Examining the 'Competitive Market Supervision Act' of 2001

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Examining the "Competitive Market Supervision Act" of 2001: The Forces Behind a Reduction in Securities and Exchange Commission Fees

The American policymaking process' vulnerability to external influences is widely debated, as the institutional structure allows for an exogenous actor to exert its influence on the House of Representatives *and* the Senate (Polsby, 2009, 4). This paper will examine the exogenous forces influencing the "Competitive Market Supervision Act", as it was referred to in the Senate, or the "Investor and Capital Markets Fee Relief Act", as it was referred to in the House of Representatives, which was passed in 2001 by the 107th Congress of the United States of America. This bill was one of many that contributed to the process of financial deregulation leading up to the financial crisis of 2008, and its specific purpose was to reduce the fees charged by the Securities and Exchange Commission (SEC) on "stock transactions," the "registration of securities," and "merger and tender offers" (CQ Almanac, 2001). The bill also included a provision for increasing the pay scale of SEC employees. While a diversity of groups had the potential to be impacted by the Competitive Market Supervision Act, this paper will discern which exogenous forces exerted the most influence on elected officials in the policymaking process by examining the records of Congressional Hearings, Committee Reports, and Floor Debates. It will be argued that while the bill dealt with an ideological issue, i.e., the reduction in fees essentially equating a large tax cut, the debate was not dominated by ideology, and instead showed evidence of bipartisan cooperation and that, ultimately, the bill reflected the interests of major pension funds, Wall Street, and the SEC as an organized industry.

This paper will begin with an overview of the bill, including a summary of the bill's main features and the events that led up to its drafting. It will also briefly outline the minor differences in party support, because although the focus of this paper is on the forces influencing both political parties, the differences in party support still influenced the debate and ultimate passing of the bill. It will then examine the major influences on this bill— beginning with the ideological debate around the measures in this bill, and how this debate was not in fact central to the outcomes. This paper will then evaluate how the State Teachers Retirement Systems of Ohio and the California Public Employee Retirement Program pension funds lobbied for the adoption of this legislation, and how Securities' Associations and brokerage firms representing the broadly referred to category of "Wall Street" also publicly expressed their support for the bill. Finally, it will examine how the SEC, not surprisingly, organized as an industry group through statements by its chairwoman and the labour union that represented them to lobby its support for a bill so central to its operations.

The Need for a Reduction in SEC Fees: Competition and Economic Prosperity

By way of background, it is important to note that the SEC was established after the Great Depression as an autonomous body to provide regulation over the American Stock Market. The SEC ensures that American investors are protected, that markets remain efficient, and that the companies involved in these markets remain fully informative to their shareholders and potential investors (Securities and Exchange Commission, 2012). The SEC still fulfills that mandate today, and as mentioned in several statements by Congressmen during the House of Representatives' hearing on the bill, the SEC is one of the key reasons why the American Stock Market is globally trusted and globally competitive (Saving Investors Money, 2001). The SEC has always been able to fulfill its mandate by charging small fees on the transactions that occur on the stock market (SEC, 2012).

In 1996, Congress passed the National Securities Market Improvement Act, a piece of legislation that reformed the structure of SEC fees in order to ensure that fees remained large enough to finance the SEC's operations (Saving Investors Money, 2001). However, conditions after 1996 greatly changed the effects of these fees, and revenue from the fees began to far exceed the amount needed for the SEC's operations. For example, in 2001, revenue was expected to be $2.47 billion, while the cost of running the SEC was only $423 million (CQ Almanac, 2001). The driving force behind this growth of SEC profitability was the massive growth of general stock market activity and valuations due to the rise in technology and internet stocks (Saving Investors Money, 2001). The excess profits generated by these increased SEC revenues were treated as general tax revenue by the federal government, and this represented an important part to the debate of the Competitive Market Supervision Act. For example, several Democratic Congressmen pointed out that for the 2003 fiscal year, a reduction in these fees would have resulted in a loss of $1.5 billion in general government revenue (Saving Investors Money, 2001).

