AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

SAVING INVESTORS MONEY: REDUCING EXCESSIVE SEC FEES

HEARING

BEFORE THE

SUBCOMMITTEE ON
CAPITAL MARKETS, INSURANCE AND
GOVERNMENT SPONSORED ENTERPRISES

OF THE

COMMITTEE ON
FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION

MARCH 7, 2001

Printed for the use of the Committee on Financial Services

Serial No. 107–3

U.S. GOVERNMENT PRINTING OFFICE

70–890 PS WASHINGTON : 2001

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: (202) 512–1800 Fax: (202) 512–2550
Mail: Stop SSOP, Washington DC 20402–0001

HOUSE COMMITTEE ON FINANCIAL SERVICES

MICHAEL G. OXLEY, Ohio, *Chairman*

JAMES A. LEACH, Iowa
MARGE ROUKEMA, New Jersey, *Vice Chair*
DOUG BEREUTER, Nebraska
RICHARD H. BAKER, Louisiana
SPENCER BACHUS, Alabama
MICHAEL N. CASTLE, Delaware
PETER T. KING, New York
EDWARD R. ROYCE, California
FRANK D. LUCAS, Oklahoma
ROBERT W. NEY, Ohio
BOB BARR, Georgia
SUE W. KELLY, New York
RON PAUL, Texas
PAUL E. GILLMOR, Ohio
CHRISTOPHER COX, California
DAVE WELDON, Florida
JIM RYUN, Kansas
BOB RILEY, Alabama
STEVEN C. LATOURETTE, Ohio
DONALD A. MANZULLO, Illinois
WALTER B. JONES, North Carolina
DOUG OSE, California
JUDY BIGGERT, Illinois
MARK GREEN, Wisconsin
PATRICK J. TOOMEY, Pennsylvania
CHRISTOPHER SHAYS, Connecticut
JOHN B. SHADEGG, Arizona
VITO FOSELLA, New York
GARY G. MILLER, California
ERIC CANTOR, Virginia
FELIX J. GRUCCI, JR., New York
MELISSA A. HART, Pennsylvania
SHELLEY MOORE CAPITO, West Virginia
MIKE FERGUSON, New Jersey
MIKE ROGERS, Michigan
PATRICK J. TIBERI, Ohio

JOHN J. LAFALCE, New York
BARNEY FRANK, Massachusetts
PAUL E. KANJORSKI, Pennsylvania
MAXINE WATERS, California
CAROLYN B. MALONEY, New York
LUIS V. GUTIERREZ, Illinois
NYDIA M. VELÁZQUEZ, New York
MELVIN L. WATT, North Carolina
GARY L. ACKERMAN, New York
KEN BENTSEN, Texas
JAMES H. MALONEY, Connecticut
DARLENE HOOLEY, Oregon
JULIA CARSON, Indiana
BRAD SHERMAN, California
MAX SANDLIN, Texas
GREGORY W. MEEKS, New York
BARBARA LEE, California
FRANK MASCARA, Pennsylvania
JAY INSLEE, Washington
JANICE D. SCHAKOWSKY, Illinois
DENNIS MOORE, Kansas
CHARLES A. GONZALEZ, Texas
STEPHANIE TUBBS JONES, Ohio
MICHAEL E. CAPUANO, Massachusetts
HAROLD E. FORD, JR., Tennessee
RUBÉN HINOJOSA, Texas
KEN LUCAS, Kentucky
RONNIE SHOWS, Mississippi
JOSEPH CROWLEY, New York
WILLIAM LACY CLAY, Missiouri
STEVE ISRAEL, New York
MIKE ROSS, Arizona

BERNARD SANDERS, Vermont

Terry Haines, Chief Counsel and Staff Director

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT SPONSORED ENTERPRISES

RICHARD H. BAKER, Louisiana, *Chairman*

ROBERT W. NEY, Ohio, *Vice Chairman*
CHRISTOPHER SHAYS, Connecticut
CHRISTOPHER COX, California
PAUL E. GILLMOR, Ohio
RON PAUL, Texas
SPENCER BACHUS, Alabama
MICHAEL N. CASTLE, Delaware
EDWARD R. ROYCE, California
FRANK D. LUCAS, Oklahoma
BOB BARR, Georgia
WALTER B. JONES, North Carolina
STEVEN C. LATOURETTE, Ohio
JOHN B. SHADEGG, Arizona
DAVE WELDON, Florida
JIM RYUN, Kansas
BOB RILEY, Alabama
VITO FOSSELLA, New York
JUDY BIGGERT, Illinois
GARY G. MILLER, California
DOUG OSE, California
PATRICK J. TOOMEY, Pennsylvania
MIKE FERGUSON, New Jersey
MELISSA A. HART, Pennsylvania
MIKE ROGERS, Michigan

PAUL E. KANJORSKI, Pennsylvania
GARY L. ACKERMAN, New York
NYDIA M. VELÁZQUEZ, New York
KEN BENTSEN, Texas
MAX SANDLIN, Texas
JAMES H. MALONEY, Connecticut
DARLENE HOOLEY, Oregon
FRANK R. MASCARA, Pennsylvania
STEPHANIE TUBBS JONES, Ohio
MICHAEL E. CAPUANO, Massachusetts
BRAD SHERMAN, California
GREGORY W. MEEKS, New York
JAY INSLEE, Washington
DENNIS MOORE, Kansas
CHARLES A. GONZALEZ, Texas
HAROLD E. FORD, JR., Tennessee
RUBÉN HINOJOSA, Texas
KEN LUCAS, Kentucky
RONNIE SHOWS, Mississippi
JOSEPH CROWLEY, New York
STEVE ISRAEL, New York
MIKE ROSS, Arizona

CONTENTS

	Page
Hearing held on:	
March 7, 2001	1
Appendix:	
March 7, 2001	47

WITNESSES

WEDNESDAY, MARCH 7, 2001

Gramm, Sen. Phil, a U.S. Senator from the State of Texas	2
Schumer, Sen. Charles E., a U.S. Senator from the State of New York	13
Evans, Scott C., Executive Vice President, TIAA-CREF Investment Management, (Teachers Insurance and Annuities Association-College Retirement Equities Fund)	35
Quick, Christopher C., CEO, Fleet Meehan Specialist, Inc., on behalf of The Specialist Association of the New York Stock Exchange	37
Toes, James A., Director, Merrill Lynch & Co., Inc., on behalf of the Security Traders Association	38
Unger, Hon. Laura S., Acting Chairman, U.S. Securities and Exchange Commission	23

APPENDIX

Prepared statements:	
Baker, Hon. Richard H.	48
Oxley, Hon. Michael G.	61
Ackerman, Hon. Gary L.	50
Crowley, Hon. Joseph	52
Jones, Hon. Stephanie T.	55
Kelly, Hon. Sue W.	57
Mascara, Hon. Frank	58
Menendez, Hon. Robert	59
Schumer, Sen. Charles E.	63
Velázquez, Hon. Nydia M.	62
Evans, Scott C.	83
Quick, Christopher C.	87
Toes, James A.	93
Unger, Hon. Laura S.	66

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Kanjorski, Hon. Paul:	
"Many Holes Weaken Safety Net for Victims of Failed Brokerages," *New York Times*, Sept. 25, 2000	97
Evans, Scott C.:	
Written response to questions from Chairman Michael G. Oxley	86
Unger, Hon. Laura S.:	
Written response to questions from Chairman Michael G. Oxley	81
Securities Industry Association, prepared statement by Thomas J. Cavalier	107
Security Traders Association, written response to questions from Chairman Michael G. Oxley	115
State Teachers Retirement System of Ohio, prepared statement	118

SAVING INVESTORS MONEY: REDUCING EXCESSIVE SEC FEES

WEDNESDAY, MARCH 7, 2001

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE
AND GOVERNMENT SPONSORED ENTERPRISES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to call, at 9:30 a.m., in room 2128, Rayburn House Office Building, Hon. Richard H. Baker, [chairman of the subcommittee], presiding.

Present: Chairman Baker; Representatives Shays, Cox, Royce, Lucas of Oklahoma, Barr, Shadegg, Weldon, Fossella, Miller, Ose, Ferguson, Hart, Rogers, Kanjorski, Bentsen, Mascara, Jones, Capuano, Sherman, Meeks, Inslee, Hinojosa, Lucas of Kentucky, Crowley and Israel.

Also Present: Representatives Oxley and Kelly.

Chairman BAKER. Good morning. I would like to call this hearing of the Subcommittee on Capital Markets to order and welcome each of you here this morning.

As an advisory for Members who are present, because of our distinguished first panel of witnesses this morning, I have counseled with Mr. Kanjorski's staff and with Chairman Oxley that we would proceed to receive the testimony of the Senators. Should others wish to make opening statements, we would proceed to those after the Senators have concluded their testimony and before the second panel.

It would be my intent at that point to make brief remarks, recognize Mr. Kanjorski, Chairman Oxley, and Ranking Member LaFalce, should he participate this morning, and limit our opening statements for that purpose. As we are all aware, we have 47 Members and even with 3 minutes per Member we would use up most of the morning telling each other hello.

So I will suggest that if that method is acceptable to all present we would proceed accordingly.

[The prepared statement of Hon. Richard H. Baker can be found on page 48 in the appendix.]

At this time, I am particularly pleased to introduce a very good friend and the leader on financial service modernization in the Congress and welcome to our first meeting here the Chairman of our newly organized Financial Services Committee. We now have much more similar jurisdiction, and I am looking forward to a long and productive working relationship with you and Members of your committee. Welcome, Chairman Gramm.

STATEMENT OF HON. PHIL GRAMM, A U.S. SENATOR FROM THE STATE OF TEXAS

Senator GRAMM. Mr. Chairman, thank you very much.

Let me first congratulate you on your chairmanship and Paul on being the Ranking Member. I want to congratulate you for consolidating financial services jurisdiction in one committee. I can assure you it will make my life much easier. And let me also say that I look forward to working with each of you as we try to make financial services cheaper and more available to a larger number of Americans.

I am happy to have the opportunity today to testify on something that seems to me not only imminently reasonable but something that every Member of Congress should be supportive of and that is our efforts to try to see that we don't take fees that were established to fund the SEC and allow those fees to become a source of general revenue in Federal Government.

As you know, Mr. Chairman, today, even though no one intended it, we collect six times as much in fees on securities transactions, tender fees and fees on the initial offering of stocks as we need to fund the Securities and Exchange Commission.

The level of this excessive fee is very large, $14 billion over the next 10 years, if we allow the current law to stand. People who try to save and invest, accumulate every mutual fund, every retirement program, both public and private, in America, every person saving for college or for retirement will end up paying billions of dollars of fees that no one ever intended that they pay and do not serve the purpose for which the fees were imposed.

To give you an idea of the magnitude of these excessive fees, if you take the average worker and look at a 45-year retirement program, on average that retirement program would pay about $1,300 of fees above the level necessary to fund the regulation that is required for the markets that they use to operate efficiently.

If that $1,300, instead of being paid in excessive fees, were invested, that would mean that the average investor in a retirement program, an IRA or 401(k) program over their working life could expect about $5,800 of additional funds on their retirement, rather than going to the Federal Government in these excessive fees. So this is a major issue. I think that you can see what a major issue it is when you look at the groups that have endorsed the bill in the Senate. Our bill in the Senate basically sets up a process to assure that we always have enough money to fund the SEC. It guarantees that when we are overperforming under our current rate structure the fees be dropped; if we are underperforming, the fees be raised. We do it in such a way as to hold the appropriators harmless. And so the net result is we guarantee a funding source for the purpose that the fee was initially adopted but for no other purpose.

This effort has been endorsed—and I think you are hearing from some of these same groups—by TIAA-CREF, which is the Nation's largest teacher retirement program. It has been endorsed by the American Shareholders Association, by the National Treasury Employees Union and by the California Public Employee Retirement System, among other groups.

I believe that it is very important that we adopt this bill. We have included in the bill a pay parity provision for the SEC. As I

am sure this committee is aware, in the recent past we have become concerned that financial regulators were losing people due to wage increases in the private sector. We raised salaries for financial regulators such as the Comptroller of the Currency and the Federal Reserve Bank, but a similar change was not made with regard to the SEC. As you can imagine, the rate of turnover is very high among professional people.

I think it is fair to say that, whether one believes we need more regulation or less, that I think there is a very strong consensus that we need to have the most qualified people, the most able people administering those regulations.

So that is the essence of the Senate bill. We have passed the bill on a voice vote in the Banking Committee. We are going to be on campaign finance reform for the next couple of weeks in the Senate. But it would be my goal toward the end of this month or the beginning of the next month to bring this bill to the floor of the Senate where I am hopeful that we will be successful.

So I want to commend this subcommittee for holding this hearing. I am very happy to be here. I know you are hearing from a lot of people, but if anybody has a question I would be very happy to try to answer it.

Chairman BAKER. Thank you, Senator.

I have been advised that Senator Schumer is on his way. He should be here in about 10 minutes. What I would suggest is the subcommittee proceed with a few questions. On the Senator's arrival, we will recognize him for his statement.

Senator, I have certainly agreed with your view about the need to reduce unwarranted fees—or let's just call this a tax. It has no relation any longer to providing for appropriate level of operation for the SEC. We should ensure for the appropriate level of operation for the SEC, as your legislation does. But one other point in discussion of this subject with some Members, there have been those who question the timing: Why this? Why now?

In looking back over the performance of the markets over the last year, after the decade of extraordinary growth in 401(k) net worth to most working families—and I would also quickly point out that we have investing, at least since 1995, people online engaging in $8 trades who are not institutional investors investing hundreds of thousands, but working families investing a hundred at a time, making provision for their child's education, maybe to buy their first home, looking forward to their retirement one day. So this very much is a consumer-oriented approach.

Unfortunately, given the events in the larger economy over the last year, many of these working families have seen that portfolio value drop from 10 percent to maybe a third of value. And if we are to unleash this billion-and-a-half dollars of unnecessary fee collection, isn't that a logical thing to do to promote additional economic growth, perhaps aid in a small way in the recovery of those values of those savings of working families across the country?

Senator GRAMM. Mr. Chairman, let me say it is interesting that you mentioned about the people trading online at very low commissions, because Island Ecn, which has been a leader in that effort, which has brought down commissions dramatically, has told our committee that in analyzing their data that their average customer

pays more in fees than Island makes in profit. So this has become a relevant factor to people who tried.

I would also caution people that when we are talking about big institutional traders, they may be big and they may be institutional, but basically they are big because they have millions of people's money. And that money belongs to working men and women all over America who every day pay these transaction fees; and by paying these transaction fees their level of investment is lower, their retirement security is lower, the hurdle they face in saving enough money to send their children to college is higher. So in the end, with the biggest institutional investor, with Fidelity, every penny they are investing belongs to people in your district, in my State, who are trying to meet some of life's goals with this investment. And when you are paying six times the fee that is required to fund the regulation which you benefit from, then you are making that hurdle higher for people.

I would also say there is one other reason for doing it now, and that is the very rapid growth of foreign exchanges. And on these foreign exchanges you don't have these transaction fees. And what is happening, just to give you an example, we invented futures. We had an absolute monopoly on the market. Yet now a larger value and volume of futures are traded in Germany than traded in the United States because they have become very competitive. They have had some regulatory advantages; and they have also had some advantages, quite frankly, in that they had not built the structure that we had built in our exchanges. And, as a result, they are becoming very fierce competitors.

I think there is a competitiveness argument to be made for lowering these fees by making American markets more attractive not only to American investors but to foreign investors as well.

Chairman BAKER. I just wanted to make clear the point some would argue this is to benefit Wall Street types. In fact, the whole mission we are engaged in here is to help working families maintain their money for their own futures; and I think sometimes that gets lost in this debate.

Senator GRAMM. Well, if I could say, Wall Street types, as you call them, basically are conduits. But the people who are actually paying the fees, as is obviously who has endorsed this bill, are people who are in the National Treasury Employees Union, people who are in the California Public Employee Retirement Program. That is where the fees are being paid.

Chairman BAKER. Without doubt.

Mr. Chairman, given our new rulings around the House, I have expired my 5 minutes, and therefore I would recognize Mr. Kanjorski.

Mr. KANJORSKI. Thank you, Mr. Chairman.

Senator, let me put this in perspective. We did make an adjustment in 1996, and it was a very fair adjustment that fees go to cost. No one, however, could have anticipated the explosion of the markets in the last 4 years. This is not something that has been planned or thought about as if by accident or perhaps by good fortune.

Do you feel the same support for this bill would exist if we separated the pay parity piece from the fee reduction?

Senator GRAMM. Well, I think you would have obviously the support of the investing community. I think the two go together.

I think what we are trying to do is to set up a reliable system to guarantee a funding source for the SEC. And I think, while we are doing that, that guaranteeing that SEC employees are competitively paid and we have got a chance to have effective regulation, I think the two go together.

I would say that in 1996 when we passed that old law we intended through that law to eliminate excessive fees. And I think you are right. No one ever decided they wanted to have the excessive fees. It is just that we do have them. The 1996 law we wrote was a static law which made a one-time adjustment. We thought that would fix the problem. It didn't. And the approach we have taken is to try to set up a system where annually you do an evaluation and adjust the fees.

Mr. KANJORSKI. Although we call this a fee, Chairman Baker has referred to it perhaps as a tax. I will accept either one as the description. But, if we are going to lose a billion-and-a-half dollars a year, obtained by charging 33 cents for every $10,000 in trading—which does not seem excessive, about the cost of a call in a telephone booth—how would you make up for the loss of those revenues?

I find it very difficult to ask this question, because you always have a million ways to make budget cuts. But, in all seriousness, we are going to lose a billion-and-a-half dollars, Senator. What fees are we going to increase? What taxes are we going to increase? Where do you see that billion-and-a-half dollars coming from?

Let me suggest several areas that I look at in analyzing this issue.

One, the Securities and Exchange Commission does not have what we call CRA. This money very easily could be a potential way of funding that type of activity.

Two, there is a decided disadvantage in the United States varying from region to region. We all recognize that one-third of our economy falls into a classification of a distressed area. In reality, this fee overcharge, if maintained and used for other purposes, could clearly fund regional economic development in distressed economic communities, including those in Texas, Mississippi, and throughout the South.

Or we could use it for environmental cleanup. A billion-and-a-half dollars would fund a $30 billion environmental cleanup fund for the country. That would help Pennsylvania in a very big way. We have a lot of land reclamation needs and polluted water as a result of past mining practices. And, 1/10 of that fund would be enough to clean up the land in Pennsylvania.

So, while I agree it comes out of a particular category, it does not seem to be all that penalizing. I am wondering, rather than running on down that road, if it would not be better to hold the fee adjustment until we see what happens to the overall budget and revenue picture of the Government.

Senator GRAMM. Well, if I may, let me respond by saying that basically what you are doing is—I think there are two arguments I would like to make. One is, the fee was imposed for a specific purpose; and the fee is not now being used for that purpose; and I

think there is a certain illegitimacy in taking a fee that was meant as a user fee and using it for general Government.

The second question is, even if you had decided to do that, you would have to ask a question: Is America benefited more by expanding economic development programs or funding environmental cleanup than it would be advantaged by letting literally millions of families do a better job in building up their retirement and saving money to send their children to college?

I think that a stronger argument can be made that the American society would be benefited—not only was a tax collected for this purpose, but that American society would be benefited more by letting millions of savers and investors keep it than any other purposes that you have mentioned, as meritorious as many of them are.

Finally, let me say that, as we look at where we are today in the American economy, it is hard to imagine a better time to adjust fees to the funding needs of the agency they were meant to fund. In fact, if you can't do it today, when could we ever do it? What circumstance that has ever existed in history would be more advantageous to us for making the adjustment than today?

Chairman BAKER. I am sorry, your time has expired, Paul. I will come back to you.

Mr. Chairman, Mr. Oxley.

Mr. OXLEY. Thank you, Mr. Chairman.

Welcome, Chairman Gramm; and we look forward to our mutual relationship in the jurisdiction of the two committees.

I want to thank you for your leadership on this issue and your leadership in the last Congress getting finally, after all those years, financial services modernization passed which bears your name along with Chairman Leach and Chairman Bliley. It was a pleasure to work with you. Many of the folks in this room had a great deal to do with our success, and I think the fact that the committee has expanded jurisdiction goes directly to our success in passing Gramm-Leach-Bliley, and we are excited about that. Obviously, the next step is to deal with some of the issues that we have before us, including the rate cut for these fees.

Let me ask you this: You had indicated that you had hoped to get the bill to the floor late this month or early April. We obviously would like to keep abreast of that progress from the Senate and also from our perspective as well. I had some discussions with the gentleman from New York beside me here, Mr. Fossella, who will be lead sponsor on the legislation; and we hope to introduce that bill perhaps as early as next week but certainly the week after. But I want you to know that we are not slacking off, but we are going to try to keep pace. We think that the arguments you made make a great deal of sense and that this is a perfect opportunity to pass this needed legislation.

I have no particular question but simply wanted to commend you and also your cosponsor, Chuck Schumer—he is, as you are, a former Member of this body—for, both of you, for your leadership and bipartisanship on this very important issue. I yield back.

Senator GRAMM. Thank you, Mr. Chairman. I look forward to working with you.

I think this is something that, obviously, there is a lot of work to be done. But I think we can do it.

I would like to say this is a fee and not a tax. This is a user fee which has been not through any effort by Congress to do it, but simply because the power of the American economy is now used for a purpose that it was never collected. It is important that we keep it a fee and not a tax, because by fee it is within your jurisdiction. If this were a tax, it would be under the jurisdiction of the Ways and Means Committee.

[The prepared statement of Hon. Michael G. Oxley can be found on page 61 in the appendix.]

Chairman BAKER. Thank you, Mr. Chairman.

Mr. Bentsen.

Mr. BENTSEN. Thank you, Mr. Chairman.

Mr. Chairman, always good to see you. I have to say as a fellow Texan I am proud to see that Wall Street is coming to a Texan to get help on this matter.

Senator GRAMM. Well, actually, I went to Wall Street to get help on this matter.

Mr. BENTSEN. Senator, I think you are on the right track on this bill. But I do have a couple of questions. One is—and also I want to say I think, if I understand your testimony, the sort of anti-deficiency language, though, in your bill protects the functions of the Securities and Exchange Commission, which I think we would all agree for investors' sake, we would want to make sure that the SEC is not shortchanged in the process.

You in your bill, as I understand it, you reduce all fees, not just the Section 31 transactional fees.

Senator GRAMM. That is right.

Mr. BENTSEN. Can you tell us why you chose to not just focus on the base of consumer side but instead on the registration fees and merger and acquisition fees?

Second of all, if you could tell us, you mentioned that this the excess fee collection is about $14 billion, I think, over 10 years—or projected to be that amount as we are looking at—out 10 years on a lot of issues today. I don't know and I didn't look for this, but I don't think this is in the President's budget blueprint. You may have noticed it. And, if not, have you talked with the Office of Management and Budget and do you have a read from the Administration of how they feel about your legislation?

Senator GRAMM. Well, let me deal with these two points.

First of all, as I looked at the fees, all three fees are ultimately paid for by the saving and investment community. Probably the most inefficient fee from an economic point of view is an excessive fee that is imposed on the issue of a new stock. I mean, that is like taxing seed corn. That really is a tax that makes it harder for every small business in America to grow and create jobs and become a bigger business, and I felt there was a very strong argument for that.

In mergers, ultimately, the owner, the seller of the one stock, the buyer of the other stock is the American public. So while we sort of think of those things as being big business, from the point of view of the Treasury Employees Labor Union and their thrift savings plan, which many of us participate in as Federal employees,

we are substantial investors in every one of those transactions as savers and investors. So we decided in the Banking Committee that the way to do it was to do all three fees equally.

Could you do it any other way? You could probably make an argument either way. My basic belief was that all of these fees ultimately were paid by savers and investors; and, second, that they were all excessive if—that we were collecting 6 times as much as we needed.

The second question, I believe the Administration will endorse this. I am very reluctant to speak for the new Administration, but I believe in the end that they will be supportive of reducing these fees.

Mr. BENTSEN. But, at this time, do you know offhand if it is assumed in their budget?

Senator GRAMM. I don't know whether it is or not.

Mr. BENTSEN. Thank you.

Senator GRAMM. At some point obviously they will be called upon to say whether they support the repeal of the fees. I believe they will.

Mr. BENTSEN. Knowing how bashful you are, I am sure you will find a way to ask them about it.

Senator GRAMM. Well, I have talked to them about it.

Mr. BENTSEN. I am sure you have.

Thank you, Mr. Chairman.

Chairman BAKER. Thank you, Mr. Bentsen.

By time of arrival, the next to be recognized is Mr. Fossella.

Mr. FOSSELLA. Thank you, Mr. Chairman; and thank you for your leadership and, in particular, Mr. Oxley as well. And I welcome you, Chairman Gramm.

