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STATEMENT OF THE HONORABLE RAY GARRETT, JR.,
CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION
BEFORE THE SUBCOMMITTEE ON SECURITIES OF THE
SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS,
ON S. 2519, 93d Congress, 1st Sess.

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Mr. Chairman, members of the Subcommittee. I am pleased to have this opportunity to present the Commission's views on S. 2519, a bill designed primarily to facilitate the development of a national market system and to strengthen and improve the Commission's oversight of self-regulation in the securities industry. Taken in conjunction with four prior bills emanating from this Subcommittee, governing, among other things, exchange membership, commission rate structure, transfer agent and depository functions, disclosure of institutional investment activities and regulation of municipal securities brokers and dealers, this series of legislative proposals, as well as that proposed by your counterparts in the House of Representatives, represents the most thorough and important effort to revise the Securities Exchange Act since its adoption almost 40 years ago.

I want to take this opportunity to commend the Subcommittee and its staff. We believe S. 2519 represents sound legislative policy and we support its general aims. The Subcommittee's staff has worked closely with our own staff and I hope legislation on these important subjects ultimately will be shaped around our cooperative efforts.

For the past two years, this Subcommittee, the House Subcommittee on Commerce and Finance and the Commission have been engaged in exhaustive studies of the securities markets. Our own studies have benefited from the concurrent studies undertaken here in Congress. As a result of these studies, comprehensive legislation has been introduced and definitive administrative policy has been formulated. Although the proposals of the Commission, this Subcommittee and the House Subcommittee differ somewhat in the approaches to the restructuring of our national securities markets, all are in accord that improvement is necessary and that such improvement can be fostered by establishing a comprehensive communications system, providing universal availability of price and volume information in all securities markets and quotations from all qualified marketmakers, and eliminating inappropriate barriers to dealing in all markets by qualified professionals.

I believe we all recognize that the process of restructuring our securities markets toward the attainment of a satisfactory central market system is immensely complex, involving difficult problems of technology, legal rules and concepts, and economic readjustments. We do not presume to suggest that the best central market system for the future can be attained by legislative or administrative fiat -- either by the Congress or the Commission. The cooperation of the several interested industry groups is essential to work out the multitude of specific problems that are arising.

We think it is appropriate, however, and indeed, necessary, for the government to play a role in this process by the establishment of major objectives and by retaining the power to prevent developments that appear contrary to the public interest, to arbitrate, so to speak, among competing interests when negotiation fails, and, where no other course is available, to compel the adoption of measures that are essential to make the evolving central market system compatible with these major objectives. Obviously, the government can and should exercise this power, in part through legislation and in part through Commission action.

We have embarked upon an effort to obtain these important objectives, as set forth in our Policy Statement on the Structure of a Central Market System, issued earlier this year. S. 2519 is, in large measure, well-designed to enhance the Commission's ability to perform its proper functions working toward these improvements in our markets.

The Subcommittee has already received copies of our detailed comments on S. 2519, and I shall not attempt to cover all the matters we discussed in those comments. Rather, I should like to focus on a few of the more important views we have concerning various of the provisions of S. 2519.

Implementation of a Central, or National Market System

As I have indicated, the Commission, together with the several interested components of the securities industry, is engaged in the process of effecting a restructuring of the securities markets, commonly referred to as the creation of a central, or national, market system. While we believe we presently have authority to do what is appropriate or necessary for the Commission to do in connection with such a major overhaul of our markets, the adoption of explicit legislative provisions authorizing this effort will surely speed the process and redound to the benefit of all investors, large and small.

Of particular utility in this regard, are Sections 6, 11 and 7 of the bill; the first two grant the Commission flexible authority to achieve our jointly-held goal of assuring price priority for public orders in a central market system. These sections would explicitly authorize the Commission to require all marketmakers, whether operating on or off an exchange, to disclose to Commission-designated persons the limited price orders these marketmakers hold. While it is our present intention to effect price priority for public orders through

an electronic central repository for all active limit orders, should such a system prove impracticable, the Subcommittee's proposals will offer a viable alternative.

