Testimony of Ben A. Plotkin
Chairman and CEO
Ryan Beck & Co.
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Hearing on

"Self-Regulatory Organizations: Exploring the Need for Reform"

I. Introduction

Mr. Chairman and members of the Committee, my name is Ben A. Plotkin, and I am Chairman and Chief Executive Officer of Ryan Beck & Co., a 60 year old NASD member firm based in New Jersey with 38 offices in 13 states. I am also Chairman of the Securities Industry Association's (SIA) Regional Firms Committee, which represents the interests of regional firm members of the SIA. I thank the Chairman and the Committee for the opportunity to testify on issues relating to the proposed mergers between the New York Stock Exchange ("NYSE") and Archipelago Holdings, Inc. and The Nasdaq Stock Market ("Nasdaq") and Instinet, LLC, and especially to present the Regional Firms Committee's support of the Hybrid self-regulatory organization ("SRO") model.

I am not here to advocate a business position on the two proposed mergers. Rather, I am here to emphasize the Regional Firm Committee's keen interest in the broader self-regulatory issues that currently face this industry. These regulatory considerations -- indeed, these challenges – are brought that much more to the forefront by the proposed mergers. We believe the time is ripe for sweeping self-regulatory reform and respectfully request that you to take

these considerations, and the unique challenges they present to the regional firms throughout this country, into account as you consider the implications of the proposed mergers.

The Role of the Regional Firm

Regional securities firms play an important and unique role in the U.S. markets. As a matter of definition, many of the so-called “regional” firms, like Ryan Beck, do business from coast to coast. We are simply smaller and much more focused on certain types of clients; we serve these clients in a way that larger, national firms often cannot. Our client base, in many respects, are more typical individual investors looking for quality advice. They are often small businesses looking to access the capital markets or municipalities with financing needs below the radar of large national firms. Our clients increasingly look to us – indeed expect us -- to provide the full compliment of services offered by the national firms but on a more targeted, cost-efficient basis. Many clients are drawn to regional firms precisely because of the smaller scale feel and more personalized attention we are able to deliver. Regional firms endeavor – and have thus far succeeded – in meeting these needs and expectations. Yet many of the same circumstances that have historically enabled regional firms to attract and retain a loyal client base can also present unique challenges when seeking to satisfy the increasingly complex, and often times duplicative or conflicting, regulatory framework within which we operate. If regional firms are to continue giving value to our client base -- the small businesses and families struggling to save for retirement or for their children’s college education that we serve -- the enormous challenges posed to regional securities firms by the unnecessary costs of the current regulatory structure, needs to be considered and addressed.

Inefficiencies of the Current Regulatory Framework and its Impact on Regional Firms

The securities brokerage industry is one of the most heavily regulated in this country. Brokerage firms of every size and scope are subject to regulation and oversight at both the federal and state level, as well by at least one, if not multiple, self-regulatory organizations.[1] Most regional firms are members of multiple self-regulatory organizations ("SROs"), including the two national SROs – the NYSE and NASD. In addition, we are regulated by the SEC and, in the case of most larger regional firms, 50 state regulators. While the National Securities Markets Improvements Act of 1996 (NSMIA)[2] took measures to eliminate certain duplicative and competing regulations at the federal and state level, no comparable legislation has addressed the issue of multiple, and potentially conflicting, SRO rules aimed at the same substantive conduct.

Regional firms' resources can be hit particularly hard when forced to contend with duplicative rulemaking, examinations and enforcements, as well as duplicative registered representative and other fees. The ever-increasing demands of complying with different, and sometimes conflicting, rules can place regional firms at a competitive disadvantage to their national firm counterparts – an effect ultimately detrimental to investors generally. This is

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1 Pursuant to Section 15(b)(8) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), U.S. registered brokers and dealers are required to become members of at least one self-regulatory organization. *See* 15 U.S.C. § 78o(b)(8) and 17 C.F.R. § 240.15b9-1.

2 104 Public Law 290 (1996). For example, Section 15(h)(1) of the Exchange Act, which was adopted as part of NSMIA, provides that "[n]o law, rule, regulation, or order, or other administrative action of any State or political subdivision thereof shall establish capital, custody, margin, financial responsibility, making and keeping records, bonding, or financial or operational reporting requirements for brokers, dealers, municipal securities dealers, government securities brokers, or government securities dealers that differ from, or are in addition to, the requirements in those areas established under [the Exchange Act.] The Commission shall consult periodically the securities commissions (or any agency or office performing like functions) of the States concerning the adequacy of such requirements as established under [the Exchange Act.]"

because the scale of national firms enables them to absorb the cost of unnecessary regulatory duplication better than regional firms can. Add to this backdrop the fact that the SROs have been particularly active in their rulemaking, examination and enforcement initiatives during recent years and the resulting impact on regional firms has become that much more acute. If left unaddressed, there will be continued consolidation among small and regional firms as they struggle to cope with high relative regulatory costs. This can only lead to less efficient capital markets as it relates to small business, small governmental entities and individual investors.

