strategy is to gain a cost advantage over its competitors through greater reliance on technology and enhance productivity. The CHX has invested heavily in creating systems and processes that can efficiently execute large numbers of transactions. Our productivity has increased more than 50 percent in each of the past 5 years. These investments are fixed costs. As volume increases, these fixed costs are being spread over a greater number of trades, which, in turn, allows the CHX to reduce transaction fees for all users of its markets. The strategy has proven to be successful to the point where there are now many products that have no associated exchange fee.

While the CHX has been able to reduce its transaction fees as the volume has increased, Section 31(a) fees have remained constant. The result has been that an increasingly larger percentage of our customer's cost of doing business at the CHX is beyond our ability to control. Cost is, in large part, what gives the CHX a competitive advantage and that advantage grows as our volume grows. A Federal Government tax rate that remains fixed regardless of volume or SEC needs limits our ability to compete and provides a disincentive to pursuing further volume-related efficiencies.

Mr. Chairman, let me cite a specific example of just how these excessive fees can impact a small business trading on our Exchange. Rock Island Specialists, a specialist firm on our floor, has 70 employees. It competes successfully with firms many times its size because of the quality of its service and importantly, its ability to control its costs. Like all successful small businesses, Rock Island Specialists would like to grow its business and create new employment opportunities, but growth requires capital.

This year Rock Island will pay the U.S. Government approximately $4 million in Federal income taxes. It will pay the U.S. Government an additional $1.75 million in Section 31(a) fees; a 44 percent Federal surtax on its business. I believe that we are all better served by allowing small businesses to use the excess fees to build their businesses and create greater competition in the marketplace. Investors will benefit from the competition and new jobs will be created.

Section 31(a) Fees Harm Our Ability to Compete Internationally

European exchanges are consolidating their operations. It is our view that, in the near future, only a few large exchanges are likely to dominate the European market. These exchanges will pose a competitive threat to U.S. exchanges should they add U.S. securities to the multi-national mix of securities traded in their markets. The ability to route orders over vast distances to foreign markets and to receive prompt reports of executions is becoming less difficult with each advancement in communications technology. National boundaries are losing their relevance in the securities markets.

Foreign exchanges will be in direct competition with U.S. regional exchanges for trades in securities listed on the U.S. primary securities markets. The foreign exchanges are likely to find, as U.S. regional exchanges have found, that to be successful they will have to compete on quality and cost executions. But these foreign competitors will not be subject to Section 31(a) fees and therefore have a cost advantage over U.S. regional exchanges. This advantage could prove critical to the CHX and other U.S. regional exchanges that compete with the primary markets, and with each other, based largely on their ability to provide lower cost transactions.

This potential competitive threat can be seen in the financial futures markets which, since their inception in the 1970's, have been international markets. Traders from around the world direct orders to U.S. futures exchanges to trade foreign currency; Eurodollars, U.S. Treasury Bonds, and other financial futures contracts. Similarly, traders from around the world direct their orders for German Bund financial futures to a German futures exchange. As recently as 2 years ago, those traders directed their orders for Bund futures contracts to a futures exchange in England. In this example, the business left England and went to Germany because the futures exchange in Germany could provided the same product in a more cost efficient means.

The lessons learned from events in the international derivatives markets also can apply to securities markets. We can expect that investors will shift from a market in one country to a market in another to trade the same product at a lower cost, just as has happened in the derivatives markets. Anything that imposes a higher costs on U.S. exchanges, such as excessive Section 31(a) fees, risks harming our international competitiveness.

The Current Section 31(a) Fees Structure Deserves Congressional Attention

As noted above, the current Section 31(a) fee structure was carefully crafted by Congress in 1996 to meet important public policy goals. Again, the CHX supports a fee structure that provides stable, long-term funding mechanism for the SEC to ensure that its essential regulatory and oversight functions are continued. Today, the Commission's funding is no longer in question. Given the explosive growth in securities transactions and the likelihood of continued expansion, the issue has become whether the current Section 31(a) fee formula is appropriate in 2001 and beyond. From the perspective of the CHX, excessive fees harm our ability to compete at home and abroad to provide the highest quality service at the lowest industry costs for our members and all investors.

The Competitive Market Supervision Act of 2001 will restore the Section 31(a) fee structure to its intended purpose: Fully funding the SEC. We support this effort to eliminate what has become an unfair tax on investors and an unfair burden on participants in the U.S. equity markets.

We appreciate the Committee's interest in this issue and we appreciate the opportunity to present the views of the CHX. We remain committed to focusing our efforts on lowering trading costs while enhancing U.S. leadership in this most critical of industries.

