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. 3126, 93d Cong., 2d Sess.

March 27, 1974

Mr. Chairman, members of the Subcommittee. At this Subcommittee's request, I am prepared to discuss the Commission's views on several proposals for additional legislation, each designed to make explicit the Commission's authority, after making certain findings, to require that all trading in securities listed on national securities exchanges be confined to securities exchanges registered with the Commission pursuant to Section 6 of the Securities Exchange Act of 1934. At present, as the Subcommittee is aware, listed securities also may be, and many are, traded in the over-the-counter markets, commonly referred to as the "Third Market."

These legislative proposals are intended to respond to, and deal with, the argument raised initially by the New York Stock Exchange - - that, if the elimination of fixed commission rates, which we have proposed occur on or before May 1, 1975, takes place prior to the implementation of a central, or national, market system, the nation's auction trading markets could be seriously impaired, to the detriment of the public interest and the interest of investors.

The Commission, at the request of various members of this Subcommittee and its staff, has set forth its basic position on the question before you today, as well as our suggestions concerning certain legislative proposals in this area, in a number of letters. I am submitting copies of that correspondence for the record, but I think it might be helpful to explain briefly what our general position has been and is on this difficult issue.

After a careful review of the arguments of the New York Stock Exchange, we advised this Subcommittee last December that we had serious doubts that the sequence of events predicted by the New York Stock Exchange was likely to occur. We are still of that opinion. However, we recognized then and we recognize now that it is not possible to predict the future with certainty, particularly under conditions that have never existed before. We indicated our

belief, to which we still adhere, that if the serious impairment of the markets, which the New York Stock Exchange feared from the elimination of fixed commission rates prior to the implementation of the central market system were to occur or appeared likely to occur, we could seek to prevent or remove such impairment by utilizing the full extent of the authority granted to us in S. 2519, as well as any other authority we have under existing statutes.

Nevertheless, since the question has been raised of our authority to take remedial action, we have supported the efforts of the staff and the members of this Subcommittee to prepare specific statutory language on the subject. Inasmuch as several drafts of proposed language are before the Subcommittee, I would like first to discuss the issues as they appear to us, and then relate our views on the issues to the different approaches.

The first question is whether the Commission should have the authority by administrative action to cause all transactions in listed securities to be effected on a national securities exchange in every case or in specified cases, in whole or to a limited extent. Although the decision, whenever and by whomever made, will be a difficult one - - and it is therefore tempting to urge the Congress to assume the burden - - we think the complexity of the matter, the variety of techniques that might be employed to produce the desired result, and the exigencies of time and timing in the face of changing and unpredictable circumstances, throw the balance, in our judgment, toward putting the burden on the Commission.

The second question is what circumstances should justify or compel the imposing of restrictions on trading in listed securities. Should it be simply actual or prospective detriment to the public interest and the interest of investors, or something more precise? Since the proposed provision is directed to a specific possible problem, and a possible remedy, it would be well for the legislation to specify the nature of the problem with which it is concerned. In this respect, however, we favor identifying the impairment that is feared as that of our securities markets generally and not simply the effect upon any particular securities exchange or market. We realize that the largest existing market in listed securities is and is likely to continue to be the

New York Stock Exchange. However, we think it more appropriate for the Congress to state the subject of its concern to be our markets generally and not limit its concern to that Exchange.

The third question is the weight to be given to competitive factors in fashioning the remedy, assuming that the relevant impairment or threat of impairment has been found. In this regard, we have favored stating in the statute that the remedy of restricting trading to exchanges cannot be imposed unless exchange rules at the time do not unreasonably impair the ability of nonmember firms to solicit or effect transactions for their own account. On the other hand, we think it would seriously hamper the Commission in fashioning an effective remedy for the benefit of our securities markets if the remedy had to meet the test of being the one among all possible remedies that would produce the least anticompetitive effect. Still more would this be true, if our decision under such a standard was subject to concurrence by the Attorney General.

A fourth question is one of the appropriate time at which the proceedings preliminary to a decision under this provision can or should take place. We believe that the proceedings should neither be premature nor come too late. We have a reluctance, which I am sure the members of the Subcommittee share, to make such important economic decisions on estimates and forecasts of future effects. On the other hand, we have no intention of urging that we be required to wait until, if this should occur, the worst fears of the New York Stock Exchange have come to pass, before we could take effective action. It therefore seems to us, if we are to have the responsibility to resolve this question, we should also be given flexibility as to when we begin our inquiry into the problem, and when we resolve the questions presented.

Now, turning to the various proposals that are before this Subcommittee, let me discuss first S. 3126 as submitted by the chairman of the Subcommittee, and Senators Brock and Cranston. That bill would require the Commission to prohibit brokers and dealers from effecting transactions in listed securities otherwise than on a national securities exchange if the Commission makes specified findings with respect to the effect of exchange rules on securities dealers and on competition and with respect to impairment of the fairness and orderliness of the exchange markets or the functioning of exchanges.