Other than to add very briefly that I think you hit the nail on the head, Chairman Gramm. That is that the moral argument of this is often ignored and lost, and that is this fee was intended to fund the SEC. The promise and the commitment through Congress to the American people and investors was for that very purpose.

And I think trying to work with you and others in the Senate and people like Mr. Oxley here is all we are trying to do is give a refund to the American people and the investors that actually have to pay this fee. We are not saying that we want to underfund the SEC. To the contrary, the SEC is going to be fully protected and, thus, investors are going to be protected.

In addition, we ask ourselves a very simple question. Do we believe that this overpayment to the Federal Treasury is better left in the hands of investors, families across America? I think Mr. Baker highlighted that. Or do we believe it is better spent here in Washington?

As I see it, the answer is crystal clear, that if we really want to keep our economy growing, if we want to make more Americans investors, if we want to remove this unnecessary or excessive fee, we reduce it in a reasonable way. So I merely take this time to thank you, as Mr. Oxley does, for your leadership in the Senate. I believe at the end of the day we will do this and do what is best in the interest of Americans and the investors that have to pay this fee. And I thank you for your time.

Senator GRAMM. Thank you.

Chairman BAKER. Mr. Mascara.

I am sorry. Mr. Crowley is next.

Mr. CROWLEY. Thank you, Mr. Chairman. Senator, welcome; and thank you for your testimony today.

Let me applaud you on your bill and Senator Schumer's bill. I support your measure.

My office has been working with Congressman Towns and with Congressman Fossella in their markup of their bill. The concern that I have, the thing that really separates your bill from what I believe is Mr. Fossella's bill, is the issue of pay parity for the SEC workers; and I was wondering if you could enlighten us as to why you think that is important. I think it is important. But why you think it is important, why you think it should be included in the House version of the bill.

Senator GRAMM. Well, first of all, the SEC is losing its most capable people because the differential between their pay at the SEC and the private sector has gotten so large.

Let me make it clear that the SEC will never be able to compete on a monetary basis with the private sector, so we don't have anyone working at the SEC or the Fed that doesn't want to do that job. Most people could get more in the private sector. Some are doing that job to learn skills and become credentialized to ultimately go into the private sector, which I think is a good thing for both the Government and the private sector.

But we decided in our financial regulators that we wanted to increase pay for highly skilled people to try to make it possible for the people who wanted to stay at the Fed and the Comptroller through supervision to have ability to do that. Because the jurisdiction of the committees were different. The Banking Committee provided this pay parity for financial regulators, but a similar bill was not provided by the Commerce Committee. So, as a result, we have got employees, financial regulators at the Fed that are making one salary; and then we have got people who are doing jobs at the SEC that are at least as challenging, but they are making a lower pay grade.

So this is, in part, simply good Government policy. It is partly a matter of equity. Again, nobody intended to give the pay parity to people at the Fed and these other financial regulators and not to the SEC. It was one of the by-products of our old jurisdiction where you had people doing similar type work but under jurisdiction of two different committees.

If you look at the rates at which highly skilled people have left the SEC, I don't quite remember that number, but I think that the turnover rate was something like 9 percent—13 percent last year. That was much larger than in the financial regulatory agencies, and I believe pay parity is a reason.

Again, whether you want more regulation or less, we want good regulation; and you can't have good regulation without having good people.

Mr. CROWLEY. Is it your understanding that the industry itself supports that measure?

Senator GRAMM. I do understand that.

Mr. CROWLEY. Do you have any knowledge as to whether or not the industry itself overall would support including pay parity in this legislation?

Senator GRAMM. Well, in our bill in the Senate, we had both pay parity and the fee reduction; and we had broad support for that. I can't speak for industry anymore than I can speak for the Administration, but I think at least most people that I know in the securities business they would rather have more competent people regulating them than less competent people.

Mr. CROWLEY. So for the record, Senator, would you like to see included in the bill pay parity?

Senator GRAMM. I have it in my bill because I thought it fit, and for the record I would prefer it in the final bill.

Mr. CROWLEY. Thank you. I yield back the balance.

Chairman BAKER. Thank you, Mr. Crowley.

Mr. Ose.

Mr. OSE. Thank you, Mr. Chairman.

Senator, I appreciate you coming to visit with us today. I followed you over here.

Senator GRAMM. Oh, this committee is so big it is hard for an old person to figure out where people are. OK.

Mr. OSE. It is equally difficult for a young person, I must tell you.

Senator GRAMM. I had to look four rows up. I tell you it also is disconcerting to see people sitting on the top row that I hardly know. I once was over here, but it has been a while, obviously a while.

Mr. OSE. The only reason I know it is tough for young people is Vito told me.

On the pay parity question, do you have any numbers to quantify how much additional funding SEC might need to achieve pay parity?

Senator GRAMM. I don't have those numbers with me, but I think the SEC is going to—are you going to testify? Since we have a perfectly capable person who is being paid to do that, I am going to let her tell you, but they do have the numbers and will provide them.

Mr. OSE. In terms of the industry itself, many of the intermediaries like Fidelity and others at the end of the day they will go into the market and sell their excess or buy the short having reconfigured their interior portfolios. Are fees collected on the interior transactions?

Senator GRAMM. Yes.

Mr. OSE. They are.

The question I have is that if we are collecting one-and-a-quarter or one-and-a-half billion versus an SEC cost requirement of about $380 million a year, your proposal, if I read it right, would take the fee or tax charge, however you want to assess it, from 1/300th of 1 percent to 1/500th of 1 percent. But it seems to me, if you do the math, you ought to go from 1/300th to 1/900th of 1 percent; and I am curious why we only go a little bit of the way.

Senator GRAMM. I think part of it was in our 1996 law in these outyears we are already reducing the rate somewhat. Believe me, we have spent a lot of time trying to figure out how to do this right

since we don't want it to come back 4 years from now and do it again.

Second, we have tried to do it so that we don't disadvantage our appropriators so that we ended up getting opposition that we don't need. I will get somebody to put down on one sheet of paper exactly how all the numbers work and give them to you.

Mr. OSE. I would appreciate that.

My final question is, if I understand the 1996 legislation, it was very specific that this fee was designed to cover SEC's costs. It was not to cover SEC's costs and CRA or environmental remediation and X, Y and Z. Am I correct?

Senator GRAMM. There was no doubt about the fact, A, when the fee was first imposed and, B, every time we have changed, and including 1996, it has been the clear intent of Congress that the fee pay for the SEC's operation under the basic argument that the investing public benefits from the regulatory process and, therefore, they should pay for it. But no one has ever made an argument that I am aware of, that the Congress has adopted anyway, that the fee should become a general revenue source.

I would argue—and I don't want to drift off into my old days as an economics professor—but if you were going to define efficiency of a tax as the most efficient tax is where I take a dollar out of your pocket, but I don't change your behavior, so you are a dollar poorer and the Government is a dollar richer, that would be the most efficient tax. The most inefficient tax is a tax where I take a dollar out of your pocket, but in doing so, I change your behavior, say the death tax, so that you sell your business sooner, you do all kinds of other non-productive things so that the cost might be $5 or $6 for every dollar we collect.

I would argue that these fees, while they are justified to pay for the SEC, they are a very inefficient way to raise money. The cost they impose on society is much higher than the money we get. The idea of imposing fees on the issue of new stock, a direct tax on sort of the seed corn of the economy, as a way of funding the Government, it would be almost the worst imaginable tax you could come up with. Yet, through no intent by anybody, we have come up with exactly that system; and that is what we are trying to fix.

Chairman BAKER. Your time has expired.

Mr. Israel.

Mr. ISRAEL. No questions.

Chairman BAKER. Mr. Lucas.

Mr. LUCAS OF KENTUCKY. No questions.

Chairman BAKER. Mr. Hinojosa.

Mr. HINOJOSA. Thank you.

Senator GRAMM. We know that name well where I am from.

Mr. HINOJOSA. Thank you, Senator Gramm. It is a pleasure to see you.

For me, it is a new experience to serve on this Financial Services Committee. I am going to pass up this opportunity to ask questions. Instead, I think I am going to listen and better understand your legislation; and from everything I have heard, it seems like a very prudent thing to do. So, up to this point, I have no objections.

Senator GRAMM. Thank you, dear friend.

Chairman BAKER. Thank you very much, sir.

Mr. Ferguson.

Ms. Hart.

Mr. Weldon.

Mr. WELDON. Thank you, Mr. Chairman.

I just want to go on record as being in support of the fee reduction as well as the pay parity. I can readily see how that is important.

Chairman Gramm, I appreciate you coming here and testifying.

There will be arguments made, I think we have had heard some this morning, about the revenues and what they could be used for, quote, unquote, and that, of course, all those arguments always assume sort of a zero sum game, that if the Government doesn't get the money then the money is essentially lost. I wonder if you could elaborate on that. As I understand it, economic theory, that if we don't take that money in, then that money is going to be out there in the economy, essentially doing good things, creating jobs and in the end producing wealth and sending more money back to the Government.

Senator GRAMM. Well, let me say this, that I think the debate about Government spending versus taxes is a totally legitimate debate when you are debating the tax bill.

I think on a user fee that the idea that we made a mistake when we set the fee in not taking into account the kind of economic growth we have experienced and therefore we have had this windfall at the expense of schoolteachers in California, retired couples in Florida, struggling parents in New York City, and therefore, since we have had the windfall that nobody ever intended, that now it is our money and therefore we are giving up something in having a fee that fits the purpose that the fee was adopted, I think that is a debate we ought to be having on the tax cut and not on this fee issue.

The point is, the fee was put in place to fund the SEC and not to be a general revenue source. We are collecting six times as much as we need by the most conservative estimate; and, in doing so, you basically are affecting every saver and every investor in America.

When you bring together the diverse groups that support this bill, it is pretty clear that this is basically a grass-roots effort. And I just—today, with tens of millions of Americans increasingly investing their money in mutual funds and retirement programs, with—the average American family 3 years ago had more wealth in its financial assets than it did the equity of its home, it seems to me that there is hardly anything that is more people oriented than not penalizing people that are trying to get ahead and save and invest and become owners of wealth.

In the America of 50 or 100 years ago, only a very small number of people could ever benefit from the power of compound interest, and they were so greatly disadvantaged—I mean advantaged as a result of it. Now ordinary people are getting the opportunity, really for the first time, to benefit from it; and I don't think that we should be continuing excessive fees on them. That is really the argument, I think.

Mr. WELDON. Thank you, Mr. Chairman. I yield back.

Senator GRAMM. If it is OK, why don't I stop and let Senator Schumer testify?

Chairman BAKER. Mr. Chairman, what I suggest—I understand Senator Schumer also has some time constraints—that perhaps we would recognize the Senator for his remarks; and for the Members we will pick up in the order we left with questions at that point. So that whoever has been patient and waiting to ask their questions, you'll ask either Senator at your choice.

Chairman BAKER. It is a pleasure to welcome you back, Senator. As a former colleague on this committee, we look forward to working with you in our expanded jurisdiction capacity and thank you for coming.

STATEMENT OF HON. CHARLES E. SCHUMER, A U.S. SENATOR FROM THE STATE OF NEW YORK

Senator SCHUMER. Thank you, Mr. Chairman; and I would like to thank you and Ranking Member Kanjorski for holding this hearing today.

I would like you to know when you come down from New York to Washington you know that New York is at many disadvantages here in the Capitol. But this is one place where it is not. I count five New Yorkers here. And since this bill not only benefits America and New York, the financial capital of the world, we couldn't have a better forum to start out.

I would also like to just thank you for getting going early. This is another one of—you would be surprised, Mr. Chairman. Over in the Senate there are many—or several ongoing Gramm-Schumer collaborations, and this is but another.

Chairman BAKER. It is a source of continuing amazement over here, I would add.

Senator SCHUMER. The Senate changes you in remarkable ways.

But, actually, Phil said this is really a grass-roots bill; and to prove it he brought me along here. Just kidding.

Anyway, I want to thank you and I want to thank Chairman Gramm for his leadership on this issue. It is of great importance to investors across the country, big ones and little ones and every one in between.

I am pleased to be working with the Senator to be lead Democrat in the effort to reduce the Section 31 and 6(b) fees in the Senate. Frankly, Mr. Chairman, I have never been more sanguine about our prospects, and starting this bi-cameral process early in the legislative cycle optimizes our chances for getting this done in Congress.

As everyone here knows, these fees were enacted to fund the SEC as sort of a user fee. No one had any objection to that and—like the surcharge on airline tickets. Unfortunately, the fees have been—basically fallen out of line with the SEC's budget. Because of the democratization of the securities market in the 1990's, the volume of trading exploded and so has the volume of fees.

I am sure Phil mentioned the numbers. Based on trading volume 40 years ago, Section 31 fees would have been about $3 million. If fees had only grown with inflation, today they would be $17.7 million. But today they are not $17.7 million, they are $2.3 billion.

That is an annual growth rate of 19 percent, and it is 600 percent of the SEC's budget.

Now, Congressman Kanjorski and I would probably like to see the SEC's budget go up that much, but I know Mr. Chairman and Chairman Gramm would not like to do that. So we think we ought to return it to the taxpayers.

The way the law is currently written, the fee collections are used to fund the SEC; the rest becomes part of the overall Federal budget. Which means inadvertently this body and our body on the other side have passed a tax on investors that goes to funding all sorts of other projects and programs. We never intended that, and it is about time we undid it, and that is why we are here.

S. 143 will rationalize the process by reducing the fee rate, capping the total fees collected; and, at the same time, it guarantees the funding that the SEC needs to grow in this expanding securities world. Over 10 years it is going to save investors $14 billion. And since, according to the SEC, investors pay 87 percent of Section 31 fees, all types of investors, from the retiree who owns 50 shares of Cisco to the mutual fund representing all of us with billions in the market, everyone will benefit.

I don't have to remind this subcommittee nearly 50 percent of Americans have direct investment in the stock market. The Gramm-Schumer bill provides relief to every single one of them. So I would—I think theses issue have been talked about freely. I know Senator Gramm has given a great opening statement. So I am—instead of taking the committee's time, I am going to ask that the rest of my statement be read into the record.

Chairman BAKER. Without objection.

Senator SCHUMER. And I am here available for your questions until I get a buzz from the Commerce Committee where I have to go back to.

[The prepared statement of Hon. Charles E. Schumer can be found on page 63 in the appendix.]

Chairman BAKER. Understanding that, we would quickly recognize Mrs. Jones, who is next in line.

Mrs. JONES. Thank you, Mr. Chairman; and, Senator Gramm, Senator Schumer, thank you for coming.

I have to add a little humor to this. You see, all these guys just came on this subcommittee when they don't have a chance to sit at the top row. When I started, I was first at the bottom corner over there. We used to call it the kids table. So they are enjoying sitting at the top of the row.

I am going to make my question kind of short. I would ask both of you to address it.

The Section 31 fees are apparently the area in which there has been the most growth. I think, Senator Schumer, you just said that 87 percent of the Section 31 fees are paid by consumers. Your bill actually addresses more than Section 31 fees. If in the other areas the fees have not grown at that magnitude, why is it that you propose that those fees be cut as well?

Senator GRAMM. Well, let me respond by saying that the figure that Chuck used is the figure where people pay the fee directly. The fees are paid indirectly by the other 13 percent. We just decided to do them across the board because it was the simplest way

to do it. There is nothing magic about it. We have an excess of fees. We could have rearranged the distribution of it. But we just thought it was simpler to reduce all the fees across the board and keep the same relationship among the three fees.

Senator SCHUMER. That is—basically, Phil has summed up the answer. I mean, our job here is to take this extra several $1.8 billion or whatever it ends up being and bring it back to where it should be to the investor. And if we rearranged all the different fee amounts based on income—it is a great question, but we thought it would create more complications and get in the way of our overall goal. But it is not an irrational thing to do. What you suggest is not an irrational thing to do.

Mrs. JONES. Just as a follow-up, and this is a new area to me since this is a new responsibility to me, too, the Banking Committee, I am assuming—or I would ask that perhaps whatever you have been doing on this issue to assess whether or not in the other areas there has been the significant growth and maybe we might need some of those dollars for the administration, I have no idea, but I would appreciate any information, if you don't do it toward some, subsequently it would be——

Senator SCHUMER. Congresswoman, my staff informs me—I don't know if it is the same exact percentage, but because of IPOs and everything else there has been the same dramatic growth.

Mrs. JONES. They are trying to tell you something.

Senator SCHUMER. But those may be reduced under the 1996 act, she reminds me.

Mrs. JONES. Thank you, Mr. Chairman.

Chairman BAKER. Thank you, Mrs. Jones.

Next would be Mr. Barr.

Mr. BARR. Thank you, Mr. Chairman. It is a pleasure to have our two colleagues from the Senate here today.

With regard to the issue of pay parity, I have some real concerns about sort of getting into that whole issue. Where we would draw the line with any number of Government agencies and indeed our military that have a serious problem with pilots leaving, attorneys leaving and going into private practice, at least in part because of disparities in pay and it being more lucrative in the private sector, I don't know that we could ever or would ever want to try and reach pay parity, get into a bidding war with private industry. There is something very special about public service, and certainly we all understand and the vast majority of Federal employees that I know and work with are men and women of tremendous honor and they make very serious sacrifices to serve the public, as all of us do.

Is an issue of the fee reductions, the fee ratio reductions important enough that we should move forward with it even if we don't have the pay parity provision in the legislation?

Senator GRAMM. Let me respond by saying that by pay parity we mean parity among financial regulators. We have already done it for the other financial regulators, and so we were simply taking this opportunity where we were adjusting the fees to bring all salaries of all financial regulators in the system into parity.

I am for it. I am also for fee reduction. So I learned long ago in our business if somebody is voting with you on one thing, don't in-

sist that as a condition to do that they vote with you on everything, or else Chuck and I wouldn't be sitting here together.

But I would ask you to look at this issue. The concern you raise is clearly a valid concern. We are not talking about parity with the private sector. Most people who are working for the SEC probably could make more money in the private sector, but there is no logic to people at the Federal Reserve Bank doing a similar kind of job being paid on a different scale, and we find ourselves in that unusual circumstance today.

Senator SCHUMER. The only thing I would say to the Congressman is the parity is aimed at banking regulators who are under different types of rulings. The job of being an SEC employee is just as difficult, if not—Chairman Levitt—former Chairman Levitt and I think Acting Chairperson Unger will be here later to talk about the difficulty of finding good people in these. And we need them. The SEC regulation system, where there has been a broad consensus based on disclosure rather than detailed regulation, needs good people there; and we are really suffering. So this isn't going to cost that much. It is not private versus public, which is opening a whole can of worms but, rather, simply equaling our parity to those of the banking regulators who run different rules, because there is different types of agencies.

Mr. BARR. OK. Thank you for the clarification. Thank you, Senators.

Chairman BAKER. Thank you, Mr. Barr.

Mr. Meeks.

Mr. MEEKS. Thank you, Mr. Chairman.

Senator Schumer, let me just ask this very briefly. You know, because of the Gramm-Leach-Bliley law, we have separated the barriers from banking, insurance and securities. My question is this: Banks still operate on the CRA rules and regulations, and some have suggested why not take some of the excess fees and apply them to funds for economic development and environmental restoration, leveling the playing fields with the banks as far as the CRA requirements. What do you think about that?

Senator SCHUMER. I think it is an interesting idea, though it is one I would oppose for this reason. The original sort of tradeoff with the banks, why they are under more severe forms of regulation than say the securities industry, is because they got Federal insurance; and still, to this day, people go to banks because they know Uncle Sam is there. Recent history has proven most people believe it is there, not just for the $100,000, but for the whole ball of wax, and history has borne that out. Phil and I would probably disagree whether that was good or bad, but that has never happened.

The whole framework of the securities industry, which is more entrepreneurial, which is more "win a lot of money and lose a lot of money," has never had that Federal insurance. I think it would be a terrible idea for both the industry and for the country to give them that Federal insurance. They would certainly demand it if we extended CRA and other types of things which I have been fully supportive of.

As you know, in Gramm-Leach-Bliley that was our major sticking point until we came to an agreement on that. And I think it

would be a bad idea, because I think it would change the whole entrepreneurial nature of the securities industry.

I support putting in more dollars. I know how good CRA has been for the community you represent and for hundreds of communities across America and scores across New York, but I don't think this would be the right way to do it.

Mr. OSE. Will the gentleman yield for a follow-up?

Mr. MEEKS. I yield.

Mr. OSE. I want to go back. I asked earlier about the pay period qualification. I scanned Ms. Unger's testimony. It is about $70 million to achieve pay parity.

If I understand correctly, if we opted to do that, that would take us from about $380 million in SEC costs annually to $450 million, which would still be roughly ⅕th of what the fees are, according to Senator Schumer's testimony.

I come back to my point that the underlying legislation authorizing the fee collection only allowed collection for the costs of SEC. Is that correct?

Senator GRAMM. The way it works is that we look at the adopted budget of the SEC and we adapt the fee to that. So whatever Congress decides in terms of funding for the SEC, that will—with a delayed process will determine what the fee will be.

Now, as you know, when we grant pay increases in the Federal Government, sometimes we absorb the pay increase and sometimes we fully fund it without absorption, and sometimes we have a degree of absorption and a degree of funding.

The decision about funding the SEC will be made by the Appropriations Committee, and they will make a decision—assuming that we grant pay parity, they will make a decision as to whether any of it should be absorbed, all of it should be absorbed, part of it should be absorbed. But there will be no problem in terms of the fee, because the fee will be adjusted; and we maintain a cushion in the way we have set it, in any case, for a fairly short period of time. So we try to come up with a dynamic way of doing it so we are sure, no matter what happens to volumes, that we do not end up with this excessive collection of fees.

Mr. OSE. If I understand the math of the proposed flexibility, instead of being four or five times what is necessary, we get down to one-and-a-half to two times what SEC costs are on an annual basis.

Is that about right?

Senator GRAMM. We have a cushion in the bill of some 40 percent or something like that.

Mr. OSE. I thank the gentleman.

Chairman BAKER. Our next Member would be Mr. Fossella.

Mr. Cox.

Mr. COX. Yes, thank you. I want to thank my Senate colleagues and betters for attending today and providing your testimony.

Even though, Senator Gramm, I missed your testimony, I——

Senator GRAMM. I could give it again.

Mr. COX. You will be providing it.

Obviously, the central question for us is whether or not to conform our House legislation to what you have provided. I know we will hear from Chairman Unger that she supports our doing that,

and I wonder if you can think of any good reason that we should not.

This is not a trick question.

Senator GRAMM. Again, I stated earlier in responding to Congressman Barr that we decided to do it this way because it made sense to us.

Mr. COX. I ask you this question not so much because the answer appears obvious, but because if we were to move to conference, presumably the whole thing would be conferencible and we could do it there.

Is there any reason to think that moving a bill quickly through the committee, as it has been presented to us, might get this enacted into law faster?

Senator GRAMM. That is a decision you've got to make. We made the decision to do it together because we thought it made sense, obviously, because it is in our bill, if we get to conference, and I believe we will, it will be conferencible.

But however you want to do it, again, if somebody is for part of something, I am not going to say, don't be with me on part of it because you are not with me on the rest of it.

Mr. COX. Did you——

Senator SCHUMER. Which he doesn't always say on everything.

Mr. COX. Did you address in your earlier presentation—I apologize if you did—what you expect the Senate timing to be?

Senator GRAMM. I said we passed it out of committee on a voice vote. We have legislation pretty well stacked up until the last week of this month. My objective is going to be to try to get this bill on the floor of the Senate either the last week of this month or the first week or two of next month.

So we are going to try to move forward, and we are working hard on it. There is a strong grass-roots base of support.

The number of beneficiaries of this bill is very, very large. My guess is with direct investors, with IRAs and 401(k)s, we probably have, counting family members, some 200 million beneficiaries. So it is hard to imagine a bill that will touch more lives.

Granted, it is just a little bit here, a little bit there. But as I said, on a retirement program, we are talking about $1,300 of excessive fees. If you could invest those fees instead of having them taken away and be $5,800, there are not many retirees that could not find a use for $5,800.

Mr. COX. This has been essentially a love fest today, with minor exceptions at the margin. We are obviously all in agreement here on the merits of fee reduction and rationalization. The only question, it seems to me, that is before us is to what extent we try and conform ourselves to your overall approach with respect to the pay structure at the Securities and Exchange Commission.

I would certainly urge our subcommittee to do whatever we can to do this as quickly as possible so we can have legislation before the President as soon as possible.

I yield to my colleague.

Mr. KANJORSKI. Thank you, Mr. Chairman.

First——

Mr. COX. In fact, even though I was not here for your earlier comments, I understand it is not entirely a love fest.

Mr. KANJORSKI. May I make a point? First of all, Senator Schumer, you indicated that we have no insurance policy for investors. In fact, we have the Securities Investor Protection Corporation.

