TESTIMONY OF
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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
UNITED STATES
HOUSE OF REPRESENTATIVES

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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

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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."

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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:

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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

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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

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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.

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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).