

MEMO# 11704

March 6, 2000

SENATE HEARINGS ON MARKET STRUCTURE ISSUES AND SEC FEES

1[11704] March 6, 2000 TO: EQUITY MARKETS ADVISORY COMMITTEE No. 12-00 SEC RULES COMMITTEE No. 33-00 RE: SENATE HEARINGS ON MARKET STRUCTURE ISSUES AND SEC FEES _____ On

February 28 and 29, the Senate Committee on Banking, Housing and Urban Affairs held two hearings in New York City to address the regulatory and structural environment for the changing securities markets as well as the fees collected by the Securities and Exchange Commission. Attached is the prepared testimony of the witnesses. Hearings on the Structure of the Financial Markets SEC Chairman Arthur Levitt testified that competition among markets, transparency of pricing, better linkages between market centers, and best execution of customer orders are the issues that must be addressed to ensure the continued success of the U.S. securities markets. Chairman Levitt also noted two concerns about the evolution of the U.S. securities markets - that the traditional markets have not been quick enough to adjust to the changes in the securities markets and must do so in order to remain competitive, and that the level of interaction between the buying and selling interest in the securities markets, is not adequate and that market participants must therefore address the issue of fragmentation. Philip Purcell, Chairman and CEO, Morgan Stanley Dean Witter & Co., believes that the securities markets are evolving towards a network of multiple market centers. Purcell testified that the network should operate according to several guiding principles including that the network must be linked together with a price/time priority rule to mitigate the effects of internalization, i.e., the practice of trading as principal with agency orders, and payment for order flow. Similarly, Henry Paulson, Chairman and CEO, Goldman Sachs & Co., testified that Goldman Sachs also supports a central electronic linkage for order display and execution with price/time priority. Paulson also stressed that the options markets need to be overhauled to incorporate many of the technological advances incorporated into the equity markets. In addition, Paulson believes that the structure of broker/dealer regulation needs to be reexamined and that it is time to consider the creation of a single, independent SRO. David Komansky, Chairman and CEO, Merrill Lynch & Co., testified that Merrill Lynch also supports a market-wide linkage of exchanges and qualified ECNs with price/time priority. Merrill also would support several exceptions to a price/time priority system, including a block size exemption. Allen Wheat, Chairman and CEO, Credit Suisse First Boston, testified that U.S. policymakers should set a goal to establish a global, 24-hour, seven days a week electronic marketplace. Wheat also stated that CSFB believes that the likely market structure of the future will be one with centralized 2exchange-like markets. In addition, CSFB believes that the demutualization of the NYSE and Nasdaq may be a necessary part of the change needed by these markets to survive. Wheat also testified that any future marketplace must incorporate the following elements in order to be successful: a completely integrated

market for retail and institutional investors, complete visibility of the order book, decimalization, fully functional 24-hour trading, and an integrated market for both listed and OTC stocks. Wheat also questioned whether internalization benefits investors and stated that CSFB believes it has a negative effect on transparency and does not promote competition. Charles Schwab, Chairman, Charles Schwab & Co., testified that there are a number of areas where retail investors in today's marketplace are at a disadvantage to institutional firms. For example, Schwab stated that retail investors need more transparency to public real-time market information and more access to IPOs as related to institutions. Schwab also believes centralizing all trading in one system with price/time priority would make the securities markets worse because a centralized system would hamper competition and innovation in the markets. Schwab also defends internalization and states that internalization is one of the most effective ways to ensure that their customers get reliable, high quality executions. Richard Grasso, Chairman and CEO, New York Stock Exchange, also testified that a centralized market is not the best system to implement and that it is unlikely that institutions would send their orders to such a system that in his view would diminish competition and transparency and potentially lead to off-shore executions. Similarly, Frank Zarb, Chairman and CEO, NASD, also does not support a mandatory central limit order book with price/time priority. Zarb stated that a central limit order book would end the competition and innovation in market structure and prevent better markets in the future. Hearings on the Competitive Market Supervision Act Chairman Levitt supported the proposed legislation to reduce the total fee collections that the SEC will be required to collect. He testified that the legislation achieves significant reductions in excess SEC fee collections while addressing most of the SEC's concerns, including concerns over receiving adequate funding to increase salaries to retain SEC staff. J. Patrick Campbell, COO, Nasdaq Stock Market, noted that transaction fees charged under Section 31 of the Securities Exchange Act have increased dramatically in recent years, to a point that is well beyond those needed to fund the SEC. He testified that the Section 31 fees are a tax on investors and that the excess fee collections should be returned to investors. Keith Helsby, Senior VP and CFO, New York Stock Exchange, testified that the excess revenues from Section 31 fees represent a tax on capital that could be put to more productive economic use in the private sector. Hardwick Simmons, President and CEO, Prudential Securities, Inc., testifying on behalf of the SIA, stated that the SEC fees that were developed to fund the cost of regulating the securities markets now exceed the government's cost of regulation to such a large degree that they constitute a tax on capital formation and a tax on each investor. Similarly, Lee Korins, President and CEO, Security Traders Association, testified that the SEC fee collections have consistently outpaced budget estimates and the SEC's funding needs and act as a tax on investors and the gross trading revenue of securities professionals. The STA therefore supports the legislation as it reduces the fees while preserving adequate funding for the SEC. Finally, Robert Seijas, Executive VP, Fleet Specialists, representing the Specialist Association of the New York Stock Exchange, testified that they support continued full funding for the SEC but object to the misuse of the Section 31 fees through overcollection of the fee and application of the proceeds to unrelated objectives. 3Ari Burstein Assistant Counsel Attachments