I would like to offer for the record an article in the *New York Times* Business Section of September 25, 2000. It is a rather detailed article and one story involves a case in Pennsylvania. Someone invested $100,000 in bonds, and the bonds were fraudulently purchased and absconded by the investor and it took them 4 years to get their money back. It shows the inadequacy of the fund as to how it is operating.

We need to address this issue. These funds could go to correct these sorts of excesses and failures that are out there. They could protect the American investors we all talk about protecting—not the Wall Street brokers, but ordinary investors in our districts. This is the fund that should do it.

Mr. Chairman, I ask to submit that article for the record.

Chairman BAKER. Without objection, we will put this in the record.

[The information referred to can be found on page 97 in the appendix.]

Senator SCHUMER. Congressman.

Mr. KANJORSKI. Yes.

Senator SCHUMER. I think the best way to protect investors is to give the SEC the funds it needs. They will admit to you that they don't have those now, and our bill helps do that. Of course, SIPC is not a grand scheme of Federal insurance the way we have it for——

Mr. KANJORSKI. You mean on the SEC pay scale, bringing it up to parity with other financial regulators.

Senator SCHUMER. And let them hire the people we need.

Chairman BAKER. We have a couple more Members.

Let me announce this: We have a vote on the floor. I would intend to stay another 10 minutes, with your cooperation. I have two Members who have been here most of the morning. I know they would like to ask of the Senators before they leave.

Mr. COX. In the interest of moving along, Mr. Chairman, I yield back the balance of my time.

Chairman BAKER. It has been expired a little while back.

We have two Members—excuse me, three. We have Mr. Shadegg; Mr. Rogers; Mr. Sherman, who just stepped out; and Mrs. Kelly, who is not a Member but has been patiently participating this morning. If we can, I would like to get those three Members in before the clock runs, starting first with Mr. Shadegg.

Mr. SHADEGG. Thank you, Mr. Chairman. I will be brief.

I simply—I guess to join the love fest want to say that on behalf of the interests in my district who have looked at this legislation and have let me know their sentiments, including, at least the figure I have is some 80 million families that invest, I think this is legislation that is well overdue. I commend you on your efforts and I appreciate you for taking your time to come here this morning.

I yield back the balance of my time.

Chairman BAKER. Thank you, Mr. Shadegg.

Our next Member is Mr. Rogers.

Mr. ROGERS. Mr. Chairman, I will yield my time.

Chairman BAKER. Mrs. Kelly.

Mrs. KELLY. Thank you, Mr. Chairman.

I thank both of you Senators for coming over this morning. I appreciate your letting me speak here at the committee today.

I simply want to ask, you have something in your bill that I don't think I have heard discussed. What is the advantage of reducing the other fees that are in the bill, the mergers and tenders fee and the registration fees? I wonder if you could just speak quickly to that.

Senator GRAMM. We made a decision that all three fees have grown exponentially and that we wanted to keep them at their same relative rate; so reducing one, we would reduce the other.

I would say the same argument applies; to the degree that we incur costs at the SEC in overseeing the issuing of new stock, we should collect the amount of fees we need to oversee the issuing of new stock and not more. The same is true with mergers and tender offers. The fee should reflect the cost of overseeing, supervising, and making decisions in those areas.

I would say also that every one of these fees is ultimately paid for by investors, and so I think all the same arguments apply. I don't think there is one fee that is more consumer-oriented than the other.

I would have to say, from a philosophical point of view, which has nothing to do with the fee and its use, I find the fee on the issue of new stocks probably the most inefficient economically, because it imposes a fee on a transaction that is so critical to the American economy, and that is the issue of new stock and really the birth of new public companies.

But we decided not to get into all of that. I think Chuck said it well: We were not trying to create problems, we were trying to solve problems, and keeping all three of them proportional was a way of doing that.

Mrs. KELLY. I thank you.

My office just did a little quick calculation. We found that if you had a long-term investor that went into the market with $1,000 in a mutual fund with the returns matching the Standard & Poors 500 in 1950, it would be now worth about half-a-million dollars; but if you figure in a compounded 2 percent, which is conservative, fee, it is only worth $230,000. That is a big cut.

I think that these fees really—I agree with you, I think we should maybe take a look at the whole gamut of them.

Thank you very much. I yield back.

Chairman BAKER. Thank you, Mrs. Kelly.

Mr. Kanjorski wants one more round before we recess.

Mr. KANJORSKI. It is tough to get into a discussion when Senator Gramm and Senator Schumer are on the same side. I do not know where we go. We have the whole gamut covered.

Senator GRAMM. When you are outside our spectrum, you are pretty far out there on the wings.

Mr. KANJORSKI. You have made a very strong argument here for equity and fairness, and that appeals to me. Certainly these fees were intended to cover the costs of regulatory transactions, but it remains a question as to whether or not we can get these fees into balance.

But if you are going to carry that principle over, Senator Gramm, I am still worried about losing $1.5 billion to the Treasury. How are we going to make it up? If you are going to say that we do not have to make it up, then we have a problem.

Mr. Schumer, you should take up on this issue. We have a lot of trust funds in the United States Government that we have been robbing and not using because we need those trust funds to cover the budget. When is their day of fairness?

Let me give you one example, and I ask your assistance on it. We have almost $2 billion in the Abandoned Mine Land Fund. It has been used to run every other agency of the Government of the United States for the last 6 years without any major portion of the fund going back to reclaim land. That is what the fees paid by the coal operators were to be used for—to make up for past bad practices that affect human life and put it at risk.

Do you not think before we give the money back or reduce this fund that we should make whole these other funds, and make sure that the funds that they are no longer being used for general Treasury purposes—which it not what they were created for? Where is the equity here?

Senator GRAMM. Let me respond by saying that we really have already started doing that. I worked with Senator Byrd on trying to fix the problem we had with the Highway Trust Fund, where 26 cents out of every dollar of gasoline taxes was not going to road construction, was not going to mass transit. We fixed that. As a result, every penny of it goes for those purposes.

I believe that we should—with user fees and trust funds, that we need to basically have them go for the purposes they are created for. This is the one that is under our jurisdiction. It is not a trust fund; it is simply a funding source.

We have already done it for the biggest trust fund, which was the Highway Trust Fund. I think this is a major step toward doing what you are talking about.

Mr. KANJORSKI. So I could anticipate the support of Senator Gramm and Senator Schumer in the Senate when we try and make whole the Abandoned Mine Land Fund? That it is the right thing to do. These $1.2 billion should be paid out to fix this land trust fund.

Senator SCHUMER. Let me say it is a little bit of a different argument in this sense: This is not a trust fund. In other words, there is not a whole lot of money sitting here. You can argue—if you have a trust fund, where it sits there, you can argue it either way—either spend the money on the intended purpose or return the money to the taxpayers.

Mr. KANJORSKI. But the reason we have not been able to fix this is that if you spend the money on its intended purpose, there is a shortfall of revenue in the overall Federal budget. This legislation is going to exacerbate that problem. We are going to lose $1.5 billion a year of revenue that is now going to the United States, so that is less of an opportunity to pledge our money to these funds.

But you are certainly right. I agree with you completely.

Senator GRAMM. These fellows don't own this.

Senator SCHUMER. Right. But it is fundamentally not an honest way, and I don't mean dishonest in terms of crooked, but in terms

of telling people what they are paying; when you pass a law to do one thing, like the nickel gasoline tax, and then it does another, and you at least have to pay, you know—and that is not fair, which—the fund you are mentioning, it is the same thing.

Mr. KANJORSKI. But we do not have the revenues to pay out that fund money. The fact is, I am perfectly agreeable to go along with you and be fair on this type of fee arrangement. What I am asking for is an equitable commitment from two extremely effective Senators to help us be true to the purposes of these other funds and to make sure the revenues are there, from whatever fair source they come from, to pay out as intended by the Congress for the last 20 or 25 years.

Senator SCHUMER. I would be very sympathetic to that argument.

Senator GRAMM. I would have to say that I think trust funds should be used for the purposes they have been collected. Trust funds are a little bit different. But within that caveat, I think either you ought to lower the fee and collect less, or you ought to use the money for the purpose that it was collected.

What we are trying to do here is lower the fee.

Chairman BAKER. If I may interrupt, we are down to about 3 minutes on the floor.

I especially want to extend my appreciation to both the Senators for being here on our first full hearing of this new subcommittee. I think you set a high standard of bipartisan cooperation for us to emulate. I appreciate your bold leadership.

And, Senator Gramm, for the record, some may have indicated you didn't go far enough in cutting taxes. I want to clear the record. This subcommittee will never accuse Senator Gramm of not being aggressive enough. Thank you.

We will stand in recess pending the second panel. We are going to go right over and vote and come right back. We will have limited opening statements, as promised to Members.

I would expect to reconvene in about 15 minutes.

[Recess.]

Chairman BAKER. I would like to reconvene our hearing of the Capital Markets Subcommittee.

Upon consultation with Mr. Kanjorski, we determined that we would both submit statements for the record, as well as make it permissible for all Members who choose to submit an opening statement to do so at any time.

I am pleased to welcome our next witness, our entire second panel, and welcome you here. I know certainly of your experience on Capitol Hill and your longstanding service within the SEC, and in your capacity as acting director, we look forward to your insightful knowledge on this subject, as well as others, over the coming months and years, I'm sure.

So we extend our welcome to you, Ms. Unger.

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

Ms. UNGER. Thank you very much, Chairman Baker, and thank you, Ranking Member Kanjorski, and—is there any other Member up there—other Members as they come in.

Chairman BAKER. They are on their way. They weren't as committed to getting here as Mr. Kanjorski and I, but they are on their way.

Ms. UNGER. Thank you for the opportunity to testify here on behalf of the SEC regarding fee collections required by the Federal securities laws.

I am also honored to be the first SEC Chairman to appear before the Capital Markets Subcommittee of the newly created House Financial Services Committee.

Today the subcommittee examines an issue of considerable importance, as you have heard, to our capital markets, the current fees the SEC is required to collect. Registration fees, transaction fees, and merger and tender offer fees impose excessive costs on investors, public companies, and securities firms. Although Congress first imposed those fees as a means of recovering the cost of securities regulation, the Congressional Budget Office today estimates that fee collections this fiscal year will total almost $2.5 billion, which is an amount more than five times the SEC's current budget.

The Commission shares the committee's concerns regarding these excess collections and believes that there is an opportunity for Congress to significantly reduce these fees.

Crafting a successful fee reduction is technically complex and it affects a number of interested parties. Because these fees are the source of the SEC's funding, it is also critically important to the Commission that the fees be reduced in a way that is consistent with full and stable long-term funding for the agency. A stable source of long-term funding will ensure that the SEC continues to effectively perform its statutory mission of protecting investors and maintaining market integrity.

I want to briefly mention four elements that the Commission believes are essential to any successful fee reduction, all of which is explained in greater detail in the written testimony.

First, any bill should take into account the difficulty of predicting future market conditions. The NSMIA example that you talked about a little bit today, or that the Senators talked about a little bit today, shows that simply reducing the fees and the fee rates will reduce collections only if our markets do not exceed current projections. Fees should be reduced in a way that leads to more stable and predictable fee collections in the future.

Second, any bill should reduce fees in a manner that spreads the cost of regulation among those who benefit from the activities of the Commission. By targeting all three types of fees the Commission collects, Congress can reduce costs not only to investors and other market participants, but also on the capital-raising process.

Third, any bill must be administratively workable for both the industry and Government. The current fee collection system involves a large number of parties, all of whom will have to be able to work with any fee rate reduction mechanism in the future.

Fourth, and above all to the agency, we believe that any fee reduction bill must be consistent with full and stable long-term funding for the agency.

This involves two prongs. The first is preserving the ability of our appropriators to fund SEC operations out of offsetting collections, and the second is ensuring that the agency continues to be able to attract and retain qualified staff.

The Senate fee reduction bill that Senators Gramm and Schumer described to you ensures that the currently projected offsetting collections will be available to our appropriators to fund the agency in future years. The Senate bill also addresses the SEC's current staffing crisis by giving the Commission the much-needed ability to match the pay and benefits of our sister regulators at the banking agencies.

For fiscal year 2000, the attorneys, accountants, and examiners at the banking agencies made 24 to 39 percent more than their counterparts at the SEC. You can imagine the effect that this has had on our staff's morale, not to mention their pocketbooks.

The pay discrepancy between us and the banking regulators is particularly illogical in the wake of the historic Gramm-Leach-Bliley Act. Gramm-Leach-Bliley requires increased coordination among financial regulators as they undertake examinations of increasingly complex financial services firms.

More than ever before, Commission staff members are working side by side with their banking counterparts and performing similar regulatory functions while making substantially less. The Commission must be able to attract and retain a high caliber of staff to tackle some of the most complex and difficult issues it has ever considered.

No segment of American business has been more transformed by the rapid pace of technological change in recent years than the securities industry. No less important, our markets today are increasingly global, a trend that most expect to accelerate in the coming years.

The demographics of our markets have radically changed as we have become a Nation of investors. Twenty years ago, only 5.6 percent of Americans owned mutual funds. Today some 88 million shareholders representing 51 percent of U.S. households hold $7.4 trillion of mutual funds. This exceeds by about $4 trillion the amount on deposit at commercial banks. All of these developments raise complex and critically important challenges that the SEC must be prepared to meet.

At such a critical time in our market's development, the Commission simply cannot afford to suffer a prolonged staffing crisis. Alarmingly, our attrition rate is nearly double the Government average. Over the last 2 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 to take better-paying jobs. If this trend continues, the Commission's mission of protecting investors and maintaining the integrity of the market will be seriously threatened.

We would prefer to lift Title V restrictions before a crisis arises, as it did for the banking agencies in 1989.

In conclusion, I want to commend the subcommittee for conducting this hearing. We look forward to working with you and other interested parties on this issue.

Thank you, Mr. Chairman.

[The prepared statement of Hon. Laura S. Unger can be found on page 66 in the appendix.]

Chairman BAKER. Thank you, Ms. Unger. We certainly appreciate your appearance here this morning.

My first question goes to the methodology preferred by the Commission with regard to fee reduction itself. I understand there are at least a couple of different approaches. One is perhaps a little more difficult for the Commission to calculate in a timely manner, meaning less than 6 months, when a certain trigger might be initiated for fee reductions; the other of which may set sort of a cap approach, where it is a fixed amount.

Do you have a recommendation to the subcommittee as to which or what manner of adjustment to the fee reduction in order to ensure funding of the SEC operations would be preferable?

Ms. UNGER. I think that Congress attempted in NSMIA to fix the fee schedule and bring it closer in line with the cost of regulation.

The lesson I learned was that the fee schedule needs more flexibility. The Senate bills' floor and ceiling provision takes into account market growth and the impact that it would have on the amount of fees the Commission receives that eventually go into the appropriations pot of money.

The floor and ceiling approach is a difficult but possibly workable solution. Right now, the staff is in the process of meeting with the industry to find out from the people who would actually have to implement this system. First, how workable it would be, since they would be the ones collecting the fees. If that is going to be problematic for them, and if there is some type of recommendation they can make what has been introduced in the Senate, we would be happy to work with the Senate staff on making those recommended changes.

Chairman BAKER. Well, just my initial observation without getting into the detail, it appears on the face of it that the Chairman Oxley approach offers some benefits that Senator Gramm's approach does not with regard to complexity of calculations and certainty of funding. But perhaps I will follow that up with a more detailed written analysis and get your opinion on that.

Ms. UNGER. We would like simple and certain.

Chairman BAKER. And I am sure, the funding.

I noted with some interest the fact that now 51 percent of U.S. households now engage in some mutual fund investment activity.

Do you have any indication—I notice when the New York and American Exchanges close, the number of shares traded during a particular day, that does not really represent the number of transactions. On a daily basis, what would be the scope of responsibility for the SEC's supervision related to the number of transactions today, say, versus a decade ago?

Ms. UNGER. I have those numbers; not quite a decade ago, but I will give you what I have.

For 2001, the combined NYSE and NASDAQ average daily share volume is 3.5 billion shares a day. In 1996, that same calculation

was 955 million shares a day. The average daily dollar volume for that same period for 2001 is $123 billion per day. For 1996 it was only $29 billion per day.

Chairman BAKER. What is of obvious concern to me is the individual who trades directly. It is difficult enough in understanding broker language and reading the disclosures they are required by law to provide the investor, but where the investor is acting directly online, the ability to have the transparency to understand the risk one is assuming—and I think perhaps in the last few years investors almost felt guilty in admitting they were not in the market, and a lot of people chased the opportunity without truly understanding the risk they were encountering.

To that end, I think having adequate staffing within your agency is extremely important, not only on the enforcement side, but even on the education side; and providing additional transparency of the market to the investors so they understand the true risk they face.

But I don't want to go over my time, because I know there are other Members who do have significant interest.

At this time I recognize Mr. Kanjorski.

Mr. KANJORSKI. Thank you very much, Mr. Chairman.

Ms. Unger, I called the attention of Mr. Gramm and Mr. Schumer to the article that appeared in the *New York Times* Business Section on September 25, 2000, talking about the inadequacies of the Securities Investor Protection Corporation and the act establishing that entity by Congress.

Have you had a chance to look into that problem, and if you have not, will you take the opportunity to do so? Because there are funds here that could flow to the benefit of investors that seem to be delayed in their recoveries or contested on their recoveries, to their great loss.

It seems to me that the very limited coverage given by that act could be expanded to more closely parallel, as appropriate, the positions of the FDIC.

Ms. UNGER. Actually, our Office of Compliance Inspections and Examinations, which we call OCIE, is looking into a couple of claims that have been made, I would say, in the last year or so, and some of the experiences we have had with those claims in connection with SIPC.

So my understanding is that they will be bringing to the Commission soon their findings and perhaps some recommendations in connection with that whole process.

Mr. KANJORSKI. The article seems to point out that the legal fees and the trustees' fees exceed the payments made to the investors, and inordinate defenses are put up to inhibit the investors from receiving compensation back, as was originally intended by Congress.

If you could you go over the article and do a study, I would appreciate it. It seems to me that before we correct this fee schedule, we should see if we are adequately protecting investors from any fraud and abuse occurring in the securities industry, and we should first try and utilize these funds to make that whole.

Ms. UNGER. I will take a look at the article and talk with the staff people who are working on that.

Mr. KANJORSKI. One other thing. As I understand it, the SEC handles the civilian side of enforcement, but if there is fraud or

abuse or some other activity in the securities industry that causes referral to the Justice Department, that expense is not borne by this fee effort.

It would seem to me that we should not only look at civil costs involved in the administration of the Securities and Exchange Commission, but also the costs incurred by the United States Government when referrals are made to the Justice Department.

If these funds only pay for the salary and operational costs of the SEC, it means that general taxpayers are paying for the administration of the criminal justice system in the securities industry. That would not seem to represent a fairness to me.

Ms. UNGER. Actually, the fees that were discussed, the Section 31 fees and Section 6(b) fees, are statutorily set fees that the appropriators changed and continue to change every year. The articulated rationale for the fees is to recover the cost to the Government of securities regulation.

We have civil authority, and we have administrative authority. We do bring actions involving fraud and violations of the Federal securities laws.

It just so happens that in New York, the Southern District and the U.S. attorneys have taken an active interest in white collar crime. We often coordinate with those agencies. We give them documents; we lend them personnel. So, in fact, we are sort of subsidizing that actively; and there is or has been some actual funneling of our money to those to combat criminal violations.

Mr. KANJORSKI. But would it not be wise for us to do an analysis or study of just what the costs are to the Justice Department of administering the criminal administration of justice in securities fraud?

I do not think in the Boesky case the SEC paid all the costs of that case. Obviously, the Justice Department out of their budget paid some of that cost, and their budget comes from the general tax revenues of the United States, not from these fees.

It would seem to me if we want to really get accurate here and do what Senator Gramm talked about, that is, use the fee to really pay for the regulation and enforcement—and when I say "enforcement," it is both civil and criminal in the securities industry—we should allocate a portion of these fees to be returned to the Treasury to help offset the general tax revenues costs that are going to the Justice Department to administer the criminal laws in the securities industry.

Ms. UNGER. I will just make one final point on your issue. That is, what we are only talking about is fees right now on the capital-raising and transaction costs. We also get a large sum of money in terms of disgorgement in our enforcement actions. Last year that number was $19 million. That does go into the General Treasury Fund.

Mr. KANJORSKI. $19 million?

Ms. UNGER. $19 million.

Mr. KANJORSKI. That is hardly enough to pay for some of these extremely expensive cases.

Ms. UNGER. In the case of Boesky, the number we collected against him in the most recent action was $30 million. Then prior

to that I think it was in the area of $100 million. That all does go into the General Treasury Fund.

Mr. KANJORSKI. Has anybody made a study, however, of what the costs are on criminal enforcement of securities laws or other criminal activities that emanate from the securities industry?

Ms. UNGER. I am not aware of that.

Mr. KANJORSKI. Would it not be wise to analyze whether a portion of these funds should be directed that way, or at least not cut? While the benefit here goes to the investor, there is a cost to the average American taxpayer who is not a securities investor for carrying out the criminal justice system through the Department of Justice, as opposed to the SEC.

Chairman BAKER. Let me jump in here. We will be able to come back to you, Mr. Kanjorski, but we have a couple of Members that I need to get in. Then we will come back.

Mr. Fossella.

Mr. FOSSELLA. No, sir.

Chairman BAKER. Mr. Royce.

Mr. ROYCE. Thank you, Mr. Chairman.

I wanted to ask the Chair, if I could, if Ms. Unger could explain—we heard the Chairman of the Fed explain that the economy was flat, that arguably we are maybe growing at 1 percent.

Could you describe how cutting excess SEC user fees might help stimulate capital formation and how it might encourage a more perfect market, perhaps, by reducing transaction costs to come in and out of the market?

We were talking about the negative savings rates in the country. Could you tell us a little bit about how this might have a positive impact?

Ms. UNGER. As was noted earlier, the proposal does, or the legislation does cut three different kinds of fees: the registration fees, merger and tender offer fees, and the transaction fees.

I can talk about each one of those, and Senator Gramm so eloquently said how important it was not to have a tax on capital formation and not to have unnecessary fees associated with that, which has been the case.

I can tell you the amount of fees we have collected over the years for each of those fee categories, depending on the marketplace, of course, and it does fluctuate; and the reason I think that they want the bill to include all three kinds of fees is to have some diversification and stability in the fee collections, depending on the marketplace.

As to the transaction fees, one thing that had not really been discussed is that of the full amount of the fee collected, about 85 percent of it is paid by the investor. If the securities industry reduces the fees accordingly, that amount is money that will be going back to investors.

It is interesting that you should raise the question of what stimulates the economy, because in the context of all these tax cuts, I have been asking people, what would you do if you had a $1,000 tax cut? Would you spend it, save it, or invest it? And everybody says, spend it or invest it.

So I think that is what we are hoping for, when people have a little extra money, that they spend it or they invest it. That is

where the money will probably go. If you look at the fees in and of themselves, they are not huge, but when we look at the aggregate amount of the fees, it is huge.

Mr. ROYCE. Given the aggregate amount of the fees, is it more likely people would look differently at how quickly they enter or exit the market if they perceived that the cost of doing so, the transaction cost, was reduced?

Ms. UNGER. I am not sure I understand the question.

Mr. ROYCE. I am just looking at it from the standpoint of reducing the cost to the potential investor.

Ms. UNGER. For people who move quickly, maybe intraday or short-term investors, you might say, I think those are maybe a different category of investors.

I think when we talk about the number of Americans or the American households that own mutual funds, we are talking about a longer-term investor. It is probably difficult to predict exactly what the impact will be of the fee reduction in terms of people's behavior in the marketplace, but I feel pretty confident that it will have some type of impact on their behavior.

Mr. ROYCE. Thank you, Chairwoman Unger.

Chairman BAKER. Thank you, Mr. Royce.

Mr. Kanjorski, want to take another swing?

Mr. KANJORSKI. On that issue, it is not quite fair to talk about the investors, particularly these mutual find investors, receiving all this money back, is it? What portion of the investors are actually mutual funds?

Ms. UNGER. What portion?

Mr. KANJORSKI. When you talk about 50 percent of the American households now having stock holdings, what portion of that 50 percent are with mutual funds?

Ms. UNGER. Fifty percent of households own mutual funds. I think it is 88 million Americans.

Mr. KANJORSKI. Eighty-eight million?

Ms. UNGER. Right.

Mr. KANJORSKI. What would be the average per year contribution to the mutual fund? I do not think it would exceed $10,000, would it?

Ms. UNGER. How much does each family invest per year?

Mr. KANJORSKI. It does not exceed $10,000. That would be a pretty big investment for the average family.

Ms. UNGER. I think there is probably a broad range in that number.

