DRAFT February 11, 1994

SPEAKING POINTS AND BACKGROUND INFORMATION FOR CONGRESSIONAL STAFF BRIEFING BY CHAIRMAN LEVITT

Accompanying the Chairman will be Kate Fulton, Jim McConnell, Sy Lorne, Barry Barbash, and Larry Haynes.

A handout entitled US SECURITIES AND EXCHANGE COMMISSION - AGENCY RESOURCES AND INDUSTRY GROWTH will be distributed to all attending the briefing. (Will give to Chairman on Monday, 2/14)

Chairman Levitt is introduced by Steve Harris

Thank you Steve and thanks to all of you for joining me and senior members of the staff today for what I intend to be an informative and informal discussion of the Commission's critical program priorities and its budget and authorization status.

With me today are (introduce senior staff)

First, I want to express my appreciation and the thanks of my fellow Commissioners for the tremendous support that you have provided the SEC over the years. While each of us may not have agreed on every single aspect of the Commission's programs, I know we are united in our interests to ensure that the savings and investments of millions of Americans are protected and that our markets are safe and robust.

The securities industry is one of the jewels of our economy and we can all be proud of its basic integrity and soundness. However, we must be constantly vigilant to ensure that investor confidence is maintained through the aggressive enforcement of the securities laws and thorough oversight of all segments of the industry. The securities industry has enjoyed tremendous growth in both overall size and complexity. Today we will discuss such priorities as industry growth, derivatives, mutual fund issues, municipal securities, Market 2000 issues or any other issue that any of you might want to raise.

However, the overarching priority for the SEC is a permanent self-funding mechanism. It is absolutely clear to me, and I trust to each of you, that the only way the Commission can be poised in 1995 and beyond to meet its growing responsibilities is by having Congress approve a full cost recovery (self funding) mechanism. It is important to emphasize that any self-funding mechanism will include the full review and oversight of existing appropriations and authorization processes.

INDUSTRY GROWTH

During the 1980s, the securities markets experienced dramatic growth and significant change, this evolution continues today and will in the future. For example, sales on U.S. securities exchanges increased from $543 billion to over $2.7 trillion between 1980 and 1993, a 397% increase. Foreign trading in U.S. equities grew nearly 687% during the same period, from $75 billion to $590 billion. In addition, the growth in the value of public offerings (excluding private placements) also was exceptional--from $58 billion in 1980 to nearly $1.1 trillion in 1993, a 1,797% increase.

Another area of tremendous growth has been in the number of investment companies and investment advisers and assets under management. At least one-quarter of all American households have used a portion of their savings and retirement dollars to purchase interests in investment companies, now valued at approximately $2.6 trillion. Money market mutual funds, in particular, whose assets now exceed one-half trillion dollars, have become popular substitutes for insured deposits for millions of Americans. Between 1981 and 1993, the number of registered investment advisers increased from 5,100 to over 20,000, a 292% increase, and assets managed by these advisers rose from $450 billion to over $9.6 trillion, a 2,033% increase. In addition:

- since 1980, investment company assets have grown at a compound annual rate of 22.4%, doubling every four years;

- from 1980 to August 1993, the number of separate mutual fund portfolios increased 666% from 564 to 4,320 and total mutual fund assets soared from $135 billion to over $1.9 trillion, an increase of more than 1,300%;

- since 1981, assets of mutual funds that invest primarily in foreign markets have skyrocketed from under $2.5 billion to $108.5 billion, a 424% increase;

- from 1980 to 1992, the percentage of U.S. households that own funds quadrupled from 6%, or 12.1 million accounts, to 27%, or 86 million accounts; and

- on average, since January 1993, roughly $23 billion of new money has flowed into mutual funds each month.

More importantly, though, is the significantly increased extent to which investors are using investment companies to fund their 401(k), 403(b) and individual retirement account plans. These investments are not government insured and the SEC is the only governmental agency responsible for overseeing the activities of the companies. Investment company portfolios reflect the increased complexity of products available in the financial markets. Their organizational structures have become more complex as many institutions such as banks, smaller broker-dealers, financial planners and industrial concerns pursue new markets by offering investment company shares to customers and employees. With complexity comes the need to more carefully and comprehensively review and analyze these products and structures to make sure investors are being treated fairly and equitably. Comprehensive inspections are resource intensive and require more time to complete. Yet, because of lack of staff, our inspections of investment companies have become more cursory and limited in scope rather than more comprehensive in order to expand the SEC's coverage of new registrants.

FEE COLLECTIONS

The Securities and Exchange Commission (SEC) is a "profit center" for the U.S. Treasury. The SEC currently produces substantial net revenue through collection of registration, transactional and other filing fees which are deposited in the General Fund of the U.S. Treasury. Since fiscal 1983, the SEC each year has collected significantly more in fees than its has been appropriated. For example, the SEC in fiscal 1993, collected $517 million in fees compared to total agency funding of $253 million. In fiscal 1994, the SEC estimates that it will collect nearly $632 million in fees compared to the agency's funding of $269 million. None of this surplus includes the hundreds of millions of dollars in court-ordered civil penalties and disgorgement resulting from the SEC's enforcement program.

CURRENT FUNDING STRUCTURE

The SEC has struggled to keep pace with this phenomenal industry growth. While the SEC's oversight responsibilities were growing, the SEC's staffing remained relatively flat between 1980 and 1988. Beginning in 1989, the SEC began receiving increases in staffing along with funding increases. However, even with these funding increases the SEC still lags behind the securities industry and has been unable to maintain coverage of these growing markets. For example, the SEC's resources to inspect investment advisers is woefully inadequate. While the number of investment advisers has grown to over 20,000 with $9.6 trillion of assets under management, the SEC has only 51 examiners. Similarly, the SEC has only 206 examiners to inspect over 21,000 portfolios with over $2.4 trillion in assets.