STATEMENT OF THE INVESTMENT COMPANY INSTITUTE

FEBRUARY 14, 2001

The Investment Company Institute* appreciates the opportunity to submit our testimony to the Committee in strong support of S. 143, the Competitive Market Supervision Act of 2001. The Institute would like to commend Chairman Gramm, Senator Schumer, and the other Members of the Committee for their continuing efforts to facilitate staff retention by the SEC and better align the fees imposed under the Federal securities laws with the costs incurred by the Securities and Exchange Commission (SEC) in implementing and enforcing such laws.

Mutual funds are an integral part of the U.S. economy and have become one of America's primary savings and investment vehicles. More than 88 million investors in over 50.6 million U.S. households own mutual fund shares today. Since 1990, the percentage of U.S. retirement assets held in mutual funds has more than tripled to $2.4 trillion. Moreover, most mutual fund investors are ordinary Americans; the median household income of fund shareholders is $55,000.

The Institute has always supported, and will continue to support, providing the Federal Government with adequate financial resources to ensure effective regulatory oversight of mutual funds. We believe, however, that fees charged under the Federal securities laws should be reflective of their intended purpose to offset the costs associated with activities of the SEC. The Institute remains concerned that, in the absence of legislation such as S. 143, SEC fees will generate revenues significantly in excess of those required to fund SEC operations. Indeed, we note that while the SEC's budget for the current fiscal year is $422 million, it will collect more than $2 billion in fees. In essence this excess revenue amounts to a needless tax on investors who are saving for retirement, sending their children to college, or otherwise providing for their future. According to information provided by this Committee, the amount of this needless tax is expected to be about $8 billion over 5 years and $14 billion over 10 years. S. 143 will eliminate this needless tax on investors by reducing fees collected by the SEC to an amount commensurate with the SEC's appropriated budget.

Importantly, S. 143 is drafted to guarantee that the SEC receives 100 percent of the funds it needs to operate. Indeed, if fee collections fall below 100 percent of the SEC's appropriated budget, the legislation will permit temporary fee increases as necessary to ensure that the agency has adequate financial resources to continue effective regulatory oversight and to continue important investor protection initiatives. The Institute supports this important provision.

In addition to ensuring that the SEC is provided adequate financial resources to fulfill its regulatory responsibilities, S. 143 will better enable the SEC to maintain adequate staffing resources. The SEC has experienced a staff attrition rate nearly twice that of the overall Federal Government. S. 143 would enable the SEC to combat this high attrition rate of its professional staff by permitting the SEC to set employee pay levels at levels comparable to those paid by other financial regulatory agencies. This provision will enable the SEC to attract and retain qualified staff, and thus ensure its continued excellence in its regulatory oversight role.

The Investment Company Institute believes S. 143 will benefit the millions of Americans invested in mutual funds and especially applauds provisions that: (1) reduce the heavy tax paid by consumers through excessive fees charged to mutual funds under the Federal securities laws; and (2) reform the SEC's pay structure to enable it to attract and retain qualified staff. As such, S. 143 will better enable the SEC to fulfill its mission of protecting investors and maintaining the integrity and the efficiency of the Nation's securities markets. The Institute endorses and urges the passage of S. 143 for these reasons. We appreciate your consideration of our views and look forward to working together to ensure that S. 143 becomes law during the 107th Congress.

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*The Investment Company Institute is the national association of the American investment company industry. Its membership includes 8,414 open-end investment companies ("mutual funds"), 489 closed-end investment companies and 8 sponsors of unit investment trusts. Its mutual fund members have assets of about $6.937 trillion, accounting for approximately 95 percent of total industry assets, and over 83.5 million individual shareholders. The Institute also represents the interests of investment advisers.

Coastal Securities, L.P.

February 13, 2001

The Honorable Phil Gramm
Chairman
Senate Committee on Banking, Housing and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

Dear Mr. Chairman:

Coastal Securities is a market maker of stocks in the NASDAQ securities market. Our transactions are solely with other market makers, accordingly we put our own capital at risk without regard to any retail activity. We make a market in approximately 100 NASDAQ stocks, resulting in buy and sell transactions with other broker-dealers. This activity provides liquidity into the NASDAQ marketplace for the benefit of all participants, including retail buyers and sellers, institutional customers, and other broker-dealers.

The Section 31 fee is an added tax (called a fee) on my firm not withstanding the fallacious logic in its application to Coastal Securities. Since we are market makers that trade only with other broker-dealers, this fee results in an economic burden on NASDAQ stocks before they reach the ultimate retail consumer. The consequence of the manner in which the Section 31 fee is applied, in our case, results in this fee being applied twice before a stock reaches a retail consumer or conversely when a retail consumer sells a stock. Clearly, this consequence is not fair nor equitable.