Mr. KANJORSKI. What I am getting at is that we are talking here about how much money we are going to save for these investors and how we are going to stimulate the market. If there are 83 million participants, and the large percentage of them invest under $10,000 in a mutual fund, they are going to save all of 33 cents a year. As someone said the other day, it is not quite the cost of a Coca-Cola.

This is not a fee reduction that is going to stimulate this economy, or have a major effect on returning money to average investors or average people. The largest portion of these funds will come from the high-investment community in a much disproportionate rate to the general population, would you not agree?

Ms. UNGER. I think the best argument for this legislation is that the statute that provides for recovery of the cost of regulation is bringing in far in excess of the cost of regulation.

You heard the numbers today.

Mr. KANJORSKI. No, I agree.

Ms. UNGER. We are talking about five times the amount of the budget.

Mr. KANJORSKI. Ms. Unger, I agree. But in reality, if we reduce funds coming to the Treasury of $1.5 billion a year, that shortfall is going to have to be made up by other means, and potentially from the general revenues, paid for by the general taxes of the 50 percent of the people who are not invested in the securities industry. It is just a matter of proportion, you know, who best can afford to pay at this point, and what are the benefits that flow.

If we had to make up the $1.5 billion from all people in the United States across the board, would that be quite fair?

Ms. UNGER. I don't see why any investor should have to pay beyond the cost of regulation. If you are going to say the money is not paying for the cost of regulation——

Mr. KANJORSKI. We are going to lose $1.5 billion. If we reduce the fee to actual costs, we are going to lose $1.5 billion in actual revenue, are we not?

Ms. UNGER. Money that never belonged in the general revenue.

Mr. KANJORSKI. Yes, but we are spending that money. It is allocated in the President's budget.

Ms. UNGER. I would love to have somebody else give me money that I could spend freely, but that is not what the statute was intended to provide. The statute was intended to provide an offsetting collection for the cost of the SEC's budget for regulation.

Mr. KANJORSKI. Of course you are aware that last year we attempted to repeal the Spanish-American War luxury tax on telephones in this country. Many people have been paying that tax for 100 years. It is not quite allocated proportionately across the system. First of all, the tax does not go to telephone regulation, and it does not go to the Spanish-American War. It goes to general revenues. We have a lot of fees and taxes that do not have attribution in this country.

Ms. UNGER. I should also clarify that the legislation doesn't provide for the precise amount of fees to cover the exact amount of the budget. There is still some excess that will go into the general revenue.

Mr. KANJORSKI. I understand that. But all morning Senator Gramm, in particular, was talking about how this is really important to the small investors of America. I think in response to the last question, you indicated this is going to be a stimulus because people are either going to invest this 33 cents a year, or go out and have a binge spending it and bring back our economy.

In reality, it is almost a nuisance fee or insignificant matter to the people that are investors, because they generally come from the upper 50th percentile of the American population, not the lower 50 percent?

Ms. UNGER. This sounds like a discussion that I probably don't want to get too much deeper into because it involves ideological differences.

Mr. KANJORSKI. Should we not be looking at some of the allocations across the country of who pays for what in the system and where we derive funds from?

What you are doing here is getting very close to the concept that everything should pay its own costs. That is almost a flat tax concept, in a way, in that you only want to take enough money out of the system to pay for the individual fees or operations of Government.

But there are some of us who are wealthier, who get greater benefits from Government, and these are just merely ways we keep it up.

Obviously, if I am a billionaire in this country, the Defense Department protects my $1 billion of wealth, as opposed to my neighbor who has nothing. The Defense Department protects much less of his wealth; it protects his person, but not his wealth.

These are just ways of getting revenue, albeit not anticipated, because we thought in 1996 we had corrected it. But I am not going into that issue, I am going to the issue of making up the lost revenues.

Chairman BAKER. If I could, I will get you to give a brief response, Ms. Unger, because we have exhausted our time again.

Mr. KANJORSKI. I want a philosophical response.

Ms. UNGER. I think what you are saying is, if you invest in the securities markets, you are going to have to pay for some other programs because they need money, and if you can afford to invest in the securities markets, you can afford to pay for part of these programs.

Mr. KANJORSKI. And you say, no, that is not true?

Ms. UNGER. I think there is a serious equity argument.

Chairman BAKER. A subject for this panel to consider over lengthy discussions.

Ms. UNGER. I think so.

Chairman BAKER. Mr. Fossella.

Mr. FOSSELLA. Just for the record, I would get back to what I see is the core issue here, and this is the moral argument.

Let us suppose that Congress in its infinite wisdom established by statute a fee of $1 for everybody who wanted to use a pencil, and there was an agency that regulated the use of pencils to make sure everybody was using them adequately and appropriately, and at some point in the future we stopped making pencils and producing pencils, but there was still money coming into this newly created entity to the tune of, let's say, $1 trillion.

Do we at that point in time say, you know what, we don't need this agency anymore, and we don't need this funding anymore, because nobody is using pencils anymore? And I think if we approach it from that point of view, as opposed to, well, we had all this money coming in that we can use for other purposes, so let's continue using it for these other purposes, I think that would be a silly way of looking at it.

So if we can just apply a little focus and what are perhaps the benefits of sending that money back to the investors who ultimately absorb the fee, and what they will do with the money, I think that is a positive thing. It depends on your view of how that

money is actually allocated and the formation of capital and how it flows and how liquid the market is.

But the true focus and purpose of this bill is merely to say, do you know what, these things are getting a little out of control, we are getting a little bit too much money. We have the acting Chair of the SEC before us saying, Congress should do something about it. I think if anything—if there is a signal that is clearer than that, I don't know if there is one, but I think it is refreshing that we have somebody from a Federal agency before Congress saying, stop this flow of funding to our agency and give it back to the folks who would otherwise pay this fee.

With that, I yield back.

Chairman BAKER. Thank you, Mr. Fossella.

Mr. Bentsen, did you have a question?

Mr. BENTSEN. Yes. Thank you, Mr. Chairman.

I apologize for being late, and having to leave the HHS Secretary over in another committee.

The question I had, I had asked Senator Gramm about the Senate bill in two areas, one that I have very much of a concern about, but I think is OK, but I would like to get your comment. That is sort of the anti-deficiency provision that is in there with respect to the Commission's functions.

He seems to feel that his bill is structured in such a way that the Commission would not—would hopefully not ever be underfunded to meet its needs if there was a fluctuation in the collection of fees, probably due to market functions. I think that is something that our committee should take into consideration as we prepare a House bill.

The second thing is, his bill, as I mentioned, would reduce not just Section 31 fees, but fees on registration, as well as mergers and acquisitions. He makes the point that all these fees flow through to the consumer one way or the other.

Does the Commission feel there is that equitable dispersion of fees—or do you have a position on that, or do you believe that it is really Section 31 fees that affect the investor and the investor class, if you will, more so than others?

You could make an argument—I have no axe to grind here, I am trying to get a feel for it. You could, though, make an argument that the registration fees are part of the soft costs of a transaction, and thus not necessarily passed on to the investor as much as the underwriter or the issuer itself, or the borrower.

Of course, Senator Gramm being the classical economist that he is, would argue that all those fees get washed out at the bottom anyway. But I would like to hear your comments on both those items.

Ms. UNGER. For the second part of what you asked, that is, reducing all three types of fees that we collect, as I mentioned to the Ranking Member, the fees were set by statute, and the appropriators have changed that statutory level over time in order to make up for these excess funds that have been going to fund other programs.

The Section 6(b) fees were really the fees that were hit first in terms of changing the statutory amount. That was the initial area where the appropriators made the adjustment.

The Section 31 fees initially only applied to New York Stock Exchange transactions for listed securities. Congress in 1996 applied those Section 31 fees to include over-the-counter transactions, or the NASDAQ securities market.

So you have an evolving source of these funds over the years. Depending on the vigorousness of the IPO market, we bring in a lot of Section 6(b) fees in one year. Depending on the vigorousness of the trading market, we perhaps bring in a lot of Section 31 fees in a particular year. I actually have a chart here, with numbers going back to 1980, describing how much the fees generated and the fees level for each year.

Back in 1980, when the registration fees were then set at 1/50th of 1 percent, we received $33 million in fees. For 1998, which must have been a particularly good year for IPOs, we received $1.34 billion. So there is a huge difference depending on where the strengths of the economy are.

So I think it does make sense that we support changing or adjusting all of the fees commensurately so that we can have an across-the-board cut in the fees.

The Section 6(b) fees impact the cost of raising capital. It is just another line item for what it costs to go into the market and raise capital.

Mr. BENTSEN. Should we be concerned at all that there sometimes is greater fluctuation in the issuance market than there is in the public markets? For instance, steel flow is down now, or has been for the last 6 months, and presumed to be down for the next 6 months or whatever?

Ms. UNGER. Yes.

Mr. BENTSEN. Is there enough disparity there that you would be concerned about the deficiency offsets that any fee reduction formula should take that into consideration, or is it such a minor deviation that it really would be more trouble than it is worth?

Ms. UNGER. Well, CBO makes the projections of what our fee revenue will be, for, I think, 3 fiscal years going forward. Those fees then become the basis for determining what the appropriate level of fees for each of those categories should be; and then there are a floor and ceiling built in in case those numbers are not met in terms of the amount of offsetting collections that will be available for our budget.

Mr. BENTSEN. Thank you.

Chairman BAKER. Your time has expired, Mr. Bentsen.

Mr. Ose.

Mr. OSE. Thank you, Mr. Chairman.

I am a little bit curious about something, Ms. Unger. That is, typically the fee schedules are implemented by regulation and rule for such things. In other words, we give an agency direction, and then they come out with rules in the *Federal Register*, what have you.

Yet, I am told that this underlying legislation in 1996 specifies 1/300ths of 1 percent in the fee area. Is that correct?

Ms. UNGER. Yes. It does set a specific amount, but going back again to the statute, in Section 6(b) and Section 31 is where you will find a specific fractional amount to arrive at what the fees should be.

Mr. OSE. So you have no latitude at SEC as to what the fee—at this point should——

Ms. UNGER. No, but you do.

Mr. OSE. We do, but you don't?

Ms. UNGER. Congress does.

Mr. OSE. Now, the reason I ask that is that it would seem to me that in that same area, the very same underlying legislation, either the 1996 or the previous, there is a very specific connection between the very specific fee and what it is to be used for—that is, SEC costs. It is not—it doesn't say SEC costs and X, Y, and Z; it says, SEC costs.

Is that correct?

Ms. UNGER. You will find those fees—the statutes that I refer to are part of the Federal securities laws and specifically designed to recover the cost to the Government of securities regulation.

Mr. OSE. I am kind of curious how it is we got ourselves in a position where, in effect, we have passed a tax law here, and we are collecting taxes and using it for some purpose that is not authorized under the—are we violating the law here?

Mr. BAKER. Oh, certainly not.

Ms. UNGER. Can you say not? Going back to 1983, people here have noticed that we have been bringing in excess fee collections and have been looking at that as a way to fund other programs.

We are a part of the Commerce-State-Justice budget because we are a law enforcement agency, and so our allocation comes out of that pot of money. So it is sometimes difficult for the appropriators to not take some of the money, but it has gotten so disproportionate.

Mr. OSE. All right. Let me go on to my next question. To the extent that we have imposed fees or taxes in excess of what is authorized in the underlying legislation, that is on the order of 3 or 4, 5 times, as I understand it, what the underlying legislation says we need to cover. In other words, we are collecting $2-, $2¼ billion. The underlying costs is $370-$380 million. Have I got the basic magnitudes correct?

Ms. UNGER. Well the statutory level for Section 6(b) fees was 1/50th of 1 percent, and it has been raised as high as 1/29th of 1 percent in certain years. Right now it is about at 1/40th of 1 percent.

Mr. OSE. I am talking about the aggregate number of dollars being collected, though.

Ms. UNGER. Right. Actually I do—the numbers as to what we collected last year from each of those fees. Is that what you are talking about?

Mr. OSE. In total?

Ms. UNGER. We got $2.27 billion in fees; $78 million came from the merger tender offer fees. $1 billion, $103 million came from Section 6(b) fees, and $1 billion, $90 million came from Section 31 transactions.

Mr. OSE. And this compares with a projected SEC cost of $377——

Ms. UNGER. About $378 million.

Mr. OSE. $378 million. I just can't——

Ms. UNGER. Well, for this fiscal year it is $423-$422 and change.

Mr. OSE. It is $377-$423.

Ms. UNGER. Still a small number when you compare it to $2.27 billion.

Mr. OSE. I just keep coming back to this question. We have very specific authorization for a fee schedule tied to a very specific purpose, and yet we are collecting far in excess of that and using it for who knows what, and I don't quite understand why that is occurring.

Thank you, Mr. Chairman.

Chairman BAKER. You have a difficult life ahead of you looking for logic in Congress, Mr. Ose. I would want to extend my appreciation to you for your courtesies and your patience in answering our questions today. We look forward to working with you in the coming years ahead. Your testimony, as all other witnesses', will be made part of the official record and I would like to advise all witnesses that we will keep the subcommittee record open for approximately 30 days for Members who may wish to have some follow-up questions in writing and to include your responses into that record.

I would suggest to our third panel that we will have another vote somewhere around the noon hour. If you gentlemen would like to come forward and try to get your statements in within a roughly 5-minute period each, we could hear all of your testimony before we go into that vote, perhaps ask questions and try not to detain you further.

So, with your cooperation, we will initiate this last panel. While you are getting situated, I will proceed with the appropriate introductions. We have three gentlemen who will be heard in this panel. The first is Mr. Scott Evans who is the Executive Vice President of the Teachers Insurance and Annuities Association, which should not be lost on Members; this is an extremely important organization, but in size has about $165 billion in equity assets for retirement purposes.

Our second to be heard from today is Mr. Christopher Quick who is the CEO of Fleet Meehan Specialist, who—I have a piece of paper on right here—is the Nation's largest financial services firm, specialist firm with assets in excess of $181 billion.

And our third witness is Mr. James Toes who has been involved in the NASDAQ market activities for some 15 years and currently is a trading manager at Merrill Lynch, which needs no further explanation.

With that I would like to call on Mr. Evans to start us off.

STATEMENT OF SCOTT C. EVANS, EXECUTIVE VICE PRESIDENT, TIAA-CREF INVESTMENT MANAGEMENT

Mr. EVANS. Thank you, Chairman Baker, Ranking Member Kanjorski and Members of the subcommittee. My name is Scott Evans, and I am the Executive Vice President of Equity Investments at TIAA-CREF. I appreciate the opportunity to appear before you today to express our support for the proposed improvements to the current system of SEC fee collections. We would also like to express our support for an improvement in compensation levels for the SEC staff.

TIAA-CREF, along with other financial organizations and associations, has written to Members of the Senate to urge their sup-

port of Senate bill S. 143 that would remedy the current fee inequity. I want to commend the full committee for making the reduction of fees charged to securities market participants a priority for the 107th Congress, and the subcommittee for acting on that priority by holding this hearing. In addition, we encourage the House to introduce a companion bill as soon as possible.

With $285 billion in assets under management, TIAA-CREF is a leading financial services organization, a major institutional investor and one of the world's largest retirement systems, with 2.3 million participants at more than 11,000 educational institutions. We offer our participants a broad array of retirement investment options through the college retirement equities fund, or CREF, which is regulated by the SEC as a 40 Act company, and also the TIAA Real Estate, Account, an SEC registrant. The TIAA-CREF group of companies also offers mutual funds and non-qualified personal annuities to the general public. In addition, we manage tuition saving programs in 12 States, and in total we hold equity shares of more than 3,000 U.S. companies on behalf of our clients.

Last year, TIAA-CREF paid over $1.1 million in SEC fees assessed on securities transactions. In addition, we have paid more than $3.6 million to register securities issued by the TIAA-CREF group of companies over the past 5 years. These fees represent a tax to our clients, reducing the funds available to them to meet their savings and investment goals. Moreover, the amount assessed is disproportionate to the SEC's spending needs. In fiscal 2001 the SEC is expected to collect $2.47 billion in fees from participants in the securities markets, more than 5 times the $423 million that is appropriated for the SEC's operating needs.

While we support the notion that market participants should fund SEC operations through user fees, the current fee levels are no longer appropriate. Congress enacted the existing structure several years ago when market activity was at much lower levels. The situation is very different today, with Americans participating much more actively in the securities markets. Given this greater level of activity, it is time to modify the SEC's fee structure in order to collect revenues that are more appropriate to the Agency's operating costs. We therefore endorse the effort underway in Congress to reduce the various user fees, including registration, transaction and merger and tender fees, to a level that is more in line with the SEC's funding needs.

Additionally, we support acting Chair of the Securities and Exchange Commission Unger's continued commitment to correcting the existing staffing crisis at the SEC. The legislation before Congress would help achieve this goal by improving the SEC's ability to match the pay and benefits offered by the Federal banking agencies. It is important that the SEC be able to attract and retain qualified individuals in order to carry out the SEC's important oversight responsibility for the securities markets and to provide for investor protection and education. We know from our experience working with the SEC staff that the continuity of personnel is critically important to the efficient functioning of this Agency. The legislation pending before Congress would help accomplish those goals.

In closing, I would like to thank the subcommittee again for its commitment to reducing excessive fees at the SEC and to providing the funding necessary to enable the SEC to compete for qualified staff. It has been a privilege to speak with you today and I would be happy later to take questions.

[The prepared statement of Scott C. Evans can be found on page 83 in the appendix.]

Chairman BAKER. An excellent free market example of being on schedule. Thank you.

Mr. Quick.

STATEMENT OF CHRISTOPHER C. QUICK, CHIEF EXECUTIVE OFFICER, FLEET MEEHAN SPECIALIST, INC., ON BEHALF OF THE SPECIALIST ASSOCIATION OF THE NEW YORK STOCK EXCHANGE

Mr. QUICK. Thank you Chairman Baker, Ranking Member Kanjorski. I am Christopher Quick, CEO of Fleet Meehan Specialist, and a member 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 on reducing excessive fees collected by the Securities and Exchange Commission. My testimony will focus on transaction fees commonly known as Section 31 fees imposed by Section 31 of the Securities Act of 1934.

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 exchange. The Exchange's auction trading marketplace is the mechanism through which 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 proper operation of the market, acting as a 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 see significantly increase this year. A total of $370 million was paid for Section 31 fees in 2000 on NYSE transactions by all New York Stock Exchange member firms and their customers. Over 86 percent of the transaction fees paid on the New York Stock Exchange floor are passed directly on to investors.

Please let there be no misunderstanding. We support continued full funding of 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 a worldwide reputation for fairness and integrity. What we object to is the misuse of the financing mechanism designed to offset the cost of operating the SEC through the overcollection of 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 1/300th of 1 percent of the total dollar amount of securities sold, the tax is creating a drag of over $1 billion per year on 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 constantly grown over the years. In fiscal 1999, the SEC's fee collections from Section 6(b) and Section 31 fees mushroomed to $1.75 billion. That is, the SEC's collections amounted to more than 5 times its $337 million budget in 1999. In fiscal 2000, the Agency collected more than $2.27 billion, more than 6 times what the Agency needed to fund its operation. Also, we expect the Exchange—expect trading volume on the Exchange to continue to increase, which in turn will have the effect of increasing the Section 31 tax.

In 1999, average daily trading volume on the Exchange was 809 million. In 2000 it was over 1 billion, and with decimalization now fully implemented, volumes surely will increase by a significant amount as it did when the standard trading increment was reduced to 1/16th from 1/8th.

We would also be wise to remember that we 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 the 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 the market prices stagnate or decline as they have in the last 12 months.

In conclusion, general tax revenue is the objective of other laws but not the securities laws. Congressional action to restore the unintended tax represented by the Section 31 fees to its original purpose, to fund the operations of the SEC and not for any other type of Federal expenditure, is long overdue. Reducing excessive SEC fees would save millions of individuals money as they try to invest their hard-earned money for the future. We urge the subcommittee to move forward with legislation to reduce excessive SEC fees. We are committed to working with you and the subcommittee regarding this important matter.

The Association is thankful for the opportunity to express its views on these fees. Thank you, Mr. Chairman, Ranking Member Kanjorski. I would be pleased to respond to any other questions.

[The prepared statement of Christopher C. Quick can be found on page 87 in the appendix.]

Chairman BAKER. Thank you Mr. Quick.

Mr. Toes, welcome.

STATEMENT OF JAMES A. TOES, DIRECTOR, MERRILL LYNCH & COMPANY, ON BEHALF OF THE SECURITY TRADERS ASSOCIATION

Mr. TOES. Thank you very much. Mr. Chairman, Members of the subcommittee. I am pleased today to be testifying before you on the issue of securities fees. I am James Toes. I am a Director at Merrill

Lynch Equity Trading, and I am also President of the Security Traders Association of New York, which is an affiliate of the Securities Traders Association, on whose behalf I am testifying today.

In 1996 Congress enacted the National Securities Market Improvement Act, reforming regulation of the securities and mutual funds market. NSMIA also restructured fees imposed by the various securities laws, including extension to NASDAQ trades of the transaction fees imposed by Section 31 of the Securities Exchange Act of 1934. In restructuring the fees, Congress intended to ensure a stable source of funding for the SEC while also ensuring that the fees did not grow so large that they became a de facto tax on savings and investment rather than a user fee, which is the very situation we find ourselves in today.

The new structure established by NSMIA was the result of a complex compromise worked out between the House and Senate authorizers and appropriators, the House Ways and Means committee, the Office of Management and Budget, and the SEC following years of congressional debate over the new SEC funding mechanism. Unfortunately, however, NSMIA has not controlled the growth of fees as originally intended. Actual fee collections significantly outpaced NSMIA's projections. We believe that the reason for this is that the Congressional Budget Office and the OMB used conservative estimates of the stock market growth which were relied on by Congress in drafting 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, over 6 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 $3.7 billion in fiscal year 2005. In other words, total SEC fees are projected to raise $15.2 billion over the next 5 years, while the SEC budget will require only a fraction of that amount over the same period. Without a change in law, these fees will generate $16 billion in excess of what Congress intended in NSMIA, over just a 7-year period from fiscal year 2001 to fiscal year 2007.

Another defect in the NSMIA fee structure is that it fails to accommodate for changes in the securities market. For example, if and when the NASDAQ's conversion to an exchange is completed, the current fee structure will result in a redirection to the general fund of a significant portion of the fees that are currently made available to fund the SEC. Thus we face the possibility of a fee structure generating billions of dollars in unanticipated fees while at the same time creating a funding crisis at the SEC.

Clearly, this is not the scenario Congress intended when it redesigned the SEC funding structure in 1996 to reduce the amount of fee surplus.

Ultimately, the investing public shoulders the burden of these fees. 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 has increased from around 32 percent in 1989 to over 50 percent in 2000. It is important to note that Americans of all incomes are increasing their savings through equity ownership. According to the most recent statistics, 29 percent of households with

incomes between $15,000 and $25,000 own stock. Therefore, this tax is paid by the smallest as well as the largest market participants.

Section 31 fees also burden those who participate in pension plans, including public pension plans. For example, over a 5-year period, many States' public pension plans will pay millions of dollars in Section 31 fees. Some examples include California, nearly, $18 million; New York, $13 million; Ohio, approximately $4.6 million; Pennsylvania, $6.5 million; and Texas, over $7 million. At a time when the Government is encouraging savings, it is inconsistent for it to levy this tax on investment.

To address the growing burden of the fees, the STA supports legislation that reduces fee rates so that they fulfill their intended purpose of funding the SEC and are not acting as a tax on investment; puts in place an automatic mechanism that will limit collections if the original fee rate cut does not reduce the actual collections as intended; and creates a safeguard that fully protects the amount of collections currently projected to be made available to the appropriators including the funding necessary for the SEC.

STA has testified in the Senate in support of Section 143 which includes the provisions outlined above. We urge the House to develop legislation with these characteristics. The Senate bill also allows for growth in the SEC budget, including pay parity for SEC employees which, by the way, we also support.

Including the safeguards to prevent overcollections and undercollections will ensure that no matter how high or how low today's fee projections are, the fees will still collect the actual amounts intended by Congress. We should not enact legislation only to find ourselves back here in 5 years because projections missed their mark or that the market structure changes created unintended shortfalls or windfalls in fee collections.

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

[The prepared statement of James A. Toes can be found on page 93 in the appendix.]

Chairman BAKER. Thank you, Mr. Toes.

Gentlemen, to facilitate the Members who are here, I am going to suspend my questions, and I will follow up in writing for you at a later time but would recognize Mr. Kanjorski. I fully expect we will have a vote here in the next few minutes and I would like to get Members' participation before that vote.

Mr. Kanjorski.

Mr. KANJORSKI. Yes. Can any of you gentlemen tell me whether or not there is a fee schedule or a tax on security transactions in Germany or Great Britain?

Mr. QUICK. I don't have the answer for that.