Section 7 of the bill, which would add a new Section 11A to the Act, is also a very important provision of the bill. It would authorize the Commission to exercise extensive regulatory authority over securities information processors and over the collection, processing, distribution and publication of quotation and transaction information. The Commission and the Subcommittee are in agreement that automated communication systems for the dissemination of transactions and quotations information are at the very foundation of a national market system. Section 7 would empower the Commission to:

(1) assure that all brokers and dealers have access on reasonable terms to all services available through any securities information system;

(2) review any exclusionary action taken by a securities information processor; and

(3) promulgate rules to facilitate the prompt, accurate and reliable collection, processing and distribution of quotation and transaction information.

We hope it will be adopted expeditiously, since it is an important measure that will ensure the prompt and efficient development of a national market system. Our technical suggestions

to improve the intended impact of this section are set forth at pages 10-13 of our written comments.

Improvement of Commission Oversight of Self-Regulation

A second major purpose of S. 2519 is to render more nearly uniform the Commission's authority over national securities exchanges and national securities associations and to improve and strengthen the Commission's authority over both categories of self-regulatory organizations. This goal is accomplished primarily through Sections 5, 12, 13 and 18 of S. 2519. Among other things, these sections provide for the improvement of the registration process for self-regulatory organizations and authorize the Commission to sanction self-regulatory organizations which do not comport with the requirements of the Securities Exchange Act or their undertakings made pursuant to the provisions of that Act.

In addition, certain of the proposed amendments to the Act contained in Section 18 of S. 2519 give the Commission direct disciplinary power over members and officers of self-regulatory organizations. We believe this grant of explicit authority will serve to strengthen the Commission's oversight

of self-regulation and we are generally in accord with the bill's approach. We have set forth a number of detailed comments concerning some technical changes we believe should be made prior to the adoption of this bill, and those are also set forth in our written comments.

Procedures and Antitrust Concepts

There are two additional matters I would like to highlight for the Subcommittee, where the Commission is troubled by some of the provisions of S. 2519.

Throughout the bill, as substantive authority is vested in the Commission or existing authority is more clearly delineated, S. 2519 appears to have taken steps to develop new procedures to accompany the Commission's exercise of its authority under the Securities Exchange Act. It is perhaps in this area, more than any other, that we have our strongest disagreement with the bill's approach.

As the Subcommittee is aware, the Administrative Procedure Act was enacted in 1946 to provide a uniform procedure for government agencies engaged in both adjudicatory and rulemaking functions. We have carefully followed those procedures over the years; indeed, most of our efforts have granted more extensive procedural rights to interested persons

and involved parties than appears to have been required as a matter of strict interpretation of the law. We have been sensitive and responsive to the requirement that our deliberations appear to be and in fact are fair.

It is for this reason that we are concerned about S. 2519's attempts to impose stricter burdens upon the Commission in performing the same adjudicatory and policymaking functions performed by other agencies.

Section 18 of the Act, I believe, adequately illustrates the difficulties we perceive in the bill's procedural approaches to the Commission's regulation of the securities industry. Among other things, that section would amend present Section 19 (b), authorizing us to modify, alter or supplement the rules of self-regulatory organizations. As a general proposition, we are in accord with the expanded scope of Section 19 (b) as proposed by S. 2519. But to avail ourselves of this authority, we would have to go through lengthy procedures representing a considerable departure from the procedures specified in the Administrative Procedure Act which are applicable to all other administrative agencies. There does not appear to be any reason, either in law or policy, why procedures set forth in Administrative Procedure Act, coupled with the requirement that the Commission set

forth the basis of and the purpose for any rule or rule changes it effects, would not be adequate to afford interested person a full opportunity to make known their views and to furnish a basis upon which appropriate judicial review of Commission action might be sought.

The procedures S. 2519 specifies for proposed Section 19 (b) could place a substantial burden on the Commission. For example, the Commission cannot always be expected to determine with precision, prior to the adoption of a particular rule, all of the effects that the rule may have on self-regulatory organizations, the securities markets, or, indeed, investors generally, even though, of course, we try very hard to do these things. If an administrative agency is permitted to act only when the consequences of its action can be measured with absolute certainty, the flexibility and adaptability of the administrative process would be negated.

