STATEMENT OF THE HONORABLE RAY GARRETT, JR., CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION, BEFORE THE SUBCOMMITTEE ON CONSUMER PROTECTION AND FINANCE OF THE HOUSE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE ON H.R. 4457, 94TH CONG., 1ST SESS. (1975)

(March 18, 1975)

Mr. Chairman, members of the Subcommittee:

I am pleased to be here today to present the Commission's views on H.R. 4457, a bill which would create a National Market Board, a board designed to assist the securities industry and the Commission in facilitating the establishment of a national, or central, market system.

This is our first opportunity, this session, to appear before this Subcommittee, and we look forward to working with you and the full Committee to insure the speedy passage of H.R. 4111. As you know, last session a good deal of time was spent on H.R. 5050, the precursor of H.R. 4111, the omnibus securities bill now pending before the Committee on Interstate and Foreign Commerce. A number of important and beneficial modifications were made to H.R. 5050 as originally introduced, and the final version deserved a far better fate than it received. We are delighted that H.R. 4111, which is substantially the same as H.R. 5050 in all substantive respects, will be marked up directly by the full Committee, and we stand ready to offer any assistance to you and the members of the full Committee.

H.R. 4457, introduced by Congressman Stuckey, is closely related to H.R. 4111 and is intended to complement its provisions mandating the establishment of a central market system. The Commission supports its adoption. Let me hasten to add, however,

that we recognize that the bill has been the subject of much criticism -- from some self-regulators, who say the bill is unnecessary and goes too far, and from some industry members and associations, who say the bill is too narrow and does not go far enough. Many of these criticisms appear to us to be the result of a misunderstanding of the bill's actual provisions.

We think this bill deserves serious and thoughtful consideration. Its major underlying premise -- the desirability of establishing, at an early stage, a body knowledgeable about the securities industry (both as it exists and as proposed) to serve as an advisor to the Commission on the central market system -- is a sound one. But, so that our position is not misunderstood, we think the first priority of business ought to be H.R. 4111, particularly if debate and argument over related bills are likely to slow up the process. However, we do not think it should, and hope it will not, be necessary to defer discussion of H.R. 4457 on such a basis.

Over the last four years, a consensus has been reached, at least of the government side and in some industry quarters, to the effect that a central, or national, market system, for the trading at least of many exchange-listed securities, should be established. Since that time, both the Commission and the Congress have held extensive hearings to determine what the broad outline of such a system should be and how it should be implemented. We are still in the process of deciding those issues, although we have made significant progress toward such a system.

Over the course of almost the last two years, however, my colleagues and I have become persuaded that a central market system, if one is to come about reasonably promptly, and if it is to be workable, must be established primarily through the efforts of

those who will operate and participate in the system, with the Commission resolving major policy disputes and insuring that the public interest is protected. A central market system cannot be created, in our view, by government fiat. It requires a careful balancing of competing interests and close cooperation from industry and self-regulatory competitors. H.R. 4111 would, in our view, make clear our authority to oversee and facilitate efforts to establish a central market system.

But recent events have demonstrated to us the importance of a continuing dialogue with securities industry members, self-regulatory bodies and potential users of the central market system. Almost a year ago, we appointed an advisory committee to counsel us on how best to implement our broad concepts of a central market system. That Committee, headed by Alexander ("Sandy") Yearley, IV, from Atlanta, is making meaningful progress toward the development of a set of governing principles for the central market system.

Representatives of the securities industry, however, have complained that they have no ready and officially-mandated means to offer their views about such diverse matters as duplication of self-regulatory operations and costs, the governance of the securities markets, the needs of the securities industry, specific problems over clearing and settlement, depository arrangements and so on. The concept of a new federal agency, which some industry spokesmen and groups have proposed to perform some of these functions, seems to us to be unrealistic and likely to be productive itself of duplication and inefficiency H.R. 4457 attempts to respond to these needs and concerns without creating new burdens or problems.

Thus, H.R. 4457 would establish, in effect, a permanent advisory committee, comprised largely of persons knowledgeable about the securities industry, whose function it would be to offer us advice on moving from where we are today to the central market system. This National Market Board, as it is called in H.R. 4457, would assume the burdens of our Yearley Committee and derive its existence not from the discretionary acts of the Commission but from the direct mandate of the Congress.

In addition, this Board would be expected to comment on and offer advice and assistance with respect to any and all significant regulatory proposals made by the Commission or the existing self-regulatory bodies that would affect the structure, functioning, operation or governance of our securities markets.