Mr. KANJORSKI. You are making a compelling argument. None of us are unsympathetic to fee schedules that are set for special purposes, and of course your fee schedule, unbeknownst to the Congress' wisdom in 1996, now has far exceeded its anticipated needs. In effect, it serves as a source of revenue for the Government to be used for other purposes. Meaning that if we reduce the fee

schedule we will get a shortfall of somewhere between $1 billion and $1½ billion a year.

Assuming that the budget of the United States is absolutely balanced, revenues to expenditures, and we are taking into consideration the additional income from the overpayment of fees that you are making, where would you suggest that we get the additional $1 billion or $1½ billion revenue shortfall that would be in existence in a balanced budget situation?

Mr. TOES. I would suggest just cutting spending.

Mr. KANJORSKI. Well, we are making the assumption this is a balanced budget in this new Administration that we are having. We are cutting programs to the bone. When the President sends up a budget, are we to presume in other words, your answer is if we cut revenues then we should just cut expenditures, regardless of where that would be? If we had to cut Social Security, if we had to cut Medicare, if we had to cut the environment expenses, you would just do that?

Mr. TOES. It is my understanding that we are not asking for our money back. We are just asking that, going forward, that we just pay a different rate.

Mr. KANJORSKI. Not the money back. Next year, if we grant what you are requesting—and I am not suggesting we should not do it—we are going to have a shortfall of $1 billion or $1½ billion in revenues. My question to you is where should we make that up? Should the Congress consider a tax on security transactions instead of the fee schedule in order to make up the $1½ billion? This solution would be honest. We would be saying we are going to get that revenue out of securities transactions instead of out of fee-generated costs.

Mr. TOES. You are going to have to excuse my naiveness with how Congress and Government works, but if you did give us what we needed, and therefore you would know that the money would not be there, then you wouldn't spend it.

Mr. KANJORSKI. Even if we had the need for it?

Mr. TOES. Well, you have got me in a corner now.

Mr. KANJORSKI. That is always our problem here. Yes.

Mr. EVANS. Congressman, to me they are two separate questions. The first question is we have a user fee that is being levied toward securities markets participants to fund the SEC so that they can regulate us. That user fee ought to be in close proximity to the costs of running the SEC. The second is a funding question that refers to general revenue creation, and there are many checks and balances to it. I believe it is outside of the scope of my testimony here today, but ultimately the revenue would have to be made up with increased tax revenue or decreased spending. That is the appropriate place for it to be considered.

Mr. KANJORSKI. And that is the correct answer. Either increase taxes on other people, other than these transactions, or decrease the expenditures perhaps on necessity.

But let me ask you a question. Are you aware of parking meters? Do you ever use parking meters?

Mr. EVANS. Yes, sir, we have those in New York.

Mr. KANJORSKI. Well, a parking fee is justified under municipal law for traffic control. If you have recently used a parking meter,

you realize that whether you put in a quarter an hour or a dollar an hour, the rental fee for that space far exceeds the costs to the Government of that regulation of parking. In most municipalities in the country it becomes a huge income revenue source. Would it not be proper for every American to make the argument that the parking fee per hour should be reduced commensurate with the money necessary to fund that proportion of the governmental function, and any additional funds should not be allowed to be used for any other purposes of Government? Is that a logical argument?

Mr. EVANS. If the legislation that enacted the ability to charge that parking fee were directly related to the costs, then I think you could make a similar argument.

Mr. KANJORSKI. You do not have the right to raise revenues in the parking fees. It is only for purposes of police powers, for regulation of traffic control.

Mr. QUICK. It sounds like we could privatize parking and do an IPO or something. It sounds like a good proposition to me.

Mr. KANJORSKI. You experts have an answer in the private market for everything. I appreciate it. I did have a hard question here. I do not want to appear that I am unsympathetic to using fees as a portion to cover up what is actually a tax, and I recognize by collecting this fee in effect we are taxing the securities industry, and subsequently their investors, but I am pressed with the problem of how we make up for the shortfall in revenue.

Mr. QUICK. Well, I would like to go back to 1996 when the fees were changed and go back to what we did before then when we appropriated the money for the sole purpose of funding the Securities and Exchange Commission by the Congressional Budget Office. Now, all of a sudden, we find ourselves in a position, because of conditions not responsible to anybody in this room, that the market and transactions and the dollar volume have exploded, that we have created these excess fees, but what we have done is we have turned it into a tax which goes into the general revenue of the budget, for which it was never intended.

Mr. KANJORSKI. I agree. But let us play a worst case scenario game. Rather than go into a soft landing, we in fact go into a depression, and the acceleration of the market from 1996 to 2000 reverses itself but does not reverse itself to 1995, it goes back to 1950 in sales. So that the fee, even under present schedule, is out there, would not be enough to generate the revenue needed.

Mr. QUICK. I think the bill itself, as Senator Gramm testified earlier, has a 40 percent cushion in it. So I do think we are not in danger of violating that 40 percent cushion.

Mr. KANJORSKI. So, we can be assured that the market will not fall 40 percent?

Chairman BAKER. Mr. Kanjorski, what we do is raise those parking fees and have an offset.

Mr. Ose.

Mr. OSE. Thank you, Mr. Chairman. I want to follow up with Mr. Evans on one particular issue that I am a little bit confused on. Within the portfolios that TIAA-CREF has, you have a zillion different individual people for whom you act as a fiduciary on their investment programs. Let's say I am one of those, and in the course of a day I want to say all right, I am going to call Scott Evans and

I am going to change the mix. And over the course of that day, of your 373,000—whatever it is—individual investors, you have 50,000 of them do a similar activity.

At the end of the day, as I understand current industry practices, you guys reconfigure your portfolios within the overall portfolio itself, shifting stock back and forth to balance buys and sells, and to the extent you are short or long, you will go into the market and either buy or sell to make up the accurate end-of-the-day reconfiguration; is that correct?

Mr. EVANS. Roughly, Congressman.

Mr. OSE. Roughly is about as good as it gets.

Mr. EVANS. We have 2.3 million participants in our pension accounts and they can on any given day change the allocation of their pension savings that they have invested with us. They would put those orders in. We would then take those orders, and when the net sales—that is when the sales exceeded the purchases—we would sell securities. Then and only then would we be assessed the Section 31 tax—I am sorry, Section 31 user fee of approximately $33 per million on that transaction. When there is a purchase there is no user fee, as I understand it.

Mr. OSE. The only fees you pay are on the long or short portion at the end of the day? You don't pay for the intraportfolio movement?

Mr. EVANS. That is not a transaction in the securities markets. When a transaction occurs and it is a sale transaction, we are assessed a fee under Section 31.

Mr. OSE. Mr. Chairman, I think we need to clarify this, because my understanding of the earlier testimony was that the intraportfolio transactions were subjected to the assessment, the fee, the tax, whatever you want to call it. So I appreciate, I appreciate you clarifying that. I mean, you are the practitioner. You ought to know.

Mr. EVANS. We may be referring to different types of transactions, but as I understand it, Congressman, when TIAA-CREF goes to the securities markets and transacts with a third party, that is when the user fee is assessed.

Mr. OSE. Inside the portfolio itself, separate from the market, when you balance everything out prior to going into the market, those movements are not subject to the tax or the assessment. In effect, that is almost a trusteeship, if you will?

Mr. EVANS. I don't believe so, Congressman, but the question is on a level of detail that I may be mistaken. In looking at how the $1.1 million of fees is structured, I believe my answer is correct.

Mr. OSE. All right. Moving on to my second question. I have actually taken the time to go back to the 1934 legislation and the 1996 legislation, and the reason I did was I wanted to find out if embedded in the legislation itself, pursuant to my earlier questions, there was an actual description of what the purpose of these transaction fees or these registration fees is. And I just want to read for the record, if I may, that as regards registration fees—this is actual legislation, statutory authority: "A commission shall in accordance with this subsection collect registration fees that are designed to recover the costs to the Government of the registration process."

And then in the transaction fees it says virtually the same thing, substituting transaction for registration. It does not say collect fees for ad infinitum programs outside of the jurisdiction of the SEC.

So we really do have a true problem here in that we are assessing America's investing public, the people who provide our industry and businesses with capital, a tax that is clearly not authorized.

And with that, Mr. Chairman, I yield back.

Chairman BAKER. Thank you, Mr. Ose.

Mr. Bentsen.

Mr. BENTSEN. Thank you, Mr. Chairman. I have one question and one comment. I am in support of this, but I also sit on the Budget Committee, and even though we now have all the money we are ever going to need and surpluses as far as the eye can see, even though I think it was just 6 short years ago it was deficits as far as the eye can see, and even though we know these projections will never be wrong and there is no need to discount future revenue streams, at least I know you all do, but we don't need to do that—that, you know, there shouldn't be a problem, but we do kind of have to think where we might come up with $14 billion, because this isn't in the President's budget, and you start adding $14 billion here and $12 billion there and $10 billion there, and pretty soon you get right through the contingency. So it is a little bit more difficult than you might think, and it is doesn't matter which party you are in either.

But the question is this: The proposal put forth in the Senate would—and this is something we are trying to put together, a proposal here would, if I understand it, allow sort of a 6-month look back or look forward, with the ability to make adjustments in the fee structure to ensure that there were sufficient funds for the operation of the Commission.

From your standpoint, does that give you some concerns that as market makers or as dealers or as investors that you would have to make adjustments, or is it easy enough, particularly under the Section 31 fees, that you either have one fee or another fee and you just make an adjustment, but is it something that the back office can handle or is it an administrative nightmare?

Mr. EVANS. From our perspective, the variability of the Section 31 fees, in order to continually reassess their capability of covering SEC costs, is a practical solution, and whether it is $33 per million or $14 per million or whatever the fee, it is not a large issue for us administratively. Our principal interest is that that fee level is closely aligned with the SEC's ability to fully fund themselves, including their ability to adequately compensate staff relative to other Federal banking agencies.

Mr. BENTSEN. I guess my question is just specifically if we tell you it is one thing on January 1 and we come back on June 1 and tell you it is something else, is that problematic or not—or July 1—is that problematic or not?

Mr. EVANS. It could present problems if there are retroactive adjustments. If the fee going forward were adjusted to compensate, I think that might be a more practical——

Mr. BENTSEN. So would it be better to have just a set amount per year and if you are off a little bit you just make it up? Would that be your preference as opposed to having——

Mr. EVANS. The more simple the fee, Congressman, the easier it is to administrate.

Mr. BENTSEN. Do any of the others have comments on that?

Mr. QUICK. It is a 30-day adjustment in the Senate bill. It wouldn't present a problem from a specialist standpoint at all.

Mr. BENTSEN. It would not?

Mr. QUICK. It would not.

Mr. BENTSEN. And what about for Merrill or a dealer?

Mr. TOES. On Merrill Lynch it wouldn't be a problem. It is hard for me to speak for the other broker-dealers, Smith Barney, and—but our understanding is that a 30-day would be adequate time.

Mr. BENTSEN. So that the back office would be able to work it out and adjust it accordingly?

Mr. TOES. Yes.

Mr. BENTSEN. Thank you, Mr. Chairman.

Chairman BAKER. Thank you, Mr. Bentsen.

Gentlemen, the record will remain open for 30 days for Members to submit additional questions to you in writing and to include your responses as part of our official record. I want to thank you for your participation and make it clear that there is general agreement among many Members that this action is indeed appropriate. There is continuing discussion about the appropriateness of how the formula is to be implemented, the pay parity issue raised by the SEC. There may well be other issues that will circle this, but just the assurance from the committee to you and other market participants that we believe that the assessment is inappropriate and that action should be taken by this section of Congress sooner rather than later, and your appearance here today has helped us toward that final goal.

Thank you very much. Our hearing is adjourned.

[Whereupon, at 12:17 p.m., the hearing was adjourned.]

A P P E N D I X

March 7, 2001

The News from U.S. Rep. Richard H. Baker
Sixth District, Louisiana
FOR IMMEDIATE RELEASE: March 7, 2001
CONTACT: Michael DiResto, 225-929-7711

Opening Statement
The Honorable Richard H. Baker
Chairman, House Financial Services Subcommittee on
Capital Markets, Insurance and Government Sponsored Enterprises
March 7, 2001
Capital Markets Subcommittee Hearing
"Saving Investors Money: Reducing Excessive
Securities and Exchange Commission Fees"

Today we commence an examination in the House of the problem of surplus fees on securities transactions, registration, and mergers collected by and for the purpose of funding the Securities and Exchange Commission (SEC). At a time when access to investment capital is at a premium, we will hear that since 1990 more than $9 billion has essentially been lifted from market consumers because of excess assessment of SEC fees. Clearly the stakes are high for Congress to take responsible but timely action to remedy this problem.

I want to commend committee Chairman Mike Oxley for his commitment on this issue. I know that his previous efforts toward SEC fee reduction will lay the groundwork for our examinations in this Congress. I know that this is indeed a top priority for him. Likewise I commend Financial Services Committee members Vito Fossella for his hard work and Sue Kelly for her leadership on this issue.

We are fortunate today to hear from two others whose hard work and expertise on this issue are welcome contributions to our House examination. I thank Senators Gramm and Schumer for taking time from their busy schedules to testify at a House subcommittee hearing. This unprecedented joint appearance lends added significance to the seriousness of the issue. But more importantly, it underscores the possibility of a bipartisan, bicameral solution to the problem.

Last year, SEC Chairman Arthur Levitt testified before Congress that 82 percent of SEC fees collected on Nasdaq trades, and 87 percent collected on New York Stock Exchange trades were passed directly to investors. That means that of the estimated $2 billion in surplus fees the SEC will collect this year, roughly $1.7 billion rightly belongs to the people. I believe they deserve a refund.

I am pleased that acting Chairman Laura Unger is here today to provide the SEC's current views. As markets trade almost as much in information as assets, we must be equally attentive in our examination to ensure that the SEC has the ability to perform vital consumer protection against fraudulent and insufficient disclosure of sensitive information. If reliable and timely information is the consumer's best protection, then we would do well to consider the views of the agency that helps monitor the fairness of its transmittal.

And I welcome the comments today of several securities industry representatives, who will offer us firsthand testimonials about the impact of excessive fees on the consumers they deal with daily.

For the purposes of this subcommittee let me say from the outset that I am interested today in discovering how Congress might bring about the deepest cuts across the broadest range of SEC fees while at the same time fully and adequately funding operations of the SEC.

Whether it's through pensions or personal IRAs, more and more working families are planning for the future by participating in financial markets. We might call them the growing legions of "secure-future-consumers." Government should be welcoming this trend, making it easier for more American "consumers" to invest responsibly and safely for their futures, not targeting them as a revenue source or limiting the full potential of their long-term hopes and dreams.

-30-

HOUSE OF REPRESENTATIVES
WASHINGTON, DC 20515
(202) 225-2601

218-14 NORTHERN BOULEVARD
BAYSIDE, NY 11361
(718) 423-2154

229 MAIN STREET
HUNTINGTON, NY 11743
(631) 423-2154
http://www.house.gov/ackerman

Gary L. Ackerman
Congress of the United States
5th District, New York

COMMITTEE ON
INTERNATIONAL RELATIONS
RANKING DEMOCRAT, SUBCOMMITTEE ON THE WESTERN HEMISPHERE
SUBCOMMITTEE ON ASIA AND THE PACIFIC

COMMITTEE ON BANKING AND FINANCIAL SERVICES
SUBCOMMITTEE ON CAPITAL MARKETS, SECURITIES AND GOVERNMENT SPONSORED ENTERPRISES
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

CONGRESSIONAL CAUCUS ON INDIA AND INDIAN-AMERICANS
CHAIRMAN

STATEMENT BY MR. ACKERMAN

HEARING ON REDUCING SEC FEES

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTITIES

MARCH 7, 2001

Mr. Chairman, I am so pleased that you have convened this hearing today on this important issue. I am honored to be a member of this new subcommittee which now has jurisdiction over securities, exchanges, and insurance. I look forward to an exciting session and to working with my colleagues on these issues. Although I cannot be with you today, I want to express my strong support for the issue of reducing securities transaction fees and for legislation that will address this issue, along with the issue of pay parity for SEC employees.

Our securities laws impose fees on securities transactions, such as the sale of stock, the registration of new securities, and merger offers. These fees were originally intended to cover the federal government's cost of regulating the securities industry. However, over the last 20 years, we have seen a dramatic increase in fees collected. This amount now greatly exceeds the cost to run the SEC. The Congressional Budget Office estimates that in fiscal year 2001, the Government will collect $2.47 billion in fees, while the SEC's budget remains at $423 million.

Congress has already demonstrated its support for lowering securities fees. In 1996, we passed the National Securities Markets Improvements Act (NSMIA). This legislation will reduce certain fees over time. However, this reduction will not even begin until 2007, and due to the exponential growth of securities transactions, the reduction will be negligible. Therefore, we need to act now to further reduce these fees.

Section 31 fees are paid by individual investors. A reduction in these fees will be a benefit not only to Wall Street, but to so many families throughout the country, who today own stock more than ever. SEC Chairman Levitt testified before the Senate Banking Committee last year that over 52% of American households own stocks either directly or through Mutual Funds. Moreover, Chairman Levitt stated that investors pay 87% of Section 31 fees levied on New York Stock Exchange transactions and 82% of Nasdaq transaction fees.

In addition to individuals, state and local pension plans will benefit from a reduction in these

fees. For example, in my state of New York, it is estimated that public pension plans payments in Section 31 fees will be approximately $13.5 million over five years.

An important component of any legislation addressing reducing securities transaction fees is pay parity for SEC employees. In response to the Savings and Loan crisis of the late 1980s, Congress recognized the need to for highly qualified individuals to serve as banking regulators. Unfortunately, the SEC regulators were not included at that time because of jurisdictional issues at that time. However, the need for highly qualified individuals to serve as regulators is no less important today. It is simply unacceptable for the SEC regulators to not be paid on par with their counterparts in other financial agencies. These regulators are stationed not just in Washington, D.C. They live throughout the nation and work in the SEC field offices. Some of them are my constituents, who work in the largest SEC field office in New York. We must be able to attract and retain highly qualified regulators to ensure the integrity and strength of our markets. We are not seeking to compete with the private sector. As we all know, government service requires a special level of devotion to our nation which is often not compensated for, as work in the private sector would be. However, with the federal government, a certain standard should exist.

I find it ironic that the Republicans on this Committee may be resisting including pay parity in this legislation. After all, it was the Republican leadership in this Congress that has requested additional funding for their committees so that they can retain qualified staff and not loose them in a brain drain to the Administration. Why then will they not allow the SEC to pay their employees a wage which will enable them to attract and retain highly qualified individuals?

That being said, I fully support legislation which will reduce these securities transaction fees and provide for pay parity for SEC employees. I look forward to working with my colleagues on both sides of this isle on this issue. Thank you, Mr. Chairman.

Congressman Joseph Crowley
Opening Remarks - Capitol Markets Subcommittee
Excess SEC fees
March 7, 2001

I want to thank Chairman Baker and Ranking Member Kanjorski for conducting this important hearing today

The Congress established several fees on various transactions in the securities markets with the intended purpose of using the fees collected to fund the operations of the Securities and Exchange Commission (SEC). Examples of these fees are the Section 31 fees, Section 6b fees and fees on Merger and Tenders

I support the concept of these user fees and believe that the securities industry should provide the resources for a strong and steady Federal regulator. This question is not in doubt today.

But the concept of a user fee and a tax are two different things. The excessive rate of collections from these user fees, particularly the Section 31 fees, has created the unintended consequence of now serving as a tax on investment and wealth creation

As the facts bear out, over the past few years, these securities fees have turned from serving as a user fee, destined to fund the SEC, into a multi-billion dollar revenue source for the government funding outside programs with no relation to the SEC or securities

While the markets have prospered, the amounts collected by these fees have soared to nearly $2 billion a year - 5 times more then needed to fund the SEC. These lopsided surpluses in collections of securities fees are expected to continue as long as the eye can see - regardless of any downward swing in market activity

In 1996, Congress enacted reductions in the fee rates to address this issue but these reductions were to be implemented over time, with full implementation arriving in Fiscal Year 2007

However as trading volumes continue to increase, particularly over the last 5 years, these user fees continue to pull in billions of dollars more then is needed to operate the SEC

As both a member of this Committee and a resident of New York City - the financial capitol of the world - excessive fees at the SEC are a real concern to me and my constituents

This Congress - led by this Committee - needs to reduce the onerous fees on securities transactions. This would not be done as a gift for Wall Street, but as a benefit for Main Street

While these fees appear small, they can have a substantial effect on Americans who purchase and sell stock, or those Americans who own mutual funds or 401(k)'s. In fact,

these fees, with their excessive collections, have become an onerous form of taxation on investment, hindering investment and savings opportunities for Americans

Congress must reduce these fees this year and I salute Chairman Oxley's commitment to this issue

One of the reasons for America's massive economic boom of the last decade, and one of the reasons for the real increases in income for average American households in the last decade has been the entrance of average Americans into the stock market

Whether it is through direct owning of stocks or investments in a mutual fund, or saving for a retirement through a 401(k) plan, almost 50% of Americans now have a direct interest in the stock market, and they should not be burdened with this additional taxation

While the savings rate for Americans is at the lowest point in our history, more Americans are investing funds -whether it be for a child's education, to buy a home, to save for retirement or just to create a nest egg.

Every time these Americans sell stocks, or their mutual funds sell stocks which as we all know happens everyday, these people are being charged a fee

1/300% of 1% may seem like such a pittance that it shouldn't matter, but over the lifetime of an investing person, such as a person with a 401(k) plan through work, this "pittance" could cost them over $10,000 which could have been reinvested for themselves, but is rather sent to the government

And these funds sent to the government are not even used for their intended purpose. In 2000, these fees collected almost six times more money then is needed for the operations of the SEC

A hundredth of a percent here, a hundredth of percent there and soon you REALLY are talking about real money!

Second, Congress needs to lower these securities fees as a way to save American savers and investors money

The former Chairman of the SEC, Arthur Levitt, stated that these fees are almost always passed onto the consumer. In fact, he continued that investors pay 87% of Section 31 fees levied on the NYSE transactions and 82% of fees levied on NASDAQ transactions

Again, these costs are being passed onto the consumer

Third, these excessive SEC fees represent a backdoor tax on investment and capital formation

The SEC is adequately funded with these user fees-and then some. And then some more. In 2006, it is expected that Section 31, Section 6b and Tender Offers fees will bring in more

than $3.5 billion in revenue to the government - many times more then needed to fund the SEC

While it may be nice that extra funds are being sent to the general fund - that is not the intended purpose of theses user fees and Congress must escape the habit of swallowing funds dedicated for a particular program and using them wherever

In fact, even the SEC knows that reducing user fees will not harm its operations.

The SEC has come out in support of this fee reduction. Last year, one of the biggest opponents of fee reduction was the Office of Management and Budget, worried that lowering these fees, would lower general treasury revenues

But that is not the reason we have these Section 31 fees and the such. If Congress wants to tax securities then let's have an honest discussion about that issue. Most of us would I oppose that, I most certainly would. Therefore, we rely on sneaky taxation

But let us not claim that these user fees are needed for other purposes - they were not designed for that reason, and they should not be used for that reason

Therefore I argue strongly that this Congress produce bi-partisan legislation to reduce the SEC fees charged in the securities field

This legislation should be based on the solid legislation introduced by the Chairman of the Senate Banking Committee, Phil Gramm, and my colleague from New York State Charles Schumer

Congress must provide an important offset mandating that the SEC will be provided for, as well as a cap and floor to ensure the Government does not collect too much or too little money. Too much collection robs the investing public; too little would weaken the SEC

We need to ensure pay parity for the hard working and dedicated employees of the SEC. This measure is supported by the industry, labor and investors and Congress must work to balance an pay inequities hurting the SEC

And we must guarantee fairness to our investing consumers -they are saving for themselves and their families, not to pad the government roles

Therefore, I thank Chairman Baker and Ranking Member Kanjorski for holding this hearing today and I look forward to an informational discussion

Thank you

Opening Statement of Rep. Stephanie Tubbs Jones
Joint Subcommittee Hearing on "What can Congress do to help financial regulators coordinate efforts to fight fraud?"
March 6, 2001

Good Morning, Chairpersons Bachus and Kelley, Ranking Members Waters and Gutierrez and Members of this Joint Subcommittee. I ask unanimous consent that my full statement be included in the Record.

I wish to open my remarks by thanking both Chairpersons for having a joint subcommittee hearing. This issue of preventing fraud will take the insight and resources of our full committee in order to adequately address it.

We cannot overlook the importance of dealing with and preventing fraud because of its impact on the financial services industry. The financial services industry is built upon a trust between company and consumer. If that trust is weakened by abuses, negatives consequences will result as the public begins to retreat from using new and innovative products and services from the financial services industry.