Similarly, Section 21 of the bill would amend Section 25 (b) of the Act to permit any person adversely affected by a rule promulgated by the Commission pursuant to proposed Section 19 (b) to obtain review of that rule in an appropriate court of appeals. The section provides that the court "shall have jurisdiction to

review the rule on the record of the rulemaking proceeding in accordance …" the judicial review provisions of the Administrative Procedure Act. Because of the specific language of proposed Section 19 (b), it might be argued that the bill intends that the standard of review of the rules promulgated by the Commission will be a "substantial evidence" test.

The Commission does not believe that its quasi-legislative activities, including the adoption of rules pursuant to proposed Section 19 (b), should be tested by a substantial evidence standard. In exercising its quasi-legislative authority to promulgate rules, the Commission often relies upon broad policy considerations rather than exclusively upon specific facts. These considerations are not "evidence" in the common sense of that word. Since rulemaking reflects agency policy determinations, Commission rules should be invalidated only where a reviewing court finds that the Commission's action was arbitrary, capricious or an abuse of discretion, contrary to constitutional right, power, privilege or immunity, or in excess of its statutory jurisdiction or that the rule was adopted without observance of procedures required by law.

We are aware of no justification or rationale for the departures from standard procedures S. 2519 would effect, and we urge the Subcommittee most strongly to consider our position with respect to these matters.

Finally, I should like briefly to mention the bill's approach to the question of the appropriate weight to be given to competitive factors.

As you are aware, in publishing our policy statement on the development of a central market system, in March of this year, we committed ourselves firmly to a market system that would offer the greatest advantages of competition to all public investors, in an effort to make our markets more efficient and to increase confidence in the securities markets.

It is also true that many of the Commission's regulations and those of the self-regulatory bodies operate to a degree as competitive restraints. Nevertheless, these rules may upgrade standards of professionalism in the industry and thus be highly desirable.

As a matter of policy, the Commission does consider the competitive implications of its actions when appropriate and has weighed them in determining the appropriate regulatory approach to specific problems. For this reason, we do not see any compelling reason for the Subcommittee to include in its legislation an explicit standard that the Commission consider competitive factors. But, if such a standard is included, we believe the standard proposed in S. 2519 should be modified so that action within the scope and purposes of the Securities Exchange Act is the appropriate test, and appropriate judicial review of the Commission's action will be pursuant to that standard.

This is quite a different test from the rather harsh standard contained in the bill's proposed amendments of Sections 6 (b) (4), 15A (b) (8), 19 (b) and 23 (c) of the Act; namely, that any burden on competition which results from a Commission or self-regulatory rule (rather than the rule itself) must be found to be "reasonably necessary to achieve the purposes" the Securities Exchange Act. If, in view of the purposes of that Act, a rule is found to be desirable in fostering the fair and orderly functioning of the markets or in affording protection to investors, the rule should not be overturned on the ground that it may have some anticompetitive effects.

The Commission's rules are designed for the benefit of the public generally. Where there is conflict between the interests of a private few and the interest of the public as a whole, the former must bow to the latter. The Commission's statutory duty is the resolution of those conflicts. But the bill makes the job of effecting such resolutions extremely difficult. Under the bill, those whose personal ends may be interfered with by a Commission rule are given a powerful incentive to concoct hypothetical alternatives to the rule and to argue in court that such alternatives would equally well achieve the rule's purpose in terms of policies

of the Securities Exchange Act without having any anticompetitive effects. This could move the administration of the securities laws out of the Commission and into the courts, resulting in delays in the implementation of a national central market system.

For these reasons, we urge the Subcommittee to change the bill's troublesome language in the manner we have suggested.

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In closing, I would like to express my appreciation for the fine overall effort achieved by the Subcommittee in its approach to several of the most complex problems facing the securities industry at this tine. The provisions of S. 2519 which are specifically designed to facilitate the development of a viable national market system provide, for the most part, the necessary regulatory framework in which such a system can be developed.

Improvement of the Commission's role of overseer of the self-regulatory mechanism has been one of its primary goals in recent years. The Commission believes that the differences of opinion which exist between it and S. 2519 in their treatment of this problem are not substantial. We look forward to the resolution of these differences and to prompt, favorable action by the Congress on this important legislation.