Since 1990, the SEC's funding mechanism has been a combination of appropriations and offsetting fee collections, resulting from increasing the Section 6(b) rate for the registration of securities. However, since 1991, the amount of appropriated funds has decreased from $159 million to $58 million for 1994, while the reliance on offsetting fee collections has grown from $30 million to $197 million in 1994. In fiscal 1995, it is proposed that the SEC will receive a net appropriation of $0 and rely completely on offsetting fee collections to fund its operations.

There are two major concerns with continuing to rely on offsetting fee collections derived from securities registration fees. First, the agency is at substantial risk if registration filings decline unexpectedly. A reduction in filings could force the SEC to seek supplemental appropriations or face possible sudden and massive reductions-in-force or furloughs. Second, the increases in the Section 6(b) rate, if they do not relate to the services and regulation provided by the SEC, may be effectively a tax on capital formation. In fact, some representatives from the securities industry have complained that they are paying for a level of regulation that they are not receiving. If the 6(b) fee increase becomes significant, it could have a negative impact on capital formation, which is vital to the U.S. economy.

SELF-FUNDING PROPOSALS

H.R. 2239. In addition to reauthorizing the Commission for fiscal years 1994 and 1995, H.R. 2239 would create a "full cost recovery" system that would permit the Commission to use its fee collections to offset the cost of its annual appropriation. The Commission would, however, continue to be subject to funding limits established through both the authorization and appropriations process. Under H.R. 2239, Congress would set the Commission's funding level through the appropriations process, and the Commission would proportionately adjust its fee rates to recover the total amount of its annual appropriation. The net effect of the Commission's funding for government-wide budgetary purposes would be zero, but the Commission would be guaranteed a full appropriation in the event of declining fee collections. In addition, for a five year period, the Commission would set its fees to recoup a "surplus amount" that would be paid to the U.S. Treasury to maintain current revenue estimates from the Congressional Budget Office. The surplus amount would be used for general government-wide purposes, and would not be targeted for Commission use. After 1998, the applicable surplus amount would drop to zero, and the Commission would adjust fee rates to collect only its appropriated funding. Moreover, after the five year period, each specific fee is intended generally to reflect the cost of the particular Commission program from which it is derived; although the amount collected by the Commission as a whole is intended to offset the Commission's entire appropriation.

OMB Proposal. The OMB Proposal also would reauthorize the Commission for fiscal years 1994 and 1995 and create a permanent funding mechanism for the Commission. Under OMB's proposed funding mechanism, the revenue from the Commission's existing statutory fees would continue to be deposited in the General Fund of the Treasury. The Commission's appropriation would be offset by the collection of increased fees and new fees that would be imposed on the securities industry. The Commission would be guaranteed a full appropriation, with the amount of that appropriation offset by the fee increases and new fees. Using this mechanism, the net effect of the Commission's appropriation would be zero for budgetary purposes. The Commission fee levels would be set each year through the appropriations process. Thus, each year, the Commission's appropriations committee would increase the Commission's fees at a level that would essentially maintain current revenue estimates and also fund the Commission. We have been advised by CBO staff that there are serious problems with the OMB approach. CBO is concerned that this proposal may not achieve the offset to appropriations that is essential to any support for the bill.

DIFFERENCES BETWEEN H.R. 2239 AND THE OMB PROPOSAL

H.R. 2239 and the OMB Proposal have many elements in common, but there also are a number of significant differences between them. Both proposals would establish permanent funding mechanisms for the Commission and guarantee the Commission a full appropriated amount that would be offset by fees. Both bills use the same base fees, that is: section 6(b) fees on the filing of registration statements, fees on proxy and tender offer filings, fees imposed on certain securities transactions in the exchange and OTC markets, and fees on investment advisers. However, the two proposals differ when it comes to: (i) whether the revenue generated by the fees is to be earmarked solely for use by the Commission; (ii) who sets the fee rates; and (iii) the ultimate amount of revenue to be generated by Commission fees and, the resulting impact of that amount on the securities industry.

Use of Commission Fees. H.R. 2239 would earmark fees generated by the Commission for use by the Commission; after a five year period, surplus Commission fees would no longer be deposited in the General Fund of the Treasury, and the fees collected for Commission purposes would bear a reasonable relationship to the Commission's regulatory activities. In contrast, the OMB proposal anticipates that existing Commission fees would continue indefinitely to be directed to the General Fund, with new and increased fees being imposed to fund the Commission's appropriation.

Establishment of Fee Rates. H.R. 2239 provides that, the Commission would proportionately increase or decrease the statutory fee rates, subject to oversight by Congress. Under the OMB proposal, fees would be set by Congress, (e.g., the Commission's appropriations committee), presumably with input from the Commission.

Amount of Revenue Generated/Fee Levels. H.R. 2239 anticipates that, after a five year period, the amount of revenue generated by Commission fees would be limited to Commission use. As a result, it is likely that the fees imposed on the securities industry would decline dramatically at the close of the five year period. The OMB proposal assumes that the Commission will be funded by increases in the existing statutory fees, with the existing fee revenues continuing indefinitely to the General Fund. Thus, in order to fund the Commission, existing fees imposed on the securities industry will have to be increased substantially, with no reduction contemplated.

The key is to ensure that every investor who purchases mutual funds (banks or not) is equally protected