With the financial services expansion of Gramm Leach Bliley, financial companies' range of service has expanded as well as their ability to add affiliates. Thus, with this increased scope of services and the potential of abuse, we must deal with the growing concerns of how best to regulate against and offer prevention strategies to counter abuses.

In financial services, white collar criminals activity poses one of the greatest, if not the greatest, threat to the future savings of investors. More than 80% of frauds discovered in business are committed by the employees of the defrauded organization, while 50% of those frauds discovered are committed by senior management.

Moreover, regulators say financial scams using the Internet have been on the rise. These scams have included stock price manipulation, illegal pyramid schemes, insider trading and acting as brokers, advisors without appropriate licensure. These scams cost millions a year to unsuspecting investors.

We must not forget that everyday consumers are being taken advantage of. Today, it is a securities scam over a website. It is also predatory lenders operating in neighborhoods preying on African Americans and senior citizens. Tomorrow, it is our children. Or maybe it is today.

This issue is of great importance to this committee and the financial health of our economic system. While more and more Americans surf the web, while more individuals are investing in stocks and mutual funds online, preventing fraud and understanding how regulators share information about criminal fraud is key.

I hope this hearing today will shed more light on how regulators share information about these abuses, understand how to recognize them and what additional steps can be done to prevent future abuses. In our high technology age, we must match the technology of these culprits in order to ensure a viable and safe system and also maintain the public's trust in that system.

It is very important that our JointSubcommittee understand its role in understanding, legislating and regulating aspects of the financial services industry. We must not take our role too lightly because of the direct impact our actions have on the financial futures of industries and consumers.

I hope your testimony this morning provides this Joint Subcommittee and the nation greater knowledge and understanding of the work of various federal and state regulators. Second, I hope it will help us develop new support for coordinating information sharing across industry lines. Again, thank you to the Subcommittee Chairs and Ranking Members for bringing this hearing of great import to the attention of this Joint Subcommittee.

Statement of Congresswoman Sue Kelly House Committee on Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises hearing on Saving Investor Money: Reducing Excessive SEC Fees

Wednesday, March 7, 2001; 9:30 a.m. 2128 Rayburn

Thank you Chairman Baker.

I want to thank you and Ranking Member Kanjorski for inviting me to join this subcommittee today for this hearing on reducing excessive SEC fees. As we will repeatedly hear today the SEC collects five times the amount they currently need to properly fund their activities. Because of this American investors are being over taxed through these fees to the tune of $2 billion a year. These fees are excessive and unfair.

When people invest in a mutual fund, earn a pension or make other investments, they need to know that they are investing in their own future, not giving the federal government a handout. It's time to give investors and taxpayers a break.

While some may argue that these fees do not add up to much. Unfortunately, it is the small fees that add up to significant figures over a few years. As an example of how fees have a real negative effect for long term investors, an investment of $1,000 in a mutual fund with returns matching the S&P 500 made in 1950 would now be worth $500,000. But when you figure in a conservative two percent compounded fee it would only be worth $230,000. With SEC fees comprising the part of these fees we have the most control over, I believe we must set a clear course as a committee to reduce these fees to a reasonable level.

As Chairman Oxley has charged Chairman Baker, Mr. Fossella and myself with developing a committee bill which we should move forward on. As we make decisions on how this legislation will be constructed, I am pleased we have been joined today by a distinguished panel of witnesses to share their thoughts and suggestions with us. I look forward to working with all of my colleagues on both sides of the aisle on this issue as we move forward.

I yield back the balance of my time.

OPENING STATEMENT OF FRANK MASCARA FOR SEC HEARING

I would like to thank the Chairman for holding this sorely needed hearing.

While we all rejoice in the fabulous gains that the financial markets have enjoyed these past eight years, unfortunately, as this hearing will demonstrate, there are some unintended consequences to this spectacular growth. As the markets have swelled, the fees collected by the SEC to fund the agency have also swelled. The fees collected have been more than enough to fund the agency.

Congress has previously addressed this matter. In 1996, Congress enacted reductions in the fee rates, to take effect over 10 years, with the intention that after 2007 the amount collected should be limited to the amount necessary to fund the SEC. However, as the markets continued on their upward trajectory, the 1996 action has proven to be inadequate. Last session Congress considered, but did not enact, legislation to further reduce the fees collected by the SEC.

The 107th Congress is revisiting the issue. Recently, the Senate passed a bill which would reduce the fees by as much as $8.9 billion over 5 years. While a bill has not yet been introduced in the House, I am hopeful that this hearing will the lay groundwork for similar legislation in this body.

Finally, although it is not the principal focus of this hearing, let me briefly address the issue of pay parity. Legislation enacted in 1989, among other things, freed most federal regulators of financial institutions from the civil service pay schedules in an effort to boost their pay. Regrettably, the SEC was not a beneficiary of this legislation. Moreover, with the passage of Gramm-Leach-Bliley, the issue of pay parity for SEC employees is even more acute. As we demand more of our SEC employees and as markets get more complex, we must simply address this issue.

Again, Mr. Chairman, thank you for calling this hearing and I look forward to hearing the testimony.

ROBERT MENENDEZ
13TH DISTRICT, NEW JERSEY
VICE CHAIR OF THE DEMOCRATIC CAUCUS

COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE
SUBCOMMITTEES:
AVIATION
WATER RESOURCES AND ENVIRONMENT

COMMITTEE ON INTERNATIONAL RELATIONS
SUBCOMMITTEES:
INTERNATIONAL ECONOMIC POLICY AND TRADE
WESTERN HEMISPHERE

Congress of the United States
House of Representatives
Washington, DC 20515–3013

REPLY TO:
☐ 405 CANNON H.O.B.
WASHINGTON, DC 20515–3013
(202) 225–7919

DISTRICT OFFICES:
☐ 911 BERGEN AVENUE
JERSEY CITY, NJ 07306
(201) 222–2828
☐ 854 AVENUE C
BAYONNE, NJ 07002
(201) 823–2809
☐ 263 HOBART STREET
PERTH AMBOY, NJ 08861
(732) 324–6212
☐ 3108 BERGENLINE AVENUE
2ND FLOOR
UNION CITY, NJ 07087
(201) 558–0800

SUBMITTED TESTIMONY OF THE HON. ROBERT MENENDEZ
on REDUCING S.E.C. FEES
before THE SUBCOMMITTEE ON CAPITAL MARKETS
COMMITTEE ON FINANCIAL SERVICES
March 7, 2001

Thank you, Mr. Chairman and Mr. Kanjorski, for calling this hearing.

As I often point out when talking about this issue: For more and more Americans, from all walks of life, the securities market has become a major vehicle for savings and investment. And while we in Congress sometimes have honest disagreements about how to accomplish this goal, we can all agree that encouraging savings and investment is essential.

That's why what has happened with Section 31 fees in recent years is a problem we need to address -- and address promptly.

These fees were intended by Congress to cover the operating costs of the Securities and Exchange Commission. And that is a necessary and valid purpose which I totally support. Consumers and investment firms benefit from the market -- it is not unreasonable to ask market participants to help pay the costs of the very agency that ensures that the market runs efficiently and fairly.

However it is *not* reasonable to have these participants pay fees that amount to six times the funding necessary to keep the SEC operating. That is no longer a fee -- it is a tax. And this tax is burdening the life savings of American investors. In fact, many pension plans are paying millions upon millions of dollars in these Section 31 fees.

That's why I strongly support this Committee moving expeditiously to address this problem. And that's why over the last several years I have worked on legislation to address it: introducing bills with your Committee colleague, Congressman Vito Fossella, in the last Congress; and with Former Rules Committee Chairman Jerry Solomon back in the 105th.

THIS STATIONERY PRINTED ON PAPER MADE OF RECYCLED FIBERS

I believe it is important that any fee reduction legislation incorporates two key provisions:

- First, a rate reduction that brings the fees in line with their intended purpose -- funding the SEC.

- Second, an "adjuster mechanism" that will automatically cap collections if the *original* rate cut does not reduce future collections as intended, or -- conversely -- that will adjust future collections that turn out to be insufficient to allow the SEC to fulfill its mandate.

By itself, a rate cut will be inadequate. As I've argued at earlier hearings on this issue, we *need* caps and floors in place to make sure that the rate cut achieves the desired results. That's because if the CBO overestimates the market growth rate, we may find that the fees have not generated the amount necessary to fully fund the SEC -- and it will be too late in the process to correct it. Conversely, if the CBO *under*estimates the growth rate, we'll soon be right back where we are today.

This is especially important as technological innovations like online investing, greater market participation, the growth of mutual funds, and changes in the market structure spur ever greater and unanticipated dollar volume growth rates; and because the CBO has, understandably, rarely predicted the market accurately, and has usually used overly-conservative assumptions of market dollar volume growth that have significantly understated actual collections.

Including automatic caps and floors will thus provide predictability and certainty for *both* consumers and the SEC. Let's solve this problem without having to revisit it.

With that, I look forward to continuing to work with you, Mr. Chairman, and with you, Mr. Kanjorski, with Members of this Committee, other Members of the Leadership, and with all interested and involved parties, to find a fair and workable solution to the problem of these excess fee collections.

Thank you.

CURRENCY

Committee on Financial Services

Michael G. Oxley, Chairman

Financial Services Committee Chairman Michael G. Oxley
Opening Statement
Saving Investors Money: Reducing Excessive SEC Fees
Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises
March 7, 2001

I want to thank the Chair for holding this important hearing. This is an issue I've worked on for some time now.

When I chaired the Finance and Hazardous Materials Subcommittee the past two congresses, we examined this issue, and a consensus emerged: The current funding structure for the Securities and Exchange Commission is indefensible. For those who don't already know, you will learn this morning that the SEC has been running a surplus for nearly two decades, and last year took in six times the amount needed to fund its operations. When Congress first authorized the so-called "user" fees on investors and market participants in the 1930's, the intent was to create a cost-recovery mechanism for the Commission's market supervisory activities.

It has become more than that, and then some. The fees have evolved into an unrelenting tax on investors and capital. We are taxed at every turn - you pay the government when you make a telephone call, when you fill up your gas tank, when you buy groceries. Most Americans I know would be surprised to learn that they pay a tax when their retirement fund makes a trade.

The latest estimates from the Congressional Budget Office indicate the excess collection problem will only worsen. In fact, by 2006 the CBO says that fee revenue will exceed $4 billion, or ten times the most recent SEC budget!

I have asked Subcommittee Chairman Baker and my good friends from New York, Vito Fossella and Sue Kelly, to draft legislation reducing fees. I understand that they will soon be ready to introduce a bill that will put money back in the pockets of those 88 million Americans saving and investing for their retirement.

An issue that will surely be raised this morning is pay parity for SEC employees. I know that the Commission's Acting Chair is concerned about attracting and retaining first-rate professionals to do the important work of protecting investors and promoting capital formation. I, too, am concerned, and want to explore this issue further with the Commission's incoming Chairman, whomever that may be. We need to be mindful, of course, that granting pay increases to one Federal agency may lead to hundreds of Federal agencies coming to Congress, hat in hand.

I want to thank Senators Gramm and Schumer for their presence this morning. They have done fine work on this issue in the other chamber. I look forward to hearing their testimony, as well as the testimony from our other distinguished panels.

Let me take this opportunity to announce that I have asked Chairman Baker to hold a hearing next week to examine the important issue of market data. This Committee will be looking at how the regulatory structure governing the collection and dissemination of stock quote and transaction information can, or should, be changed to promote greater transparency and competition.

Mr. Chairman, let me close by saying that I'm eager to move legislation - bipartisan legislation - in short order with the help of Ranking Member LaFalce, out of this Committee and to the floor, and thank you for your leadership on this issue. I yield back.

COMMITTEE ON SMALL BUSINESS
RANKING DEMOCRATIC MEMBER

COMMITTEE ON BANKING AND FINANCIAL SERVICES
SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY
SUBCOMMITTEE ON CAPITAL MARKETS, SECURITIES, AND GOVERNMENT SPONSORED ENTERPRISES

CONGRESSIONAL HISPANIC CAUCUS
CONGRESSIONAL CAUCUS FOR WOMEN'S ISSUES
CONGRESSIONAL PROGRESSIVE CAUCUS

Congress of the United States
House of Representatives
Washington, DC 20515

NYDIA M. VELAZQUEZ
12TH DISTRICT, NEW YORK

2241 RAYBURN BUILDING
WASHINGTON, DC 20515
(202) 225-2361

DISTRICT OFFICES:

815 BROADWAY
BROOKLYN, NY 11206
(718) 599-3658

173 AVENUE B
NEW YORK, NY 10009
(212) 673-3997

16 COURT STREET
SUITE 1006
BROOKLYN, NY 11241
(718) 222-5819

Statement by Representative Velázquez
Capital Markets, Securities and Government Sponsored Enterprises
Subcommittee Hearing on "Saving Investors Money:
Reducing Excessive SEC Fees"

March 7, 2001

I would like to thank Chairman Baker for holding this hearing. It is both timely and appropriate that the first hearing of the new Capital Markets subcommittee address the issue of SEC fees.

As we all know by now, the Financial Services Committee was awarded a significant expansion of its jurisdiction for the 107th Congress. And with responsibility for oversight of the Securities and Insurance industries, this subcommittee received the bulk of that new jurisdiction. As we begin to take on this new responsibility, I want to stress to my colleagues that we should take our time and make the effort to learn these complicated and important issues with which we have been entrusted. We cannot approach our new responsibilities with the idea of taking a "cookie cutter" approach to oversight. We must recognize, both on this subcommittee and on the full committee, that the regulation and oversight of the securities industry is far different than the regulation and oversight of the traditional banking industry.

The oversight focus for the traditional banking industry is on safety and soundness. But for the securities industry, the priority must be on disclosure and transparency. As we deliberate the issue of securities fees today, and other issues affecting the securities industry in the days ahead, let us remember this very important distinction.

As for the specific issue before us today, Mr. Chairman, I recognize the importance of addressing the issue of securities fees, especially Section 31 fees. In previous congresses I have cosponsored legislation to reduce Section 31 fees. It is important that consumers and securities firms are not overcharged through transactional fees. On the other hand, it is just as important that the SEC have adequate resources to conduct its oversight functions properly. Part of adequate oversight is the ability to attract and retain qualified personnel. That is why the pay parity issue is so important. I am confident that this subcommittee can work through these issues and make a balanced recommendation to the full committee.

Again, I want to thank Mr. Baker for holding this hearing, and I look forward to working with the Chairman and Ranking Member Kanjorski on this issue and others in the days ahead.

THIS STATIONERY PRINTED ON PAPER MADE OF RECYCLED FIBERS

Testimony
Senator Charles E. Schumer

Sec 31 Fees and 6(b) fees
March 7, 2001

Thank you Chairman Baker and Ranking Member Kanjorski for holding this hearing today.

And I'd like to thank Chairman Gramm for his leadership on this issue of great importance to investors across the country. I'm pleased to be working with him and to be the lead Democrat in the effort to reduce Section 31 and 6(b) fees in the Senate.

Frankly, I've never been more sanguine about our prospects, and starting this bicameral process early in the legislative cycle optimizes our chances for getting it done this Congress.

As everyone here knows, Section 31 and 6(b) fees were meant to fund the SEC as a sort of user fee, like the surcharge on airline tickets. And since then, the fees have basically been in line with the SEC's budget.

But with the democratization of the securities markets in the 1990s, the volume of trading exploded. As a result, so has the volume of fees.

Based on trading volume data, forty years ago, Section 31 fees would have totaled around $3 million. If Section 31 fees growth had only kept up with inflation, today they'd total $17.7 million. But today, they're not $17.7 million; they're $2.3 billion. That's an annual growth rate of 19% and 600% of the SEC's budget.

Now I and Congressman Kanjorski might like to see what the SEC could do with a budget of $2.3 billion, but I think Chairman Gramm and Chairman Baker might have some objections.....

The way the law is currently written, fee collections are used to fund the SEC and the rest becomes part of the overall federal budget, which means investors are helping pay for activities ranging from tanks to highways to cancer research-- all worthy endeavors but not why Congress created Section 31 fees.

These fees have become a tax on investors and a burden on capital formation, and it's time we changed the way they're collected.

S. 143 will rationalize the process by both reducing the fee rate and capping the total fees

collected, at the same time it guarantees funding for the SEC.

Over 10 years, it will save investors $14 billion.

And since according to the SEC, investors pay 87% of Section 31 fees, all types of investors -- from the retiree who owns 50 shares of Cisco to the mutual fund with billions of dollars in the market -- will benefit.

Nearly 50% of Americans have direct investment in the stock market, and Gramm-Schumer provides tax relief for all of them.

So reducing these fees is a significant benefit to investors. But it may also have an ancillary benefit.

In the fight for dominance of the global equities marketplace, a reduction in fees may ultimately enhance the international competitiveness of U.S. securities markets.

The Chicago Stock Exchange has testified before the Banking Committee in the Senate that Section 31 fees may become a competitive albatross for U.S. exchanges, since these fees would not be paid by foreign exchanges trading securities listed on U.S. markets.

For a few years now I've been concerned about ensuring that our markets are as lean and nimble as possible as we enter an age of global equity markets.

And anything that hampers their competitiveness by building additional and unnecessary fees into their cost structure is, to quote one of Chairman Gramm's favorite expression, like "killing the goose that lays the golden egg."

The effects these fees may have on our markets' competitiveness adds an urgency to passing this legislation.

Finally, I'd like to point out that the SEC has endorsed S. 143–first because it's good public policy, but second, because the bill includes provisions that ensure that the compensation for the SEC staff is on par with other federal banking regulators.

Chairman Levitt spoke often of the SEC's difficulties attracting and retaining staff during the last eight years of a bull market. (Although with the emerging bear market, the SEC may start looking better and better.)

With the radical changes occurring in market structure and the rapid democratization of the markets, never have the challenges to the SEC been greater. And never has the need for exceptional staff been more acute.

Ever since the Great Depression when we decided a certain degree of regulation was necessary in our securities markets and the SEC was created, the SEC has promoted the free market principles of Adam Smith while protecting investors against fraud and misrepresentation. These values have been the hallmark of our free markets and the SEC for the past 60 years.

Due largely to their rigorous oversight, US markets have become the deepest, most liquid and most fair. In short, the envy of the world.

And anything we can do to assist the SEC in hiring and retaining top talent is a direct benefit to our markets.

I cannot state strongly enough that pay parity is a necessary piece of any Section 31 fees legislation.

In the Senate, S. 143 has garnered strong bipartisan support, and I urge my colleagues in the House to work across party lines to craft legislation that rationalizes the way Section 31 fees are collected and that rationalizes the pay structure at the SEC.

Again, I want to thank Chairman Baker for holding this hearing today, and I urge this Subcommittee to get an early start on passing this legislation.

I think the stars are aligned this Congress, and I look forward to working with Chairman Gramm and this Subcommittee to get it done.

TESTIMONY OF

LAURA S. UNGER, ACTING CHAIRMAN
U.S. SECURITIES AND EXCHANGE COMMISSION

CONCERNING FEE COLLECTIONS REQUIRED BY THE FEDERAL SECURITIES LAWS

BEFORE THE SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

MARCH 7, 2001

U. S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Chairman Baker, Vice Chairman Ney, Ranking Member Kanjorski, and Members of the Subcommittee:

I appreciate the opportunity to testify before you today on behalf of the Securities and Exchange Commission ("SEC" or "Commission") regarding current fee collections required by the federal securities laws. We commend the Subcommittee for holding a hearing on this important issue.

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 Subcommittee's concerns regarding these excess fee collections.

The SEC believes that there is an opportunity for Congress to reduce significantly these fees for investors, market participants, and companies making filings with the Commission. Crafting a successful fee reduction is technically complex, however, and it affects a number of interested parties. The SEC believes that any fee reduction bill must reduce fees in a manner that spreads the costs of regulation among those who benefit from the Commission's activities, must account for future market conditions, and must be administratively workable for industry and the government.

Above all, fee reductions must be consistent with full and stable long-term funding for the SEC so that the agency can continue effectively to perform its statutory mission of protecting investors and maintaining market integrity. This involves both

---

1 CBO January 2001 Baseline.

2 Pub. L. No. 106-553, 114 Stat. 2762 (2000).

preserving the offsetting collections that will be available to our appropriators to fund the agency in coming years and ensuring that the agency continues to be able to attract and retain qualified staff. The Competitive Market Supervision Act of 2001 (the "CMSA" or "Senate bill"), a fee reduction bill under consideration in the Senate this year, 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, the ability to compensate our staff at the same level as our sister regulators at the banking agencies is more imperative than ever. The Commission can continue to function effectively only by remaining an institution that can attract and retain dedicated professionals. We urge the Subcommittee to include pay parity in any fee reduction bill.

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. We will then explain what we believe are the essential characteristics of any successful fee reduction effort, illustrating how these principles apply to the Senate's CMSA, a bill we support.

Current Fee Collections and SEC Funding Structure

In previous testimony before the Subcommittee on Finance and Hazardous Materials of the Committee on Commerce, 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 system 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"); and
- 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, 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."

---

3 See Testimony of James M. McConnell, Executive Director, U.S. Securities and Exchange Commission, Concerning Fee Collections, Before the Subcomm. on Finance and Hazardous Materials, House Comm. on Commerce (Sept. 28, 1999).

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 five years.

Congress last revised the fee structure five years ago as part of NSMIA. Although some anticipated that NSMIA would lead to gradual increases in general revenue funding for the SEC, this has not occurred.[5] 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. As a result, 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:

---

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.

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

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

Section 6(b) fees are gradually being eliminated over a multi-year period ending in fiscal 2006.

Principles of Fee Reductions

The federal securities laws provide that Section 31 and Section 6(b) fees are "designed to recover the costs to the Government" of securities regulation.[7] Current and projected future fee collections remain well above what is needed to fund the agency's operations, however. We share the Subcommittee's concerns regarding these excess fee collections and encourage the Subcommittee to consider ways of reducing these fees for investors, market participants and companies making filings with the Commission. Because of the complexity of the issues and the number of interested parties, the manner in which fee rates are reduced must be carefully considered, however. We offer four basic principles that we believe are essential to any successful effort to reduce fees.

Principle One: Fee Reductions Must be Consistent with Full and Stable Long-Term Funding of the SEC

First, we believe that any fee reductions must be consistent with full and stable long-term funding that enables the SEC to continue effectively to fulfill its statutory mission of protecting investors and maintaining market integrity. This involves both preserving the offsetting collections that will be available to our appropriators to fund the agency in coming years and ensuring that the agency will be able to continue to attract and retain qualified staff.

Preserving Offsetting Collections

---

[7] Exchange Act § 31(a); Securities Act § 6(b)(1).

In our view, it is critical that fee reduction legislation preserve the ability of our appropriators to fund SEC operations out of offsetting collections. Preserving offsetting collections increases the likelihood that the SEC will receive adequate funding in the future to protect investors and promote the integrity and efficiency of the nation's securities markets.

The Senate fee reduction bill, the CMSA, provides one example of how fees can be reduced while preserving offsetting collections. The CMSA reduces fees by eliminating the general revenue portion of fee collections, which currently accounts for the majority of all SEC fees and is estimated to reach more than $1.5 billion in fiscal 2002. 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. The Senate bill preserves offsetting collections by resetting the Section 31 fee rate each year at a level designed to produce total fee collections in an amount equal to CBO's current projections of offsetting collections for the next ten years.

Pay Parity with Banking Regulators

We also urge the Subcommittee to address the Commission's severe difficulties in attracting and retaining a sufficient number of qualified staff. At present, the Commission is unable to pay its accountants, attorneys and 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 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 substantially more than they are.

This is particularly true in the wake of the landmark Gramm-Leach-Bliley Act of 1999 ("GLBA"). As this Subcommittee 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 our sister 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 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 is good public policy. With approximately 3000 staff, the SEC is small by federal agency standards. This staff is charged with overseeing an industry that

includes about 700,000 registered representatives of about 8000 broker-dealers, some 14,000 companies that file reports with us, and about 30,000 investment company portfolios. Over $41 trillion in stocks are expected to trade hands this year on the New York Stock Exchange and Nasdaq, including transactions on numerous new electronic communication networks (or "ECNs"). The mutual funds the SEC regulates now hold over $7.4 trillion in assets. This exceeds by about $4 trillion the amount on deposit at commercial banks and surpasses by $2 trillion the total financial assets of commercial banks.

The Commission today faces some of the most complex and difficult issues it has ever considered. No segment of American business has been more transformed by the rapid pace of technological change in recent years than the securities industry. New technologies, new market entrants, and new financial products are reshaping our markets. No less important, our markets today are increasingly global – a trend that most expect to accelerate in the coming years. In addition, the demographics of our markets have radically changed over the last twenty years. Increasingly, we are a nation of investors. Twenty years ago, only 5.7% of Americans owned mutual funds. Today, some 88 million shareholders, representing 51% of U.S. households, hold mutual funds. All of these developments raise complex and critically important challenges for the SEC.