The argument behind the Competitive Market Supervision Act was that these fees should be reduced because they were never intended to act as a general source of revenue for the federal government (Saving Investors Money, 2001). Furthermore, with the rise of foreign stock exchanges, there was an impetus for the US market to remain competitive; reducing fees was one way to do so (Saving Investors Money, 2001). Most Republicans and Democrats in both chambers supported the idea that it was unfair to essentially impose a tax on investors by imposing fees that were not needed to fund the SEC, and were in fact being used for completely unrelated purposes. Both political parties also acknowledged that these fees impacted a large number of American households, either through their direct investment in the stock market, or indirectly through their pension funds (Saving Investors Money, 2001). One disagreement between the two parties occurred over the effect of the absence of the excess revenue generated by these fees. Republican Senators and Congressmen both supported a reduction in SEC fees for the benefit of American households, even if it meant a reduction in general revenue for the federal government (Saving Investors Money, 2001). Democratic Senators and Congressmen, in contrast, acknowledged that while excess SEC revenues were being appropriated for reasons that were not originally intended, this excess revenue made up a significant (though by no means substantial) part of the budget (Saving Investors Money, 2001). Democrats thus were concerned with how a reduction in these fees might lead to a reduction in social spending. As such, they instead favored a less extreme reduction of SEC fees (Saving Investors Money, 2001).

A second major part of this bill was a provision to raise the pay scale of SEC employees to be more competitive with other federal regulatory agencies. This issue caused some disagreement between the two parties as well. Some Republicans worried that this might create a precedent with other government agencies asking for an increase in pay scale as well (Saving Investors Money, 2001). Ultimately, the two parties resolved their disagreement over the magnitude of fee reductions and the issue of pay parity. The House passed the bill on June 14, 2001, the Senate passed it on December 20, 2001, and President Bush signed it into law on January 16, 2002 (CQ Almanac, 2001).

Influences on the Policymaking Process

The Influence of Ideology: Bipartisan Support for the Bill

As noted above, a major component of this bill resulted in the equivalent of a major tax cut and, as such, one would have expected some significant cleavage between the two political parties on ideological lines with the bill being favored by fiscal conservatives and opposed by fiscal liberals. However, during the House of Representatives' hearing, a leading liberal figure in the Senate, Charles Schumer, testified in support of this bill. During his testimony, he admitted that:

"Congressman Kanjorski and I would probably like to see the SEC's budget go up… but I know Mr. Chairman and Chairman Gramm would not like to do that. So we think we ought to return it to the taxpayers" (Saving Investors Money, 2001, 14).

This statement illustrates the slight ideological difference that persisted between liberals and conservatives, in that liberals favored a more minor reduction of SEC fees with some of the excess revenues being left with the SEC for their purposes. Nevertheless, these ideological differences were sufficiently minor as to allow the bill to get support from liberal Senator Charles Schumer. Furthermore, the bill did indeed enjoy wide bipartisan support, as is mentioned by several Congressmen in the floor debates (Congressional Record, 2001; hereafter CR). In his prepared statement, Schumer further makes it clear that the interests of investors and keeping the US stock market competitive are the driving forces behind his support for this bill (Saving Investors Money, 2001, 64), and likely bipartisan support for the bill. Thus, although reductions in fees equivalent to a tax cut and decrease in general government revenue could theoretically create an ideological divide, there is a lack of evidence to support this theory. Instead, we have Charles Schumer, a major liberal figure supporting the bill and a relatively large base of bipartisan support.

The Influence of Major Pension Funds: Indirect Benefits for Working-Class Americans

Major pension funds expected to benefit from reduced SEC fees because they deal with transactions in the stock markets that are fairly large in scope. A reduction in SEC fees therefore also indirectly benefitted the individuals contributing to such pension funds. According to New York Congresswoman Kelly, this legislation ensured that pension holders would be "protected and encouraged, not taxed" from a reduction of fees, because the fees "exponentially add up over the years" (CR, 2001, H3169). Ohio Congressman Oxley also noted in the House's floor debate that the bill "enjoys widespread support from…major pension funds" (CR, 2001, H3165). Although all major pension funds had the potential to benefit from the passing of the legislation, it was mainly the State Teachers Retirement Systems (STRS) of Ohio and the California Public Employee Retirement Program (CalPERS) that played a detectable role in the policymaking process.