The burden of the Section 31 fee on Coastal Securities is clearly reflected in its financial numbers. For the four years the fee (tax) has been in effect, approximately 6% of our gross equity trading revenues have been paid to the U.S. government under the guise of this charge. Even more dramatic, this fee (tax) amounted to approximately 29% of our net NASDAQ profits before allocation for such things as compliance, human resources, accounting, etc. The Section 31 fee is in all practical respects an additional tax that broker-dealers in the NASDAQ market must pay. Additionally, this tax is applied on gross revenues, not net income as the more traditional Federal Income Tax is based. The effective Federal Income Tax rate for Coastal Securities is approximately 63% after considering the Section 31 fee. I think you would agree, this is a most reprehensible outcome.

Please accept my gratitude to you and your colleagues for working to reform the Section 31 fees and to make such fees more fair and equitable.

Sincerely,

Al Anderson
Coastal Securities

KNIGHT
TRADING GROUP

Robert I. Turner
Executive Vice President, Chief Financial Officer and Treasurer

February 14, 2001

Via Electronic Mail and Federal Express

The Honorable Phil Gramm, Chairman
Committee on Banking Housing and Urban Affairs
United States Senate
Washington, DC 20510

Re: The Competitive Market Supervision Act – S. 143

Dear Chairman Gramm:

On behalf of the 1417 employees of Knight Trading Group, Inc. ("Knight"), thank you for your continuing efforts to provide relief from excessive securities transaction fees. We believe the Competitive Market Supervision Act you introduced with the support of Senator Charles Schummer will greatly benefit firms like Knight and our customers. Knight supports the Competitive Market Supervision Act because it will reduce the hidden tax on securities transactions that is paid by every investing American as they or their agents execute trades on our equity markets.

Knight, headquartered in Jersey City, New Jersey, is the parent company of Knight Securities, L.P., Knight Capital Markets, Inc. (formerly Trimark Securities, L.P.), Knight Financial Products, L.L.C. (formerly Arbitrade Holdings, L.L.C.), and Knight Securities International, Ltd. Knight's subsidiaries make markets in equity securities listed on Nasdaq, the OTC Bulletin Board, the New York Stock Exchange, American Stock Exchange, Easdaq, London Stock Exchange and in options on individual equities, equity indices, fixed income instruments and certain commodities in the United States and Europe. The firm also maintains an asset management business for institutional investors and high net worth individuals through its Deephaven subsidiary. As a leading destination for online trade executions, Knight is the processing power behind the explosive growth in securities trading via the Internet. Knight's clients include the leading brokerage firms, and more than 1200 broker-dealers and 1000 institutional clients. The Company is included in Fortune's "e-50 Stock Index," an elite collection of companies that are shaping the new Internet-based economy. Currently, the five-year-old company employs more than 1417 people worldwide.

As a leading destination for online trade executions, we are familiar with the impact of Section 31 fees. Every day Knight and its customers incur this hidden tax on investing. We also know that these hidden taxes on investing greatly exceed the amount necessary to fulfill their stated purpose – funding the operations of the Securities and Exchange Commission. While everyone at Knight supports the efforts of the Commission to preserve the integrity of the market, we object to the current fee structure that raises multiple times the amount needed by the Commission for its work.

Often, the impact of such transaction fees is difficult to discern. However, as a publicly traded company that provides executions services to thousands of broker-dealer and institutional clients, we at Knight are very familiar with the impact of these fees. The impact of these fees is most visible when viewed in light of our annual expenses. Before we can consider any strategic initiatives that could result in our firm hiring more traders or technology personnel, and before we can pursue any technology upgrades, we must consider the amount of Section 31 fees we have to pay that year. We must always consider the impact of Section 31 fees on our hiring and technology decisions because these fees operate as a tax on gross receipts. Section 31 fees are deducted from our revenues before we can pay any of our normal operating expenses. These fees are also hard to predict fluctuating based on our transaction volume, which in the last few years has increased substantially. As a result of our increased transaction volume, our payments of this tax on gross receipts have also increased.

In 2000, Knight paid approximately $39,000,000.00 in Section 31 fees. This figure represents approximately nine percent (9%) of our pre-tax net income for 2000. In addition to the millions of dollars Knight paid in Section 31 fees, Knight will pay approximately $145,000,000.00 in federal taxes. Consequently, Knight's shareholders and the public see a reduced return on their investments because of these Section 31 fees. Assuming the Section 31 fees were eliminated and the savings to Knight were realized in the form of additional revenue, the government would still collect approximately $13,000,000.00 in additional taxes. Furthermore, the investing public would see a greater return on their investment dollars. Knight believes such an approach to funding the Commission does not serve the best interests of the public.

Everyone at Knight supports the efforts of the Commission and we do not believe the Competitive Market Supervision Act should threaten the ability of our regulators to ensure the integrity of our markets. However, as our figures demonstrate, these fees represent a substantial portion of our pre-tax revenues that are not required to fund the operations of the Commission. We appreciate the efforts of you and your colleagues in seeking to ensure that the fees collected pursuant to Section 31 of the Securities Exchange Act of 1934, more closely approximate the funds needed to operate the Commission.