At such a critical time in our markets' development, the Commission simply cannot afford to suffer a serious staffing crisis. Since 1996, our attrition rate has been increasing, particularly among our more senior professionals. Over the last two fiscal

years, the Commission has lost 30% of its attorneys, accountants, and examiners.[8] If this trend continues, the Commission's mission of protecting investors will be seriously threatened.[9]

In a world where first-year associates are making six-figure salaries in Washington, D.C. law firms, the salaries the SEC can provide are simply not competitive to recruit and 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

---

8 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, its value erodes over time and 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 and OPM recently approved our proposed special pay rates for certain attorneys, accountants and examiners. 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. In addition, even with special pay, the salaries of the federal banking regulators are still substantially more than we can pay our staff.

9 Resolving the Commission's staffing crisis requires statutory changes to 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 would require a net funding increase of approximately $70.9 million in fiscal 2002, with yearly adjustments for inflation thereafter. (This assumes full-funding of special pay and no new staff in fiscal 2002.)

and reduce the turnover problems we face. 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.[10]

Principle Two: Fees Should be Reduced in a Way that Accounts for Future Market Conditions

We also believe that fees should be reduced in a way that accounts for the fact that it is difficult to predict future market conditions. As activity-based fees, the current fees we are required to collect by the federal securities laws have the potential to lead to excess collections or shortfalls depending on market conditions. With the unexpected growth in transaction volume and market capitalization in recent years, our current fee rates are leading to excess collections. Simply reducing the current fee rates, however, will only produce the anticipated amount of fee collections if our current projections of future transaction volume and market capitalization are accurate.

These projections cannot be made with a high degree of certainty, however. As can be seen from the example of NSMIA, an unexpectedly strong market will lead to excess fee collections. Conversely, an unexpectedly weak market could jeopardize the amount of offsetting collections available to our appropriators to fund the agency. By building a mechanism to account for future market conditions into a fee reduction bill, we

---

[10] A broad cross-section of the securities industry have expressed support for pay parity, including the Securities Industry Association ("SIA"), the Investment Company Institute ("ICI"), the Investment Counsel Association of America ("ICAA"), the California Public Employees' Retirement System ("CalPERS"), the National Association of Securities Dealers ("NASD"), and the New York Stock Exchange.

believe that Congress can ensure that total fee collections become more stable and predictable.

Principle Three: Fee Reductions Should Spread the Costs of Regulation

Fee rates should be reduced in a manner that spreads the costs of regulation among those who benefit from the activities of the Commission. By reducing the rates on all three types of fees the Commission collects, we can reduce costs not only on investors and other market participants, but also on the capital raising process. This also has the effect of spreading the costs of regulation among those who benefit from the activities of the Commission. The CMSA takes this approach by reducing the rates on Section 6(b) fees, Section 31 fees and merger and tender offer fees.

We also encourage the Subcommittee to consider eliminating a de minimis filing fee that is imposed by the Trust Indenture Act of 1939. This $100 filing fee applies to applications for qualification of certain indentures under Section 307(b) of that Act. This filing fee generated $2300 during the last fiscal year.

Any fee reduction bill also should take into account Congress's recent adoption of the Commodity Futures Modernization Act of 2000 ("CFMA"). As the Subcommittee 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 Subcommittee's staff on ways to address these CFMA assessments and to eliminate the Trust Indenture Act filing fee.

Principle Four: The Fee Reduction Mechanism Must be Administratively Workable for Both Industry and the Government

Finally, we believe that any fee reduction bill must be administratively workable for both industry and the government. The current fee collection system involves a number of parties, including:

- the national securities exchanges, which are responsible for paying Section 31 fees on sales of securities transacted on their exchange;
- the National Association of Securities Dealers ("NASD"), which is responsible for paying Section 31 fees on sales of securities transacted by its members;
- the broker-dealers that pay Section 31 fees and who, in turn, charge their customers for some of these fees;
- the companies that pay Section 6(b) and merger and tender offer fees;
- the SEC, which is charged with collecting all of these fees;
- the CBO, which projects future fee collections;
- the Office of Management and Budget, which uses projected collections in, among other things, setting our budget request;
- our House and Senate appropriations committees, which use projected collections in determining our and other agencies' budgets; and
- this Subcommittee and our Senate oversight committees, which are charged with overseeing the rates set by the federal securities laws.

All of these parties must be able to work with any fee rate reduction mechanism well enough to be able to fulfill their role in the fee collection system. In particular, changes in the fee rates will have to be processed and put into effect by these parties. As

the entity responsible for collecting the fees, we believe that the operational challenges involved in changing rates should not be overlooked.[11] In crafting fee reduction legislation, we encourage the Subcommittee to balance the goal of reducing fees and limiting the potential for excess collections or shortfalls with practical concerns about the possible operational difficulties posed by frequent rate changes. The number of parties that participate in, and are affected by, the fee collection system also underscores the need for all interested parties to be part of the dialogue on fee reductions.

Conclusion

We again commend the Subcommittee for examining this important issue. We believe that there is an opportunity for Congress to reduce significantly fees for investors, market participants, and companies making filings with the Commission. We also believe that fees can be reduced while preserving offsetting collections and putting the Commission on equal footing with its sister regulators. We encourage the Subcommittee to consider ways of reducing the current fee collections required by the federal securities laws and we look forward to continuing to work with you and other interested parties on this issue.

---

[11] For example, in testimony last year before the Senate Banking Committee on fee reduction legislation, the New York Stock Exchange expressed concerns that the process in the bill then under consideration for intra-year changes in the transaction fee rate and the process for resetting fee rates each fiscal year might pose administrative challenges. See Testimony of Keith R. Helsby, Senior Vice President and Chief Financial Officer, New York Stock Exchange, on Securities Transaction Fees, Before the Committee on Banking, Housing and Urban Affairs, United States Senate (Feb. 28, 2000).

Questions for the Record to Acting Chair Laura Unger
Submitted by Chairman Michael G. Oxley
Hearing on "Saving Investors Money: reducing Excessive SEC Fees"

Q1 As you point out, any fee reduction must be consistent with full and stable long-term funding for the SEC. What are the relative merits, in this regard, of a fee-cutting proposal that preserves offsetting collections versus one that preserves general revenues?

A1. The SEC is provided annual funding through the Commerce, Justice, State, and the Judiciary (CJS) Appropriations bill. Since 1990, the SEC has received a significant and increasing portion of its funding from those fee collections that are categorized as "offsetting collections" and made available to CJS. Reducing these fees would likely harm the ability of the SEC's appropriators to adequately fund the Commission's activities. This is the primary reason why the SEC prefers not to reduce offsetting collections. By contrast, reducing "general revenue" collections would be less likely to affect the SEC's appropriators since these collections go directly to the U.S. Treasury. However, any reduction made to general revenue collections is subject to complex scoring rules that make accounting for a reduction difficult and involve broader policy issues beyond the scope of the SEC.

Q2. I agree that we need to do something to ensure that the Commission is able to attract and retain the best possible staff. But why should Congress single out one of the hundreds of agencies it oversees for a pay raise? Doesn't virtually every other agency have to deal with the difficulties of losing staff to the more lucrative private sector?

A2 The SEC appreciates the challenges that other federal agencies face in retaining staff. However, the Commission's attrition rate is more than double the government-wide average. The SEC needs to have increased pay flexibility not only because of the industry it regulates, but also because it is at a disadvantage relative to the other federal financial regulatory agencies. As I will discuss in my response to your third question, this disparity between the SEC and the federal banking agencies poses a real public policy threat to the health of the Commission and requires special attention and consideration.

Q3. Don't SEC employees often leave the Commission to pursue jobs that pay several times their government salary? If this is the case, how will a relatively small raise (compared with what Wall Street and other big financial concerns can pay) convince staff to remain on the government payroll?

A3. The SEC's employees frequently have private sector opportunities that pay well in excess of their government salaries. This will always be the case and the SEC is not attempting to address this fact. Instead, our belief that "pay parity" will be helpful is premised on two fundamental issues: fairness and agency effectiveness.

The SEC is unable to pay its accountants, attorneys, examiners, and other staff what their counterparts make at the federal banking agencies. 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 substantially more than they are. This is particularly true in the wake of the Gramm-Leach-Bliley Act of 1999, which demands 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 they need to fulfill their missions. For this reason, we believe pay parity will go along way toward making staff feel appreciated so that they extend their tenures with the Commission.

With respect to effectiveness, the Commission currently lacks the ability to retain employees for more than the two to three years required to train them and have them become fully productive. If we are able to pay our staff more, we will be able to increase tenures and therefore improve our effectiveness and efficiency.

Testimony before the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises House Financial Services Committee

Hearing on

"Saving Investors Money: Reducing Excessive SEC Fees"

March 7, 2001

Scott Evans, Executive Vice President
TIAA-CREF

Chairman Oxley, Chairman Baker and members of the Subcommittee: my name is Scott Evans, and I am the executive vice president of equity investments at TIAA-CREF. I appreciate the opportunity to appear before you today to express our support for proposed improvements to the current system of SEC fee collections. We would also like to express our support for an improvement in compensation levels for SEC staff.

TIAA-CREF, along with other financial organizations and associations, has written to members of the Senate to urge their support of Senate bill S.143 that would remedy the current fee inequity. I want to commend the full committee for making the reduction of fees charged to securities markets participants a priority for the 107th Congress, and the subcommittee for acting on that priority by holding this hearing. In addition, we encourage the House to introduce a companion bill as soon as possible.

With $285 billion in assets under management, TIAA-CREF is a leading financial services organization, a major institutional investor, and one of the world's largest retirement systems with 2.3 million participants at more than 11,000 educational institutions. We offer our participants a broad array of retirement investment options through the College Retirement Equities Fund (CREF), which is regulated by the SEC as a 40 Act company and the TIAA Real

Estate Account, an SEC registrant. The TIAA-CREF group of companies also offer mutual funds and non-qualified personal annuities to the general public. In addition, we manage tuition savings programs in twelve states. In total, we hold equity shares of more than 3,000 U.S. companies on behalf of our clients.

Last year, TIAA-CREF paid over $1.1 million in SEC fees assessed on securities transactions. In addition, we have paid more than $3.6 million to register securities issued by the TIAA-CREF group of companies over the past five years. These fees represent a tax to our clients, reducing the funds available to meet their savings and investment goals. Moreover, the amount assessed is disproportionate to the SEC's spending needs. In fiscal 2001, the SEC is expected to collect $2.47 billion in fees from participants in the securities markets, more than five times the $423 million that is appropriated for the SEC's operating needs.

While we support the notion that market participants should fund the SEC's operations through "user" fees; the current fee levels are no longer appropriate. Congress enacted the existing structure several years ago when market activity was at much lower levels. The situation is very different today, with Americans participating much more actively in the securities markets. Given this greater level of activity, it is time to modify the SEC's fee structure in order to collect revenues that are more appropriate to the agency's operating costs. We therefore endorse the effort underway in Congress to reduce the various user fees – including registration, transaction, and merger and tender fees –to a level more in line with the SEC's funding needs.

Additionally, we support Acting Chair of the Securities and Exchange Commission Unger's continued commitment to correcting the existing staffing crisis at the SEC. The legislation before Congress would help achieve this goal by improving the SEC's ability to match the pay and benefits offered by the federal banking agencies. It is important that the SEC be able to attract and

retain qualified individuals in order to carry out the SEC's important oversight responsibility for the security markets and to provide for investor protection and education. We know from our experience working with the SEC staff that continuity of personnel is critically important to the efficient functioning of the agency. The legislation pending before Congress would help accomplish those goals.

In closing, I would like to thank the committee again for its commitment to reducing excessive SEC fees and to providing the funding necessary to enable the SEC to compete for qualified staff. It has been a privilege to speak with you today.

Teachers Insurance and Annuity Association
College Retirement Equities Fund
730 Third Avenue
New York, NY 10017-3206

Scott C. Evans
Executive Vice President
212 916-4854
sevans@tiaa-cref.org

March 28, 2001

The Honorable Mike Oxley
Chairman, House Committee on
Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

We appreciate the opportunity to respond to your request for additional comments for the record of the hearings on "Saving Investors Money: Reducing Excessive SEC Fees."

We believe that while the fees may be incidental on a participant-by-participant basis they are excessive when taken in the aggregate. TIAA-CREF pays Section 31 fees every time it sells a security and those fees are ultimately passed on to investors because TIAA-CREF is a not-for-profit organization. The legislation will significantly reduce the level of fees collected by the SEC and thereby free up capital that would otherwise not be available to investors.

Most importantly – from a market standpoint – we believe that the fees levied by the SEC should be in line with the congressional mandate to provide for the SEC's budget. These fees were not enacted to provide excess funds for the Treasury's general revenues and we believe it is inappropriate that investors – at any level – be "taxed" to support the general revenue fund. We are confident that if the proposed legislation becomes law, sufficient revenue will be available to fund the SEC and provide pay parity for SEC employees with other federal banking regulatory agencies.

We were pleased to note that Representative Fossella, along with you and 26 other co-sponsors, introduced H.R. 1088, the Investor and Capital Markets Fee Relief Act. Thank you for supporting this important legislation.

Sincerely,

Scott Evans

THE SPECIALIST ASSOCIATION

39 Broadway, Suite 3600
New York, New York 10006-3068
Tel: (212) 701-0460 Fax: (212) 422-0069
E-mail: tsaofnyse@attglobal.net

Members
New York Stock Exchange

Hearing on Saving Investors Money and Reducing Excessive SEC Fees

Prepared Testimony of Mr. Christopher C. Quick
CEO, Fleet Meehan Specialist, Inc.
Testifying on behalf of The Specialist Association of the New York Stock Exchange

Before the House Financial Services Committee,
Subcommittee on Capital Markets, Insurance,
and Government Sponsored Enterprises

March 7, 2001

Chairman Baker, Members of the Subcommittee, good morning. I am Christopher Quick, CEO of Fleet Meehan Specialist and a member 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 on reducing excessive fees collected by the Securities and Exchange Commission ("SEC"). My testimony will focus on transaction fees, commonly known as Section 31 fees, imposed by Section 31 of the Securities Exchange Act of 1934 ("Exchange Act").

R. Peter Sullivan, III
Chairman
Robert B. Fagenson
Vice Chairman
William Silver
Treasurer

Andrew Cader
John F.X. Dolan
Stephen H. Frank
Perry P. Jacobson
James Ludwig

Sean M. McCooey
Peter J. Murphy
Christopher C. Quick
Frederick F. Tramutola, Jr.

DAVID HUMPHREVILLE
President

The Specialist Association is comprised of 18 broker-dealer firms, which include all of the individual specialists of the New York Stock Exchange ("NYSE"). 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% 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. Over 86% of transaction fees paid on the NYSE floor are passed directly on to investors.

Beginning in the 1930s, 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 one percent of the total dollar amount of securities sold, the tax is creating a drag of over one billion dollars 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. 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 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 as they have in the last 12 months.

In conclusion, 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. Reducing excessive SEC fees would save millions of individuals money as they try to invest their hard-earned money for their future. We urge the Subcommittee to move forward with legislation to reduce excessive SEC fees. We are committed to working with you and this Subcommittee regarding this important matter.

Last month, the Association submitted written testimony supporting the Senate Bill, S. 143 – The Competitive Market Supervision Act of 2001. In addition to reducing SEC fees, this bill would preserve the high quality of securities regulation by ensuring that the SEC is fully funded and by providing pay parity for SEC staff with the federal banking agencies. The Association supports these provisions.

The Association is thankful for this opportunity to express its views on the Section 31 fee. Thank you, Mr. Chairman. I would be pleased to respond to any questions you or other Subcommittee members may have.

Testimony of
JAMES A. TOES
Merrill Lynch & Co., Inc.
On Behalf of the Security Traders Association
Before the House Financial Services Committee
Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises
March 7, 2001

Mr. Chairman, Members of the Subcommittee, I am pleased today to be testifying before you on the issue of securities fees. I am James A. Toes, Director, Merrill Lynch Equity Trading and President of the Security Traders Association of New York, which is an affiliate of the Security Traders Association, on whose behalf I am testifying today. The STA is composed of 30 regional affiliates and over 7,000 individual members throughout North America and Europe, and it is the largest group of its kind in the world. Its membership includes traders for securities firms and institutions, others are partners, specialists, floor traders, proprietors or registered representatives.

History of Fees

In 1996, Congress enacted the National Securities Markets Improvement Act (NSMIA) reforming regulation of the securities and mutual fund markets. NSMIA also restructured fees imposed by the various securities laws – including extension to NASDAQ trades of the transaction fees imposed by Section 31 of the Securities Exchange Act of 1934. In restructuring the fees, Congress intended to ensure a stable source of funding for the SEC while also ensuring that the fees did not grow so large that they became a de facto tax on savings and investment rather than a user fee – which is the very situation we find ourselves in today.

The new fee structure established by NSMIA was the result of a complex compromise worked out between House and Senate authorizers and appropriators, The House Ways and Means Committee, the Office of Management and Budget (OMB), and the SEC, following years of Congressional debate over a new SEC funding mechanism. Unfortunately, however, NSMIA has not controlled the growth of fees as originally intended.

The Need to Reduce Fees

Actual fee collections have significantly outpaced NSMIA's projections. We believe that the reason for this is the Congressional Budget Office and the OMB used conservative estimates of stock market growth which were relied on by Congress in drafting NSMIA. In FY 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 FY 2001 to $3.769 billion in FY 2005. In other words, total SEC fees are projected to raise $15.2 billion over the next five years while the SEC budget will require only a fraction of that amount over the same period. Without a change in law, these fees will generate $16 billion in excess of what Congress intended in NSMIA – over just the seven-year period of FY 2001 to FY 2007.

Another defect in the NSMIA fee structure is that it fails to accommodate changes in the securities markets. For example, if and when the NASDAQ's conversion to an exchange is completed, the current fee structure will result in a redirection to the General Fund of a significant portion of the fees that is currently made available to fund the SEC. Thus, we face the possibility of a fee structure generating billions of dollars in unanticipated fees, while at the same time creating a funding crisis for the SEC.

Clearly, this is not the scenario Congress intended when it redesigned the SEC funding structure in 1996 to reduce the amount of the fee surplus.

Impact on the Investing Public

Ultimately, the investing public shoulders the burden of these fees. 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 has increased from around 32% in 1989 to over 50% 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% of households with incomes between $15,000 and $25,000 own stock. Therefore this tax is paid by the smallest as well as the largest market participants.

Section 31 fees also burden those who participate in pension plans, including public pension plans. For example, over a five-year period many states' public pension plans will pay millions of dollars of Section 31 fees. Some examples include:

- California – nearly $18 million;
- New York – over $13 million;
- Ohio – approximately $4.6 million;
- Pennsylvania – approximately $6.5 million; and
- Texas – over $7 million.

At a time when the government is encouraging savings, it is inconsistent for it to levy this tax on investment.

Reforming the Fees

To address the growing burden of the fees, the STA supports legislation that:

- Reduces fee rates so they fulfill their intended purpose of funding the SEC, and are not acting as a tax on investment;
- Puts in place an automatic mechanism that will limit collections if the original fee rate cut does not reduce the actual collections as intended; and
- Creates a safeguard that fully protects the amount of collections currently projected to be made available to the appropriators including the funding necessary for the SEC.

The STA testified in the Senate in support of S. 143 which includes the provisions outlined above. We urge the House to develop legislation with these characteristics. The Senate bill also allows for growth in the SEC budget, including pay parity for SEC employees, which we also support.

Including safeguards to prevent overcollections and undercollections will ensure that no matter how high or how low today's fee projections are, the fees will still collect the actual amounts intended by Congress. We should not enact legislation only to find ourselves back here in another five years because the projections missed their mark, or that market structure changes created unintended shortfalls or windfalls in fee collections.

In closing, Mr. Chairman, the 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.

September 25, 2000

INVESTOR BEWARE: A Special Report

Many Holes Weaken Safety Net for Victims of Failed Brokerages

By GRETCHEN MORGENSON

Kevin Heebner, owner of a building supply store in Temple, Pa., got a call four years ago from his longtime stockbroker recommending an investment in short-term bonds. Assured the bonds were safe, Mr. Heebner invested $100,000.

Sal DiMarco Jr. for The New York Times

Kevin Heebner battled the Securities Investor Protection Corporation to recover part of an investment.

Three months later, Mr. Heebner received a stunning phone call. The broker told him the money he had put into the bonds was gone. The president of the broker's firm, Old Naples Securities, had stolen it.

With his wife about to deliver their third child, Mr. Heebner, 36, reeled at the thought of a $100,000 loss. Then he remembered with relief that his account was insured by the Securities Investor Protection Corporation, created by Congress in 1970 to protect investors' brokerage accounts from just the sort of theft he had been a victim of. "I knew that if they didn't find the money from Old Naples Securities, I was insured through S.I.P.C.," Mr. Heebner recalled. The broker's "business card and letterhead all had S.I.P.C.

Audio

• AP Business Report, Updated Twice Each Hour

GET QUOTES Look Up Symbol

Go

Enter Multiple Symbols

Portfolio | Stock Markets | Mutual Funds | Bonds | Currencies | Bank Rates | Industries

logos on them; I figured S.I.P.C. would cover it."

Mr. Heebner figured wrong. For more than four years, the corporation maintained he was entitled to nothing — even though three federal courts ruled that S.I.P.C. should pay him $87,000. Only last week, days after a reporter interviewed the lawyer representing the corporation about Mr. Heebner, did the investor receive a check in the amount of $87,000.

"I never got the sense that S.I.P.C. was in any way trying to help my client," said William P. Thornton Jr., a lawyer at Stevens & Lee in Reading Pa., representing Mr. Heebner against the corporation. "They are very aggressive in attempting to prove that investors' claims do not come within certain legal definitions within the S.I.P.C. statute. And the loser is the investor."

At a time when millions of United States citizens have taken their money out of federally insured banks and put it into brokerage firms, the Securities Investor Protection Corporation's charge of protecting the investing public has never been more important.

Officials of the S.I.P.C. defend the corporation's record and say they must be vigilant in protecting against invalid claims by investors.

But a close look at this little-understood organization shows that the safety net that investors believe the corporation offers is in fact full of holes.

Industry-financed but not government-backed, the corporation is a far cry from the agency on which it was loosely modeled, the Federal Deposit Insurance Corporation, which protects bank customers against losses.

Created three decades ago after a number of brokerage firm failures and securities thefts, the corporation is chartered to protect each investor with securities held at a member brokerage firm for up to $500,000; claims for cash are limited to $100,000 a customer.

But convincing the corporation to pay can be extremely difficult. The organization, requires investors to run a gantlet of legal technicalities that would challenge even those knowledgeable about securities law.

Some securities lawyers say this is because trustees overseeing the cases are chosen by, and paid by, the corporation. This differs from the independent trustees who are appointed by the court to handle corporate bankruptcy cases, and who are working for the people owed money.

Indeed, the trustees working for the investor protection corporation — many of them from a coterie of lawyers who have made a lucrative specialty of such cases — have received far more from representing

the corporation than the corporation itself has paid to investors. Their critics say that trustees wanting repeat business from the corporation have an incentive to minimize payouts to investors. One trustee is the former president of the corporation.

In Mr. Heebner's case, the corporation made several arguments. First, because the investor had sent his money not to Old Naples but to a subsidiary, his investment was not covered. In addition, because the corporation could find no proof that bonds had ever been bought with the $100,000, the organization assumed Mr. Heebner had given the money to the brokerage firm as a loan. Lenders are not covered by the corporation.

"Although these legal arguments may follow the letter of the investor protection act, S.I.P.C.'s reliance on them is reminiscent of a private insurance company trying to use every conceivable esoteric legal stratagem to avoid customer claims," said Lewis D. Lowenfels, a lawyer at Tolins & Lowenfels in New York and a leading authority in securities law.

The list of what the corporation does not cover is long. For one thing, while $100,000 placed in a bank account insured by the Federal Deposit Insurance Corporation is covered regardless of why the bank failed, assets lost in a failed brokerage firm are not covered if the loss is a result of most kinds of securities fraud, including a failure to execute a purchase or sale of securities or misrepresentation in the sale of a stock or bond. Losses from unauthorized trading, a large problem among small brokerage firms in the 1990's, are covered only if an investor can prove to the satisfaction of corporation representatives that he complained promptly to the firm.

In addition, because the act that created the corporation covers only securities held by a failed brokerage firm, customers whose firms handle their trades through other brokerage firms may not have a claim for coverage by the corporation.

Additionally, cash held in a brokerage account that is not earmarked for a securities purchase is not covered by the organization. Nor is an investment in gold, other commodities or a limited partnership.

"The bottom line is S.I.P.C. is outdated and needs to be reviewed," said Joseph P. Borg, securities commissioner for Alabama. "It's been around since 1970, when one in 10 Americans were in the markets. Now everyone is in the markets. And everyone thinks that S.I.P.C. logo reads F.D.I.C., but the protection is very limited."