In the House's hearing on the bill, the STRS of Ohio submitted its written support. STRS of Ohio highlighted that its average annual SEC fees were $225,000, and thus they publicly stated their "strong support" for a reduction of SEC fees (Saving Investors Money, 2001, 125). Similarly, the CEO of CalPERS expressed his strong support for the bill in the Senate's hearing. The CEO testified that although CalPERS' pension fund invests a modest amount compared to mutual funds, for example, a reduction in SEC fees would still result in a rather significant $342,000 in savings per year (Strengthening the SEC, 2001).

Furthermore, in the House's hearing, Senator Gramm highlighted CalPERS in particular as a group that represents "the people who are actually paying the fees" and thus as a group that had "obviously…endorsed this bill" (Saving Investors Money, 2001, 4). This statement confirms the motivations behind CalPERS' endorsement, and that their endorsement had enough influence over Senator Gramm in the Senate's hearing for him to cite them in the House's hearing as an example of a group that will benefit from the bill. Finally, in the House floor debates, CalPERS is mentioned again by California Congressman Cox, for what it has paid in "overcharges" in the year 2000, and how these overcharges take away from "worthy people's retirement savings" (CR, 2001, H3179). CalPERS can therefore be seen to have exerted influence on Congressman Cox, as he mentioned CalPERS explicitly in the House floor debates. Ultimately, both the STRS of Ohio and CalPERS made their preferences known during the policymaking process, and the resulting outcome of the bill did indeed reflect their preferences, as the reduction in user fees reflected their objectives of making their funds more profitable to their members.

The Influence of Wall Street: For the Benefit of the Securities Industry

Wall Street, being the large brokerage houses and other entities that make up the American securities industry, expected to benefit immensely from this bill's reduction of fees, as these reduced fees would lower the cost of business for Wall Street in general, and particularly for the securities industries' institutional investors. Institutional investors pay the majority of SEC fees, but some of these fees are shouldered by other smaller members of the securities industry (Strengthening the SEC, 2001). In particular, the reduction of fees for mergers and tenders and the registration of securities would be a direct benefit to small investors on Wall Street.

Wall Street, as a broadly defined category, played a detectable role in the policy-making process by the accounts of journalists from *CQ Weekly.* Firstly, this bill was considered one of Wall Street's "top legislative priorities" from the

107th Congress (CQ Almanac, 2001). *CQ Weekly* also states that "the legislation was promoted all year…by Wall Street" because the fee reductions were seen "as a boon to institutional investors" (Schatz, 2001, 3091), illustrating that there was a perceived influence of Wall Street by a credible source. Moreover, in the House's hearing, Chairman Baker expressed his knowledge that this bill was *perceived* to be influenced by Wall Street when he stated "I wanted to make clear the point some would argue this is to benefit Wall Street types." However, he affirms that the bill is also intended to benefit all working class Americans who are eager to save for their futures through investments (Saving Investors Money, 2001, 4). He therefore maintains that this bill was about a broader set of interests than solely Wall Street's interests, but undeniably references how it benefits "Wall Street types."

Wall Street's more specific bodies, like Specialist Associations and large brokerage firms, played a detectable role in the policymaking process through their testimony in the Senate and the House. In the Senate's Hearing, for example, the CEO of the Securities Traders Association testified that "Section 31 transaction fees operate as a tax on the gross trading revenue of securities professionals" (Strengthening the SEC, 2001). He thus illustrated the security traders' interests in reducing SEC fees; these interests stand apart from simply investors' interests. The Securities Traders Association was therefore a visible supporter of the bill during the policymaking process. Moreover, representatives of the Securities Industry Association and the Specialist Association of the New York Stock Exchange (NYSE) also testified in the Senate's hearing, though their testimony reflected more how a reduction in SEC fees would be primarily beneficial to their investors, rather than to the brokers themselves (Strengthening the SEC, 2001). Regardless, a benefit to the investor clients of these Associations is a benefit to their membership in general.

