TESTIMONY OF HARDWICK SIMMONS
PRESIDENT AND CHIEF EXECUTIVE OFFICER
PRUDENTIAL SECURITIES, INC.

BEFORE THE
SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

FEBRUARY 28, 2000

Chairman Gramm, Senator Sarbanes and Members of the Committee, I am Wick Simmons, President and CEO of Prudential Securities, a national and global leader in corporate and municipal finance, and in securities sales, trading and research. I am testifying on behalf of the Securities Industry Association ("SIA").[1] SIA appreciates this opportunity to present its views concerning securities transaction fees and the recent legislative proposal offered by Chairman Gramm.

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 exceed the government's cost of regulation to such a degree that they effectively constitute a tax on capital formation, and a special tax on every American investor.

The draft legislative proposal offered by Sen. Gramm, the *Securities Fees Rationalization Act,* has earned the strong support of the securities industry because of its dual approach that combines both a fee-rate cut and a cap on revenue generated by the transaction fees. The Gramm compromise represents the best approach for full funding of the SEC and reducing the tax on capital caused by this excessive fee. If enacted, Sen. Gramm's proposal would better align the fee revenues with the cost of regulation, and would allow individual investors and the investment community to keep funds that would have otherwise been collected as excess fees and remitted to the Treasury General Fund.

RELIEF FOR INVESTORS

The U.S. securities markets serve as a strong engine for economic growth and job creation. The securities industry furnishes the seed capital for start-up companies, provides the liquidity that is essential to bringing investors into the market, harnesses investment for growth and expansion for the economy, and creates savings and investment vehicles for millions of Americans. Today, forty-eight 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 1999 SEC fee collections exceeded $1.7 billion, $1.3 billion more than the $339 million SEC appropriation for FY1999. Fee collections are projected to exceed SEC appropriations by more than $1.4 billion in 2000 and $1.5 billion in 2001. If the current statutory fee collection continues, that is a tax of more than $4.2 billion on American investors over three 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 customer's costs for the transaction. 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 bulk of the transaction fees. This is money that could help fund retirement savings, fuel economic growth, and create jobs.

We know that our markets have been made better, and fairer, by the presence of a strong and effective Securities and Exchange Commission. And, because it is in our interest — and, more importantly, in the public interest — to have an effective SEC, SIA has 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. Our support for legislation today to reduce the excess fees charged to investors, the industry, and issuers will still provide substantially more in revenues than the cost of running the SEC.

BACKGROUND

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

At the time these provisions were enacted, no one anticipated the explosion of market activity that has taken place over the past several years and continues today. In particular, no one could have predicted the phenomenal influence that online investors would have on the equity markets. In 1996, the transaction fee, already levied on NYSE stocks, was first imposed on transactions of securities listed on the Nasdaq Stock Market. At that time, the average daily volume on Nasdaq was 543.7-million shares. Today, Nasdaq's daily share volume has skyrocketed to 1.05-billion shares, a 94-percent gain, while the NYSE's daily share volume has soared from 412-million shares daily to 809 million, a 96-percent increase.

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 1996-1999 and estimated fees to be collected during the current and next fiscal year (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	$ 297.40
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*	972	790	50	1,812	377
2001*	1,008	894	50	1,953	422.8

* estimate

MARKET MAKERS

The securities transaction fees also have an impact on Nasdaq market makers and on specialists at traditional exchanges who perform similar functions. The market maker's business is similar in many ways to that of the grocer, who buys milk for ten cents and hopes to sell it for eleven. The Section 31 fee is especially burdensome to a market maker because, when the fee exceeds the cost of regulation, it amounts to a tax on the market maker's gross revenues, unlike an income tax, for example, which taxes profits. In other words, the fee must be paid whether the grocer sells milk profitably for eleven cents or is forced by market conditions to sell it at a loss for nine cents. Moreover, the Section 31 fee must be paid before the electric bill, the rent, salaries to the staff, or even federal and state income taxes regardless of whether the business is profitable. In the last several years, technological advances have lowered transaction costs. These reduced costs have encouraged more trading activity — larger share volume and even larger trading volume.

Margins have also declined, but to some extent, increases in volume have compensated for lower margins. We, as an industry, are selling more milk, but making less on each quart we sell. These declining margins have greatly magnified the effect on our industry of the Section 31 tax — the portion collected in excess of the cost of regulating the Nasdaq and NYSE equity markets. Section 31 fees are based on the value of transactions. As transaction volume and market valuations have increased, the amount of fees collected under Section 31 has ballooned. In contrast, the market maker's revenue on these transactions have declined. As a result, Section 31 fees comprise an increasing share of gross trading revenues, even though the rate of the fee has remained constant. Market makers must continue to make significant investments in technology to handle ever-increasing volumes. The increase in volumes is accompanied by lower margins and increasing SEC fees. We are on a collision course that, if left uncorrected, will have a significant effect on the ability of market makers to conduct their business profitably. We believe that our equity markets — much admired and envied throughout the world — would operate much less efficiently if there were no market makers. 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 . . . .". 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 . . . .". Unfortunately, the fees have far exceeded the cost of regulation. They divert resources which could be used more productively elsewhere in our economy; and they discourage capital investments in technology that could be used to make our equity markets more efficient and attractive to investors. This is real capital that could be used to fund new businesses, to build plants, to create jobs, and to add to the national wealth. Furthermore, the transaction fee structure creates an uneven playing field.

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

CONCLUSION

There may be some who believe that since the U.S. stock market is near all-time highs, 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 market makers five 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 in the near future: converting and expanding quote capacity to accommodate decimalization; further reducing settlement time to T+1; ensuring that investors and issuers benefit from the explosion in technology and electronic commerce; and, meeting the competitive challenges of globalization. All of these challenges have required, and will continue to require, significant financial investment on our part, as well as the time and efforts of our most talented industry professionals. We intend to meet these challenges to maintain and enhance the international preeminence of our capital markets, to help fund the continued growth of the U.S. economy, and to ensure that investors and issuers have even more opportunities in the new century.

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

Footnotes:

[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.