The corporation's president, Michael E. Don, disagrees with accusations that his organization does not put investors first.

"It simply is not true that protecting our fund is our interest," he said. "Our interest is to see to it that customers get paid." Mr. Don added

that when the corporation considered an investor's claim invalid, it had no choice but to fight the investor in court, as it did Mr. Heebner.

The Beginning

Create an Equivalent of the F.D.I.C.

The corporation started as an idea of Edmund S. Muskie, the former Democratic senator from Maine. He introduced a bill in 1969 to create a Federal Broker-Dealer Insurance Corporation that would insure brokerage firm customers against losses, as the F.D.I.C. does with bank depositors. A group representing the securities industry countered with a proposal that its chairman said would maintain public confidence in the securities markets without creating "a vast new governmental agency." The S.E.C. joined the group and drafted a proposal that was largely accepted by lawmakers.

The investor protection corporation and the F.D.I.C. are vastly different. While the F.D.I.C. is an agency of the federal government and its insurance fund is backed by the full faith and credit of the government, the corporation is financed by the securities industry and can borrow from the government, with special approval, only in emergencies. It also maintains a $1 billion line of credit with a consortium of banks.

And while bank examiners employed by the F.D.I.C. routinely monitor risks at banks, the corporation steps in only when a brokerage firm has collapsed or is close to failure.

Another difference is that a brokerage firm, no matter how large or troubled, pays just $150 a year to be a S.I.P.C. member, while payments into the F.D.I.C. insurance fund are based on a bank's size and financial health: the riskier the bank, the larger the fee. Although the healthiest banks have not had to pay into the fund for several years because it has grown so large and bank failures have been few, a financially vulnerable bank with $100 million in insured deposits would have had to pay $270,000 a year to the F.D.I.C. fund this year.

Not long ago, brokerage firms paid much more to be members of the corporation. Between 1991 and 1995, firms were levied an amount based on their net operating revenues. In 1995, for instance, members were required to pay 0.095 percent of such revenues and the organization received $43.9 million. But when the S.I.P.C. fund reached $1 billion, the corporation cut the levy to $150 a member. Last year, the corporation received $1.14 million in fees.

When a bank fails, the F.D.I.C. steps in to keep it operating or close it and return assets — up to $100,000 per depositor — to their rightful owners. The F.D.I.C., created in 1934, typically resolves bank failures by arranging for another institution to assume the crippled bank's deposits and other assets. This has the effect of keeping most failed

banks open and operating, if under a new name.

When a brokerage firm fails, the wheels grind much more slowly. First, the corporation applies to the appropriate court to issue a protective order. If it does, the corporation chooses a trustee to oversee the liquidation of the brokerage firm.

The corporation has presided over the liquidation of 282 brokerage firms. In the 247 cases completed through the end of last year, the corporation had returned $3.38 billion to customers in cash and securities. More than 90 percent of this money — $3.15 billion — came straight from the accounts of customers of the failed firms.

The corporation itself has paid investors $233 million over almost 30 years. But that amount is far less than the money received by the lawyers that act as trustees and the firms that help them shepherd the cases through the bankruptcy courts, trying to recover additional assets from the failed brokerage firms and assessing customer claims for validity. Since 1971, trustees have received $320 million, 37 percent more than has been paid to wronged investors.

The money the trustee receives comes from two sources: the assets of the failed brokerage firm and the corporation itself. As is typical in most bankruptcy cases, the corporation's trustees are paid first, customers second.

The corporation made its biggest payout to investors last June when it paid $31 million to about 10,000 customers of Sunpoint Securities, a Texas brokerage firm that failed last November when some of its officials stole $25 million, according to prosecutors.

The corporation's move to repay Sunpoint customers was swift indeed. But according to people close to the case, the failure was unusual in its simplicity. Unlike most brokerage failures, which involve accounts that hold a variety of stocks and bonds, in the Sunpoint case the missing funds had been placed in a money market fund at the firm. As a result, all the customers' claims were identical and a result of the same theft, making it comparatively easy for the corporation's trustee to resolve.

Most brokerage firm liquidations drag on for years. For instance, the trustee was recently still billing for litigation in the 1985 failure of Donald Sheldon & Company, a New York brokerage firm. The corporation said that all the customers' claims it considered valid were paid early on, but that the trustee has been trying to recover assets from principals of the firm to defray the costs of administering the liquidations. Indeed, the trustee recently won $11 million from an insurance company that had underwritten officer and director insurance for the firm.

A Nasty Example

A Look at the Case of Stratton Oakmont

The case of Stratton Oakmont, a small but notorious brokerage firm based in Lake Success, N.Y., has been particularly protracted and acrimonious. The firm was expelled from the industry by securities regulators four years ago, and the corporation stepped in after the firm was closed. Last fall, Stratton's two owners pleaded guilty to federal charges of securities fraud and money laundering; investors lost hundreds of millions of dollars during the 10 years the firm operated.

Nevertheless, of the 3,368 customers who submitted claims for S.I.P.C. coverage in the failure, as of last May only 34 had been deemed entitled, to a total of $2.1 million, according to the trustee overseeing the case. The corporation's executives and Weil Gotshal & Manges, the law firm representing the trustee in the case, argue that only 1 percent of the Stratton customers seeking remuneration from the corporation are entitled to payments.

Adam Rogoff, a partner at Weil Gotshal & Manges who is the lawyer for the trustee, Harvey R. Miller, also a partner at the firm, said: "We look for credible evidence that there was a contemporaneous reaction; we look for a letter to the company; for a complaint; for a lawsuit or an arbitration. Otherwise people take advantage of an opportunity to revisit trades and say they were unauthorized when they weren't."

Mr. Don, the corporation's president, said: "The Securities Investor Protection Corporation was not chartered by Congress to combat fraud."

While 34 investors had received $2.1 million, the professionals overseeing the case had received $7 million as of the end of May. Most of that amount — $4.3 million in fees and expenses — has been paid to Weil, Gotshal. The payments do not yet include the fees charged by the trustee, Mr. Miller.

Mr. Miller and his colleagues have spent a lot of time trying to recover assets of Stratton Oakmont principals. So far, success has been limited. According to bankruptcy court documents through May, Weil Gotshal, which has spent $8.8 million, has recovered $3.6 million in assets.

Mr. Rogoff, the lawyer for Mr. Miller, said: "You can't analyze it from a balance-sheet perspective. There are costs attendant to administering the case. We have a staff; we have office space — these are all costs relating to the process."

Asked whether the corporation is concerned about Mr. Miller's spending, Mr. Don said: "We have reason to believe that Harvey Miller has a reasonable shot at collecting substantial sums of money

in this case. We take very seriously our responsibility to make sure that the trustees don't overspend the general estate's money and our money."

Indeed, Mr. Don argued that the fees charged by trustees are necessary to fend off false claims filed by investors and to locate hidden assets held by principals of failed firms.

Stephen Harbeck, general counsel at the corporation, said that trustees' bills were typically paid as submitted. "I don't believe we have made any substantial requests for adjustments because we believe the fees they have charged are appropriate to the task involved," he said.

A key problem with S.I.P.C. liquidations, some securities lawyers say, is that trustees overseeing the cases have allegiance to the corporation that appointed them, rather than to wronged investors. To be truly in the corner of investors, these people say, trustees in brokerage firm liquidations should be completely independent of the corporation, which naturally wants to protect its assets. Trustees are indeed independent in corporate or personal bankruptcy cases because they are appointed by the bankruptcy court.

Mr. Don denied that trustees work to deny claims on the corporation's behalf. "It is a false argument," he said. "Since 1970, S.I.P.C. has advanced $354 million in order to make possible the recovery of $3.3 billion in assets for an estimated 440,000 investors. S.I.P.C. estimates that more than 99 percent of eligible investors have been made whole in the failed brokerage firm cases that it has handled."

But it is impossible to say how many investors the corporation has considered ineligible over the years might have prevailed if they had had the money or tenacity to battle the corporation in multiple courts, as Mr. Heebner did.

A coterie of bankruptcy lawyers does get repeat business from the corporation. Irving H. Picard, a partner at Gibbons, Del Deo, Dolan, Griffinger & Vecchione in New York, has been appointed trustee in four brokerage firm failures the last nine years, and J. William Holland of Holland & Holland in Chicago has overseen three liquidations since 1990. Five other lawyers have overseen two or more liquidations for the corporation the last decade.

No surprise, Mr. Don said. "We look for trustees who have developed expertise in liquidating stockbrokers and satisfying customer claims," he said. "That's why we've gone back to Harvey Miller, Irving Picard and we went to Ted Focht, because there's probably no one in the country who knows more about liquidating a stockbroker than he does."

Theodore H. Focht is the trustee in the Old Naples case who kept Mr.

Heebner at bay until this month. Retired and living in Florida, Mr. Focht was general counsel at the corporation when it was created and remained its chief lawyer for 24 years. According to Mr. Don, Mr. Focht wrote the 1970 statute that gives the corporation its charges. He was the corporation's president for a decade until he retired in 1995. The next year, he was appointed by the corporation to oversee the Old Naples liquidation. Mr. Focht hired the law firm of Foley & Lardner to help him litigate the case.

Mr. Focht denied Mr. Heebner's $100,000 claim for S.I.P.C. coverage from the outset. First, he said, Mr. Heebner erred by sending his investment money not to the brokerage firm but to a related entity, Old Naples Financial Inc. S.I.P.C. protection is afforded only to investors whose assets are held by the brokerage firm that fails.

In addition, Mr. Focht argued that the $100,000 Mr. Heebner had sent to his broker represented a loan to Old Naples and was not for the purchase of bonds, as the investor said. Loans are not covered by the corporation.

Mr. Heebner's lawyer objected to the trustee's ruling, and at a hearing in February 1998 in federal bankruptcy court in Florida, the investor told his story. The next month a judge ruled that Mr. Heebner was entitled to S.I.P.C. insurance in the amount of $87,000, reflecting a reduction of $13,000 in interest the investor had earned on the investment before the failure of Old Naples.

Mr. Focht appealed to a Florida district court, which ruled for Mr. Heebner in February 1999. Mr. Focht then appealed the district court decision to the Federal Court of Appeals for the 11th Circuit, which heard arguments on the matter last May.

On Aug. 23, the appellate court ruled in favor of Mr. Heebner and two other customers with similar cases — the other two lost a total of $610,000. Because the president of Old Naples had misappropriated clients' funds, the firm's failure was just the situation the corporation was supposed to protect against, the appellate court opinion stated.

Reached on Sept. 6, Mr. Focht said he was still deciding whether to appeal the ruling. Less than a week later, Mr. Heebner received a letter stating that he would be paid the $87,000.

Not counting Mr. Heebner and the two other investors that are now receiving remuneration on their claims, 21 of the 156 Old Naples customers seeking remuneration from the corporation had received $2 million since the firm failed.

As of last May, the most recent filing made in the case, Mr. Focht and Foley & Lardner had billed approximately $660,000 for their services.

The Catch

A Key Argument in Denying Claims

Some securities lawyers and regulators say that the arguments used by the corporation to justify the denial of Mr. Heebner's claim for more than four years are characteristic of the corporation's approach to investor protection. "It's part of the gantlet to make it as difficult as possible for an investor to make a recovery," said Mark Maddox, a former Indiana securities commissioner who is now a lawyer representing victims in the Stratton Oakmont case.

Indeed, one argument used to deny many investors' claims in the Stratton Oakmont case, if applied to all brokerage firm failures, would disqualify millions of investors from S.I.P.C. coverage even though their brokerage firms are members of the organization.

Mr. Miller, the trustee at Weil Gotshal, has argued successfully to the bankruptcy court that Stratton customers do not qualify for S.I.P.C. coverage because their assets were not held physically at Stratton, they were held at the firm that cleared Stratton's trades. The act of Congress that created the corporation states that the coverage extends only to customers of firms that hold their assets. Customers of a failed broker that used another firm to clear its trades and conduct administrative duties do not qualify.

This delineation may have made sense in 1970, when most brokerage firms cleared their own trades. But today, most of the nation's brokerage houses use clearing firms to carry out their customers' transactions and administer accounts. Using Mr. Miller's argument, customers of these firms, were they to fail, could get no satisfaction from the corporation.

"The argument may be technically correct under the law," said Mr. Borg, the Alabama securities commissioner, "but it insulates a lot of people who sell stocks. It indicates even more reason why S.I.P.C. has to be re-examined."

The corporation is overseen by a board of seven, five of whom are appointed by the president. Three of the five represent the securities industry and two, including the chairman and vice chairman, are appointed to represent the general public. The two other directors are appointed by the secretary of the Treasury and the Federal Reserve Board.

The chairman, Clifford Hudson, is chief executive of the Sonic Corporation, an Oklahoma City operator of fast-food restaurants. Mr. Hudson, who has been chairman six years, declined to discuss specific cases. "My belief is that as the statute was originally intended, S.I.P.C. management does a good job of implementing it," he said. "There are people today who would like to see the nature of

that coverage expanded. That could happen, but Congress would have to change the statute."

How the corporation compensates investors and whether it does so fairly is the subject of a study being done by the General Accounting Office that was requested by Representative John Dingell, Democrat of Michigan. The report is due next March.

Robert M. Morgenthau, the Manhattan district attorney, who has aggressively pursued fraudulent brokerage firms to help wronged investors recoup some of their losses, said: "The investor protection act has to be revisited for two reasons. It doesn't cover a majority of investors' losses, such as those incurred by fraud or malfeasance, and the red tape that is involved for investors trying to recover is incredible."

The corporation has been relatively free of scrutiny since it was created. In that period, the Securities and Exchange Commission has inspected the organization twice, once in 1985 and again in 1994. Three months ago, the S.E.C. began another regular inspection.

"We're telling people to go into the market; it's safe; it's transparent and that we're going to watch out for their interests," Mr. Borg said. "But S.I.P.C. does not provide for a lot of protection, and I think that's a defect of the law."

Submitted Statement of Thomas J. Cavalier
Chairman, President and CEO of
Butler, Wick and Co., Inc.
on behalf of the
Securities Industry Association

Before the
Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises of the House Financial Services Committee

March 7, 2001

Chairman Baker, Representative Kanjorski and Members of the Subcommittee, I am Thomas Cavalier, Chairman, President and CEO of Butler, Wick and Co., Inc., a full service securities firm including trust and asset management services located in Youngstown, Ohio. I also serve on the Board of Directors of the Securities Industry Association ("SIA")[1]. I am submitting this statement on behalf of SIA and we appreciate this opportunity to present our views concerning Securities and Exchange Commission fees.

We believe it is critical that 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

[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 U.S. 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.

such a degree that they constitute a drag on capital formation, and a special burden on every American investor.

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 fifty 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 FY 2000 SEC fee collections exceeded $2.2 billion, $1.89 billion more than the $377 million SEC appropriation for FY 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 FY 2001. In fact, fee collections are projected to exceed the cost to run the commission by more than $2 billion for each year through FY 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 five years. We do not believe it is in the interest of investors — or, 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 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 either directly or indirectly.

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. Any legislative proposal to reduce the excess fees charged to investors, the industry, and issuers should insure adequate funding for the SEC to carry out its important investor protection mandate.

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.

Since the enactment of 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. The Section 31 transaction fee 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] 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

---

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

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.

SEC PAY PARTIY

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 experience to the SEC. The SEC must be able to recruit and retain the best-qualified regulators this can be achieved by creating pay parity between the SEC and Federal financial regulators.

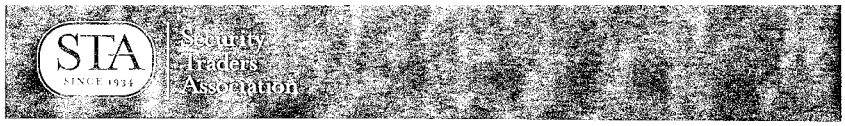
CONCLUSION

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 the Subcommittee's recognition of the disparity between the fair cost of regulation and the costly burden of SEC fees. Legislation is needed to better align the amount of fees collected with the cost of regulation while ensuring the Commission has adequate funding. SIA has already publicly supported fee reduction legislation introduced by Senators Gramm and Schumer, S. 143, that contains pay parity for the SEC and preserves fee revenues from Nasdaq transactions as offsetting collections up to the latest CBO baseline numbers. S. 143 was unanimously approved by the Senate Banking Committee last week. 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.



LEOPOLD KORINS
President & C.E.O.

June 29, 2001

The Honorable Mike Oxley
Chairman
House Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Oxley:

On behalf of the Security Traders Association (STA), I respectfully submit the enclosed answers in response to the questions submitted for the record for the March 7, 2001 hearing on "Saving Investors Money: Reducing Excessive Securities Fees."

These answers reflect the views of the STA and are not necessarily the views of any other party.

Sincerely,

Leopold Korins
President and CEO

SEC FEE RECEIPTS QUADRUPLE ORIGINAL INTENT

YEAR	NSMIA	1999 CBO	2001 CBO	NSMIA WINDFALL
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 TOTAL	$5284	$17782	$21488	$16204

(numbers in millions)

7 YEAR "WINDFALL" OVER NSMIA: $16.212 BILLION

Dictum Meum Pactum

One World Trade Center • Suite 4511 • New York, NY 10048 • tel (212) 524-0484 • fax (212) 321-3449 • traders@securitytraders.org • www.securitytraders.org
Washington, DC tel (202) 862-3719

Security Traders Association
Responses to Questions for the Record
Submitted by Chairman Michael G. Oxley
Hearing on "Saving Investors Money: Reducing Excessive Securities Fees"

1. It is indeed true that SEC fees under current law are projected to collect $16 billion more than anticipated when Congress passed NSMIA in 1996. The attached chart illustrates CBO's consistent underestimation of SEC fee receipts. CBO's 1999 estimate for the same seven-year period fell $3.7 billion short of the 2001 estimate. Given this history, it is reasonable to assume that the 2001 estimate will ultimately be revised upward.

   The consistent underestimation of fees, coupled with increased trading volumes, created the situation we are in today, with the government collecting over six times the SEC's budget in fees originally intended solely to finance that agency. Without the change in law provided by H.R. 1088, these overcollections will continue. H.R. 1088's initial fee reduction and annual adjustment to compensate for changes in stock market volume, will ensure that the level of fee collections is more rationally related to the fees' intended purpose, and will prevent future unanticipated increases in fee receipts.

   We believe it is likely that trading volume will continue to trend upward. In 2000, hardly a "boom" year in NASDAQ-traded securities, NASDAQ volume increased by 61.2% over 1999. Since Section 31 fees are tied to volume, and price level, receipts will continue to increase as trading volume continues to increase and prices continue to fluctuate.

2. Transaction fees are paid directly by individual investors when they sell stocks. Investors who save through mutual funds or pension plans pay the fees through lower returns. In testimony before the Senate Banking Committee, former SEC Chairman Arthur Levitt stated that investors pay 87% of the Section 31 fees imposed on New York Stock Exchange transactions. Also according to Levitt, investors pay 82% of Section 31 fees imposed on NASDAQ transactions. While Section 31 fees are directly paid by investors when they sell shares of stock, all fees are passed along and ultimately paid by individuals who participate in the market.

3. The government imposes the Section 31 fee on each sale of a stock. One exception is the so-called riskless principle trade, which is exempt. These are trades where market makers merely match buyers to sellers.

4. Registration of new stock, tender offers and mergers are key activities in the capital formation process and the creation and expansion of businesses, therefore Section 6(b) and merger-tender fees can, in the aggregate, act as a tax on capital formation and an impediment to entrepreneurial activity.

5. The transaction fee rate is low, but because it is imposed on each sale of stock, it quickly adds up to billions of dollars. Because the small rate is imposed on all sales transactions its scope is not apparent to the millions of investors who pay it. Furthermore, it is not directly disclosed to those who invest through mutual funds, 401(k) accounts or pension plans. Market makers and specialists absorb the cost of the fees, in certain instances, reducing their working capital. Thus, Section 31 fees can be deemed a hidden tax.

   These fees were originally created as "user" fees, meaning that the market participants who benefited from the SEC's regulatory and oversight activities would pay that agency's operating costs. However, since over 80% of the fees are now used to pay for unrelated government expenses, these fees have become a "tax," just like income and corporate taxes, which are not earmarked for a particular activity.

6. Even after enactment of the fee reductions of H.R. 1088, the SEC will still receive over twice the amount of its budget adjusted to inflation. H.R. 1088 assures that Congress and the appropriators will have enough funding even after full implementation of pay parity.

7. All investors will benefit, as individual stockowners will pay lower fees when they sell securities. Investors who participate in mutual funds, 401(k) accounts and pension plans will benefit as the costs to their investment vehicles are reduced.

8. Excessive fees reduce liquidity in the market, particularly among thinly traded issues. This is because any increases in trading costs, such as excessive fees, change the economics of market making, by making it more expensive to hold and trade less well known, less liquid stocks. Once a market maker takes a significant position in a thinly-traded stock, it is difficult to get out of that position quickly. Excessive fees act as an additional deterrent to buying and holding these stocks because they increase the already higher costs of performing the market making function.

9. As is well known, the recent bull market has given way to a bear market in the NASDAQ and a stagnant market in the NYSE. As described above, market volumes can increase in down markets, which in turn leads to increases – without legislative changes – in Section 31 transaction fee receipts. As a matter of equity, regardless of whether markets are going up or down, it is wrong for the government to establish a fee for one purpose, and collect excessive fees to fund activities unrelated to the fee's stated purpose.

STATE TEACHERS
RETIREMENT SYSTEM
OF OHIO

275 East Broad Street
Columbus, OH 43215-3771
614-227-4090
www.strsoh.org

March 2, 2001

The Honorable Michael G. Oxley
United States House of Representatives
Washington, DC 20515

RE: House Financial Services Committee, Attn: Justin Daly

Dear Representative Oxley:

On behalf of Jack Chapman, Board chair, and myself, we appreciate the invitation to appear before the House Financial Services Committee. Unfortunately on the date of the hearing we will both be in Boston on official Retirement Board business. I would, however, like to take this opportunity to express STRS Ohio's strong support of a legislative limit on Section 31 fees.

The State Teachers Retirement System of Ohio provides retirement security for nearly 400,000 members and benefit recipients. Among those members are Ohio public and community school teachers and administrators, university and community college faculty, state department of education employees and teachers in the MRDD programs. In addition, over 99,000 recipients receive over $2.6 billion annually in retirement, disability, survivor and health care benefits from STRS Ohio.

As you know Ohio public employees are not covered by Social Security. STRS Ohio was established 15 years before Social Security. All retirement and safety net benefits for Ohio's teachers are provided by the system on an actuarially pre-funded basis. An investment portfolio of over $56 billion is currently held in trust for the current and future benefits of members and retirees of STRS Ohio.

These assets are allocated among fixed income instruments, real estate, domestic and international equities and other alternative investments. Our investments in domestic equities are currently valued at some $25 billion.

Legislation that would reduce the cost of securities transactions would benefit both large and small investors. For STRS Ohio the domestic equity portfolio sales turnover rate is 19 percent per year. This is lower than the average annual turnover of equity portfolios of public pension plans as reported by Wilshire Associates, a pension plan consulting and research organization. The State Teachers Retirement Board's philosophy is that long-term investments perform better. However, our average annual cost in SEC fees is approximately $225,000. Legislation to limit these Section 31 funds would benefit the members and retirees of STRS Ohio by freeing up administrative money to be used for further investment.

STRS Ohio would be pleased to support any future legislation that would reduce the fees paid by the pension fund to the Securities and Exchange Commission when it sells stock. If we may be of further assistance or support please let us know.

Sincerely,

Herbert L. Dyer
Executive Director

RETIREMENT BOARD

JACK H. CHAPMAN, *Chair*
Reynoldsburg City Schools
Franklin County

HAZEL A. SIDAWAY, *Vice Chair*
Canton City Schools
Stark County

MICHAEL N. BILLIRAKIS
Field Local Schools
Portage County

BETTY D. MONTGOMERY
Attorney General of Ohio

EUGENE E. NORRIS
South-Western City Schools
Franklin County

JAMES M. PETRO
Auditor of State

DEBORAH SCOTT
Finneytown Local Schools
Hamilton County

ROBERT P. SHREVE
Retired Teacher Member
Westerville

SUSAN TAVE ZELMAN
Superintendent of
Public Instruction

HERBERT L. DYER
Executive Director

CYNTHIA E. HVIZDOS
General Counsel

TERRI MEESE HARRISON
Governmental Relations

EILEEN F. BOLES
Executive Assistant

DEPUTY EXECUTIVE DIRECTORS
DAMON F. ASBURY
Administration

SANDRA L. KNOESEL
Member Benefits

STEPHEN A. MITCHELL
Investments

ROBERT A. SLATER
Chief Financial Officer