Many of these associations testified again in the House's hearing on the bill. The Specialist Association of the NYSE again iterated how SEC fees were "creating a drag of over $1 billion per year on capital markets" and thus on their business (Saving Investors Money, 2001, 89). Furthermore, the Security Traders Association testified in support of the bill again in the House, this time via James Toes, who was also the Director of Merrill Lynch Equity Trading, a large brokerage firm. He unsurprisingly conveyed that the Security Traders Association strongly supported the legislation that reduced the "growing burden" of SEC fees (Saving Investors Money, 2001, 96). Ultimately, three associations that represented the interests of Wall Street were active in both chambers, providing testimony in support of the bill, thus rendering their preferences highly detectable within these hearings.

Perhaps the clearest evidence of Wall Street's influence over this bill comes from a statement made in the House's floor debate by Congressman LaFalce, who introduced a Democratic Substitute to the bill. He stated:

"Who are the other ones who are primarily supporting this bill? Well, let us not kid ourselves. It is the securities industry. It is not individual investors. They have not been coming to us. I do not think I have received one phone call or one letter from an individual investor. *But I have been inundated by representatives from the various securities industries…*"(CR, 2001, H3172, emphasis added).

This statement clearly illustrates how the securities industry actively lobbied at least Congressman LaFalce to pass this bill. Aside from publicly endorsing the bill in hearings, Congressman LaFalce's statement confirms that the securities industry was also active behind the scenes. He goes on in the debate to address how the reduction in SEC fees mostly benefits the securities industry because of their high volume of trading, as opposed to individual households or investors. As was mentioned in the House's hearing, the "fees on the sale of stock are just 33 cents per $10,000 of transactions," so the average household would not save any substantial sum of money from a reduction of these fees (Saving Investors Money, 2001, 29).

The resulting outcome of the bill specifically reflected the preferences of Wall Street because it maintained a broad cut in all fees associated with the SEC, including fees for mergers and tenders as well as fees for registering securities, and thus it is reasonable to assume that Wall Street's preferences exerted some influence over policymakers. Some Congressmen even expressed concern for the provision of reducing all SEC fees in the House's hearing, as they questioned why the bill focused on the registration fees and merger and acquisition fees instead of on the "base of consumer side" (Saving Investors Money, 2001, 7). Despite this opposition, the bill maintained a reduction in all three types of fees. Ultimately, the Committee Report released on this bill confirms that "the brokerage firms who are market makers and floor specialists on the national exchanges would receive substantial benefits" from this bill (Rept. 107-52, 2001), because of the high volume of their activity on the stock market and the reduction in registration, and merger and acquisition fees.

The Influence of Industry: The SEC and Pay Parity

The SEC, as an organized industry, expected to benefit most obviously from the pay parity portion of the bill. The SEC would have benefited directly from this provision, and although it supported reducing transaction fees as well, the pay parity portion of the bill is where it exerted the most influence by continually identifying its strong support for the provision. SEC chairwoman Laura Unger, and the union that represents SEC employees— The National Treasury Employees Union (NTEU) – exerted this influence by testifying in Congressional Hearings and by publicizing the bill to the *Washington Post*. The NTEU was an important actor in the overall influence of the SEC as an industry because they represented over 2,000 SEC employees (Barr, 2002).

Before the bill was brought before Congress, there is evidence that former SEC chair Arthur Levitt had influence in making pay parity part of the bill. According to *CQ Weekly*, Senator Gramm worked hard to ensure that the pay parity provision was never sacrificed in the bill because of a "promise" made to Arthur Levitt "before [Arthur] departed as SEC Chairman" (CQ Almanac, 2001). Further, in the House's Hearing, Gramm affirmed that "the industry itself supports the measure" (Saving Investors Money, 2001, 9). The SEC chairperson following Arthur Levitt was Laura Unger, and judging by her testimony in both chambers' hearings, she was determined to continue to exert the SEC's influence over ensuring that pay parity remained part of the bill. Ms. Unger made it clear to both committees that the employee retention rate at the SEC was "alarmingly" low, and much lower than the "government average." She referred to the industry as facing a "staffing crisis" (Saving Investors Money, 2001, 24). She argued that the high employee turnover rate interfered with the basic operations of the SEC, and that it was imperative for the pay scale of SEC employees to match the pay scale of other federal regulatory agencies (Saving Investors Money, 2001). Thus, it appears the SEC Chairwoman of the day played a highly visible role in the hearings of both chambers.