We have already submitted detailed suggestions to this Subcommittee and its staff for the revision of a legislative provision which is virtually identical to S. 3126, and those changes are contained in the letters I have submitted for the record. In essence, our major difficulty with S. 3126, as presently drafted, is that we do not believe the Commission should be legislatively compelled so to restrict trading in listed securities, but rather, we believe that the elimination of nonexchange trading in such securities should be one of the options available to the Commission, if we become convinced that action should be taken to avoid or correct significant injury to the securities trading process. The use of the word "shall" in S. 3126, in setting forth our authority to act, could be construed as placing an affirmative burden upon the Commission to act in the manner set forth, even though other alternatives might be more appropriate. For that reason, we believe the word "shall" should be changed to "may."

Similarly, the description in S. 3126 of the findings the Commission must make before adopting appropriate rules is troublesome. We believe that the viability of fair and orderly markets generally, not just the existence of fair and orderly exchange markets, should be the determinants upon which Commission action is predicated. In our letter to Chairman Williams, which I have referred to earlier, we set forth suggested language changes to accomplish this goal.

Another proposal before this Subcommittee is one submitted by Senator Tower, originally intended as an amendment to S. 2519. Senator Tower's proposed amendment would make clear that the Commission's authority to act on this matter is granted in permissive, rather than mandatory, terms, which, of course, we favor. Senator Tower's proposal, however, would permit Commission action to deal with any impending crisis only if it could first be demonstrated that the public interest and the protection of investors were "substantially certain to be" adversely affected in the absence of such action.

We believe that this proposal may be overly restrictive. Substantial certainty with respect to future events is difficult to attain. We, therefore, prefer the "is likely to be" language in S. 3126.

The next proposal, numbered Amendment 1029, is the one Senator Hart introduced on the floor of the Senate on March 19. Senator Hart's proposal has two features with which we must differ. In the first place, it would require the Commission to hold "on the record" hearings. The effect of this as a matter of procedure and in the light of the requirements of the Administrative Procedure Act, would be to convert what is a quasi-legislative policy making determination into a trial-type adjudication complete with cross-examination. We believe this procedure is inappropriate and unduly burdensome and productive of delay.

Secondly, under Senator Hart's proposal, no Commission action could be taken unless the Attorney General advises that it is the least anticompetitive means of preserving fair and orderly markets for securities. No standards and no time limits are provided for this determination, nor is the Attorney General called upon to, in any way, balance the interests of the public in having the best possible markets against anticompetitive considerations. Given these two features of Senator Hart's proposal, if it should become law, I seriously doubt whether the Commission would be able to act at all, or, if we could act, whether we could act in time to stave off any impending crisis. Moreover, we do not believe it is sound policy to give the Attorney General complete discretion to veto the rulemaking of an independent regulatory agency simply because he believes it should have been formulated differently. We, therefore, believe Senator Hart's proposal should be rejected.

As I stated earlier, there is an additional problem with respect to timing in all three of the proposals. S. 3126 and Senator Tower's proposal provide that no rule could become effective until rules of exchanges fixing rates of commission have been eliminated. Senator Hart's amendment would provide that the proceeding for determining whether there should be a rule could not commence until that time. We prefer the approach in S. 3126 and Senator Tower's proposal, provided that it is clear that we are not, and cannot be, compelled to resolve the matter in advance of the unfixing of commission rates.

Both S. 3126 and Senator Tower's proposal would preclude us from extending the life of any rule we did adopt beyond May 1, 1978 unless we first gave the Congress 90 days notice of

our intention to extend the rule. Senator Hart's proposal would not provide for any extension beyond that date. We believe that Senator Hart's proposal would unduly hamper our ability to deal with unforeseen developments when they arise and to continue to deal with them so long as is necessary in the public interest. We would also urge consideration of elimination of the 90 day notice provision as impeding emergency action, in favor of extensions from year to year with concurrent notice of each extension.

Finally, we understand that the Treasury Department proposes to suggest a different approach which has much attraction. The Treasury proposal would provide in essence, that if we find that the fairness or orderliness of the market for listed securities has been adversely affected by transactions on an exchange and in the third market, we shall take such action as may be required to eliminate or mitigate these consequences and would specify alternatives, including the prohibition of third market trading in whole or in part. While this proposal would identify the type of problem with which we would be called upon to deal, which is the one which concerns the New York Stock Exchange, it would not mandate a specific approach, which we might find inappropriate, but would simply require us to take appropriate action and would specify possible approaches. We believe that the Treasury approach would avoid the problems which we have discussed above, including the problem which concerns Senator Hart, of calling for action which could be unnecessarily anticompetitive. We, accordingly, support the Treasury's approach, subject, of course, to its being embodied in statutory languge.