I hope that the Commission and staff find these comments helpful. If Knight or I can be of further assistance to you on this matter, please do not hesitate to contact me.

Sincerely,

Robert I. Turner

Robert I. Turner

cc: Kenneth D. Pasternak

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island

VIA FACSIMILE

October 12, 2000

Joseph P. Morra
Division of Market Regulation
U.S. Securities and Exchange Commission
450 5th St, NW
Washington, DC 20549

Re: Section 31 Transaction Fees

Dear Mr. Morra:

As we recently discussed, Island is writing to request the Securities and Exchange Commission's assistance in immediately resolving a problem that costs Island more than $1,000 each day. Specifically, in connection with the collection of Section 31 fees, both the Nasdaq Stock Market, Inc. ("Nasdaq") and the Chicago Stock Exchange ("CHX") are remitting Section 31 fees to the Commission on the same transaction. To avoid double billing and to ensure fairness in the fee collection process, Island requests that Nasdaq be requested to immediately cease billing the buy side of transactions in trades involving regional exchanges trading on Nasdaq. If this issue cannot be resolved in a timely manner, Island must begin to seriously consider rejecting all orders from the CHX.

As you know, pursuant to Section 31 of the Securities Exchange Act of 1934, the Commission collects a fee on each transaction. With respect to transactions effected in Nasdaq listed securities, Section 31 fees are collected by Nasdaq and then passed on to the Commission. Nasdaq generally collects the Section 31 fee from the sell side on each transaction. In transactions where an Unlisted Trading Privilege Plan Participant is on the sell side, however, Nasdaq collects the Section 31 fee from the NASD member that was on the buy side. For example, in transactions between the CHX and Island, where the CHX is on the sell side, Nasdaq collects the Section 31 fee from Island. At the same time, however, the CHX is currently remitting the Section 31 fee directly to the SEC as it does for NYSE listed securities. Thus, the Commission is receiving the Section 31 fee from both sides on the same transaction.

It is Island's understanding that Nasdaq and the CHX are currently discussing the Section 31 fee collection issue. While Island has no opinion on how the CHX fee should be collected, Island strongly believes that it is unfair for Island to continue to pay a Section 31 fee on transactions where the CHX is on the sell side. Island's payment of the Section 31 fee on behalf of the CHX is, in effect, a subsidy of CHX trading activity. Island believes that there are only two possible solutions to this issue: 1) the CHX continues to pay the SEC directly; or 2) the CHX begins to pay Nasdaq.

Since, under either solution, Island would no longer be required to continue paying the CHX's Section 31 fees, Island requests the Commission to direct Nasdaq to immediately cease billing the Section 31 fee to the buy side. Furthermore, Nasdaq should also be required to calculate the dollar value of overpayments by NASD members and implement a procedure for crediting NASD members for past payments.

Island looks forward to finding an expeditious and fair solution to this matter. If you have any further questions, please do not hesitate to contact me at 212-231-5018.

Sincerely,

Cameron Smith

Cameron Smith
General Counsel
The Island ECN, Inc.

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island

February 14, 2001

VIA FAX

The Honorable Phil Gramm
370 Russell Senate Building
Washington, D.C. 20510

Dear Senator Gramm:

The Island ECN, Inc. ("Island") commends you on your efforts to re-examine the Section 31 fees that are imposed to recover the costs of regulation and supervision of the securities markets. Given the current review of Section 31 fees, I thought that the Senate Banking Committee would have an interest in the results of a recent internal study at Island. Specifically, in formulating our fiscal year 2001 budget, Island found that Section 31 fees actually exceed Island's profit for each transaction.

Our calculation is based upon the following:

> On Island, the average transaction size is approximately 300 shares. Given Island's tremendously low cost service, Island's total revenue on the average transaction is $.45 (45 cents). This statistic, however, does not take into account any Island operating expenses.
>
> In comparison, assuming an average transaction size of 300 shares and an average share value of $32, the average Section 31 fee (1/300 of 1% of the aggregate dollar amount of the sale) collected per transaction is $.32 (32 cents). This is more than 70% of Island's current revenue and more than Island's actual income per transaction after expenses.

While some may consider the Section 31 fee de minimis, our experience illustrates that the Section 31 fee is significant and actually inhibits our ability to deliver low cost transaction services to investors. Island is committed to using its cutting edge technology and electronic market expertise to provide the lowest cost executions in the industry. Your work in addressing the collection of these fees will greatly aid this mission, benefiting investors and strengthening our markets.

I hope that you found this information useful. Please feel free to contact me if you would like to further discuss our views on Section 31 fees.

Sincerely,

Matthew F. Andresen

Matthew Andresen
President & CEO