Furthermore, the preferences of the SEC were noted in both the Committee Report and the floor debate in the House. The Committee Report, for example, refers to the SEC as "enthusiastically endorsing" the bill (Rept. 107-52, 2001). In the floor debate, Democratic Congressman LaFalce refers also to the support of "labor unions" and deduces that they only supported the bill because of "pay parity provisions" (CR, 2001, H3172). It is likely that the NTEU was the most visible labor union that offered support for the bill, because the NTEU was vocal to the *Washington Post* about its "deep disappoint[ment]" when the 2003 fiscal budget did not in fact allow for an increase in the pay scale of SEC employees (Barr, 2002). The NTEU further commented that it would use "every resource available" to them to ensure that pay parity was realized in future fiscal budgets (Barr, 2002). There is thus strong reason to believe that the NTEU would have used "every resource available" to them during the actual policymaking process as well. Finally, again in the House's floor debate, Congressman Menendez illustrated succinctly that this bill had "strong union support, industry support, and agency support" (CR, 2001, H3170), all presumably from the NTEU and the SEC. Ultimately it is reasonable to conclude that the SEC exhibited influence over the policymaking process through its Chairperson as well as the NTEU because the bill reflected their preferences. In line with the SEC's expected benefits, the bill passed with the desired pay parity provision, even in spite of some vocal opposition from Republicans. Although the 2003 fiscal budget did not effectively allow for these pay parity measures, the pay scale of SEC employees was legally increased to match the levels of other Federal Government regulatory bodies with the passage of this bill.

Conclusions

The Competitive Market Supervision Act involved a reduction of SEC fees and an increase in the pay scale of SEC employees. The role of the internet in facilitating broader participation in the stock market, and the rise of foreign exchange markets with competitively lower transaction fees contributed to the need for this bill. While a reduction in SEC fees technically benefited all investors in the stock market, only certain organized groups like the STRS of Ohio, CalPERS, Wall Street and the SEC exerted a detectable influence on elected officials during the policymaking process. The reduction of SEC fees particularly benefitted STRS of Ohio, CalPERS and Wall Street. We find evidence of their influence in the policymaking process through testimony in hearings, reports from *CQ Weekly,* and through Congressmen referencing these interest groups in both the House's hearings and floor debates. The SEC as an industry benefitted from the increase of pay scale of SEC employees, and the testimony of SEC Chairwoman Laura Unger and the NTEU's vocal support illustrate the SEC's influence on the policymaking process. Despite some opposition to both the magnitude of reduction in SEC fees and the increase in pay scale from various political actors, the bill passed to include the provisions that these interest/industry groups benefit from.

While it is difficult to know the *extent* to which these interest/industry groups exerted influence over the policymaking process, elected officials were not shy to vocalize what groups either endorsed the bill or were consulted in drafting the legislation. The analysis of this paper ultimately suggests that interest/industry groups are able to influence the movement of policy, and that both chambers of Congress and the media provide a platform to do so. This analysis also suggests that while a bill may affect a broad base of citizens, it is the groups that are most organized, with the greatest resources, and the groups that have the most to gain (or lose) that perhaps exert the greatest influence. This is best illustrated by the large amount of evidence reviewed in this paper showing that Wall Street, a clearly organized and resourceful group, likely exerted strong influences on elected officials in the passing of this bill. While the Competitive Market Supervision Act encompassed relatively minor reductions to the regulation of the American Stock Market, the bill indeed allowed Wall Street to accrue a greater benefit from its activities on the stock market. This bill can therefore be viewed as one of many where Wall Street likely influenced the policymaking process and left the American financial system more vulnerable to the speculation and volatility that led to the 2008 crisis. The American policymaking process is thus not immune to the influence of external forces, and an awareness of these influences is a vital part of understanding the policymaking process in Congress.

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