These are the only two functions that H.R. 4457 requires the Board to perform, and we do not understand that these functions have caused anyone any great concern although some will argue that legislation is not necessary just to create an advisory committee. As an advisory body, even though founded in statute, the Board could not force its views on the Commission or the self-regulatory bodies, and yet its knowledge of the industry, and its required review of ongoing events, would insure an advisory committee that will prove of value not only to the Commission, but to the Congress and the self-regulators as well. Perhaps as important, we are hopeful that such a Board can serve as the focal point for industry opinion on significant policy matters. In addition to retaining the right to make their views known directly to the policy-making bodies, the members of the industry will have an additional voice with which to press upon us, the exchanges, the NASD and the Congress, various proposals to remedy existing concerns.

Of course, in performing these functions, the Board would not assume any governmental powers of compulsion, as some commentators had requested. But, it seems to us that no need has been demonstrated for the major task of creating another governmental unit, particularly one whose functions would so closely overlap our own. It is also true that, under H.R. 4457, the Commission would select the initial fifteen members of the Board. We have not sought such authority; indeed we have not specifically asked for any of the authority this bill would grant to us. The grant of the authority to the Commission to appoint the initial fifteen Board members, however, seems to us to be most logical.

For one thing, the power to establish advisory committees already rests with us. For another, there really are no practical alternatives. One earlier suggestion was that these appointments be made by the President, but that process might delay implementation of the Board, and could require a balancing of the appointments on the basis of party affiliation. Besides, the President appoints the members of the SEC, and the opponents of this bill seem somewhat dissatisfied with the results of such a process. Presumably, each of the existing self-regulatory bodies could be permitted to designate representative members of the Board, but our experience suggests that a Board with that composition might be ineffective in reaching prompt, reasonably objective decisions.

If, after two years, the Board should still be confined to its advisory functions, new members of the Board would not necessarily be selected by the Commission. A rule would be required to govern future appointments, and the bill would not limit us to any particular mechanisms by which the selection of members would occur.

The portion of the bill that seems to have aroused the most comment is the one that would permit the Board, subject to appropriate procedures and due process, to assume the role of governing the central market system, once that system is established.

I can understand why the existing self-regulatory bodies would find such a provision threatening to their present operations. And our support of this bill should not be taken as any indication that we are dissatisfied with the role presently being performed by the existing exchanges and the NASD or that we think they necessarily will be incapable of regulating their individual market places once a central market system is fully operational. More importantly, it does not appear to us that the bill makes either of those adverse assumptions.

The underlying premise of this portion of the bill is that a great deal of time and effort have gone into the drafting of legislation -- H.R. 4111 -- designed to make the implementation of a central market system smooth and efficient. Although most of the persons studying the question assume the establishment of such a system, the question of its appropriate governance has been left unanswered. In part, this has been necessary because the central market system is not a precise concept; it is a broad outline of a system, with the work to fill in the details still at an early stage of progress.

It may well be that, with some uniform or comparable regulations applicable to all market places, the existing self-regulatory bodies can continue to perform the vital role of self-regulation that they have traditionally performed. On the other hand, it might ultimately be concluded that a national, self-regulatory body would be more effective and efficient than 13 or 14 separate self-regulators, although it does not necessarily follow that such a national body would assume all of the self-regulatory functions.

H.R. 4457 does not commit the Congress or the Commission to a single self-regulator. As we understand it, the only thing H.R. 4457 does is to provide, at this time, a mechanism -- which need never be used -- by which such a national, self-regulatory body could be brought into existence in as fair and practicable a manner as possible, if a need for its existence should be shown. It makes sense to us to suggest that, if the Congress is going to expend great energies on directing the establishment of a central market system, it also should at least make provision for the mechanism by which that system ultimately may have to be governed.

What are the objections to such an approach?

Some of the existing self-regulatory bodies are concerned that the mechanism established in H.R. 4457 contemplates an end to the traditional role of self-regulation, and instead reflects a "nationalization" of the securities markets. We do not believe that H.R. 4457 would accomplish, or is intended to accomplish, either of those results.

The initial Board, when the Board performs only advisory functions, would in fact be appointed by the Securities and Exchange Commission, but would have many, perhaps a majority, of its members persons active in the securities industry. While serving as an advisory body, there should be no concern about the erosion of self-regulation or the "nationalization" of our securities markets, even if it is the Commission that appoints the initial Board members.

If a transition to a governing body should be contemplated, the Board itself would propose in its constitution and rules how many persons should sit on the Board, what the composition of the Board should be and who should elect these members. Naturally, its rules to this effect would be subject to the Commission's oversight, but that is true at

present for the rules of any self-regulatory organization, and would continue to be true under both H.R. 4111 and S. 249, if those bills should be adopted by the Congress as presently drafted. It seems most unlikely that the Board would propose or that we would approve a provision that members of the Board be selected by the Commission; they would, presumably, be selected in much the same way the present directors and governors of existing self-regulatory organizations are selected; and we would not object to the bill making it clear that we should not appoint the members of a self-regulatory Board except, possibly, for some control over the selection of public members.

This does not strike us as effecting the "nationalization" of the securities markets, a question that has never remotely occurred to the Commission, and is nowhere embodied in H.R. 4457. At most it would effect a centralization.

Similarly, we think the concern that this Board, if it did assume governance functions, would end traditional self-regulation is also misplaced. If the Board should assume these governance functions, the most that could be said is that one self-regulatory body would be performing some of the regulatory and governance functions now performed by 14 self-regulatory bodies. The Board would not be comprised of persons who worked for the government or who owed their allegiance or appointment to the Commission or any other branch of the government.

In any event, the question of the Board's assumption of any governance functions would be required to receive a full airing. We do not believe that the time is ripe for making that decision. The question is, who should decide when the time is ripe and who should make the decision. Should it be the Congress or the Commission? This bill would put the burden on the Commission.

As drafted, the bill would provide for a hearing not only on the question of the Board's proposed constitution and rules, but also on the question of whether there was, in fact, a need for such a Board at the time, and whether it proposed to undertake its functions in a manner that was fair and equitable to the existing self-regulatory bodies. The Commission's determinations in this regard would in our view, be reviewable in a court, which would provide some assurance against prejudicial conduct on the part of the Board or the Commission.

If there is concern about the protections to be afforded to existing self-regulatory bodies, H.R. 4457 could be amended to require that we make certain specified findings prior to permitting any assumption by the Board of self-regulatory functions, and upon making such findings, to require the issuance of an order and a detailed statement, assuring even more stringent and searching judicial review of our conclusions.

There are advantages that could be gained by centralizing the governing functions of the new national market system in one self-regulatory body which should not be overlooked.

For example, it could:

-- encourage or promote adequate efficiencies in the nation's securities markets through interface, combination or other means;

-- achieve, to a significant extent, the elimination of duplicative activities by existing self-regulatory organizations;

-- facilitate economies of cost, without impairing local initiative and intermarket competition;

-- foster and promote comparable regulation for all participants in the national market system; and

-- give effect to other factors related to the development of effective, efficient and economic self-regulation.

The bill could require us to make favorable findings on these elements before permitting the Board to convert from an advisory to a self-regulatory body.

At this time, we do not have any position on the need for such a centralized governing body, but we do recognize it as one possible alternative to the governance of a national market system. Indeed, we referred to this general problem in our statement on the central market system, in March, 1973, as something that would eventually require attention. H.R. 4457 would allow this alternative to be implemented, with appropriate safeguards, if it appears desirable in the future.

Quite recently, in this context, our Advisory Committee, from whom you will be hearing later on in these hearings, has proposed that a national securities exchange be created to merge all the existing exchanges into one self-regulatory entity -- a national securities exchange -- which would govern the exchange markets while the NASD continued to govern the over-the-counter markets. We have not formally been presented with that proposal and I cannot offer this Subcommittee our collective views on it at this time. There are, of course, differences between that proposal and H.R. 4457, and the timing of these respective proposals has been fortuitous.

Our Advisory Committee's recommendation, however, does suggest that industry leaders and persons knowledgeable, not only about the current workings of our markets but of the present plans to create a national market system as well, are inclined toward the view that a certain degree of consolidation of the regulatory governance of such a system is a desirable attribute and should be fostered by appropriate means.

H.R. 4457 appears to us to offer a reasonable and flexible approach to a complex problem. Its premises are sound, and should be unobjectionable. We would be less than candid if we did not recognize the important consequences this bill could have if certain of its provisions were implemented fully. But, the bill does not mandate any dramatic overhaul of the existing markets; it does not require the elimination or merger of any existing markets; and it does not contemplate or intend the destruction of our traditional system of industry self-regulation with S.E.C. oversight. Rather, it intends to strengthen self-regulation, and smooth the way to the central market system. We hope those with an economic stake in this legislation will realize the importance of these goals.