Today, even seemingly minor differences in the language or application of two different SRO rules aimed at the same substantive conduct can result in significant operational costs in an effort to ensure compliance. At the same time, duplicative and conflicting regulation – coupled with the associated confusion and economic burden it places on the industry, and regional firms in particular – fails to further the very investor protection goals that lie at the heart of each individual regulator's mandate. In fact, regulatory duplication can undermine investor protection, because it means that firms' compliance efforts are diverted to trying to reconcile and comply with two sets of substantive standards, rather than focusing on monitoring and preventing conduct that could harm investors.

While the SEC and the SROs have shown some recent efforts to address these concerns through increased coordination on rulemaking initiatives and examinations, there are practical difficulties and time delays, not to mention cost inefficiencies, in forcing such coordination across independently managed organizations simultaneously seeking to regulate and enforce multiple layers of rules directed at the same substantive conduct or activity. In short, the inefficiencies of the current model result in increased costs to investors, place regional firms (and the clients they continue to serve) at a disadvantage and indeed ultimately frustrate the very

purpose at which the rules are directed. While the industry is certainly appreciative, in the short term, of the regulators' efforts to mitigate the negative effects of duplicative regulation, it is unrealistic to expect that any of amount of regulatory coordination can fully counteract the inefficiencies that are inherent in the current structure.

II. The Time is Ripe for Self-Regulatory Reform

Much as I have critiqued the inefficiencies of the current, multiple SRO framework, I am not here to promote the abolition of SROs as a concept. Quite the contrary. The Regional Firms Committee continues to advocate the benefits and validity of self-regulation. Self-regulation has been an integral part of the securities industry since time immemorial and for many years it has worked incredibly successfully. In principle, self-regulation fosters efficiency and brings important expertise to the regulatory process. Self-regulation and governmental regulation are together capable of achieving a level of investor protection that is truly greater than the sum of its individual regulatory parts. The challenge is to continue to elicit those benefits by not clinging rigidly to a framework that, for various reasons, has become increasingly counterproductive. It is not enough for regulation to merely work. It must continuously evolve in order to preserve the U.S. securities markets' stature as the most transparent, dynamic, and competitive in the world.

Given the current proposed mergers, now is the appropriate time to restructure and revitalize the self-regulatory system and truly bring it into the twenty-first century. If handled appropriately, such reforms will (i) better protect investors, (ii) maximize the resources of all securities firms, (iii) avoid the potential conflicts of interest inherent in the current system and (iv) eliminate the inefficiencies that result from duplicative rulemaking and examinations.

In Support of the Hybrid SRO Model

In order to effectively and efficiently address concerns regarding conflicts of interests, regulatory duplication and the impact of inconsistent regulation, the Hybrid model proffered by the SEC in its SRO Concept Release[3] presents an appealing and practical alternative to the current self-regulatory model. Under the Hybrid model, the SEC would designate a single entity unaffiliated with any securities market (the "Single Member SRO") to regulate all SRO members with respect to broker-dealer oversight and cross-market rules, including rules governing members' financial responsibility requirements, sales practices, qualification and registration of personnel, cross-market trading, handling of customer accounts and recordkeeping. In addition, the Single Member SRO would be responsible for promulgating membership rules, inspecting members for compliance with those rules, and taking enforcement action against members that fail to comply.

In addition to the Single Member SRO, each securities market would have its own SRO (each, a "Market SRO") that would remain responsible for rules specific to that market, including rules governing the market's operation, regulation, listings, governance and market-specific trading, as well as enforcement of those trading rules.

Efficiencies and Other Benefits Furthered by the Hybrid Model

Elimination of inconsistencies and unnecessary duplication. The Hybrid model would minimize the opportunity for inconsistent regulation that results from multiple and duplicative regulatory oversight. Regional firms would therefore not be required to spend compliance resources attempting to monitor and comply with two or more inconsistent set of rules and rule

[3] Concept Release Concerning Self-Regulation, 69 Fed. Register 71256 (Dec. 8, 2004) ("SEC SRO Concept Release").

interpretations. Regional firms would instead have the ability to focus resources on achieving the highest level of compliance for the cross-market rules imposed by the Single Member SRO, thus lessening the risk of inadvertent violations of those rules. In addition, the Hybrid model would allow a firm to avoid positioning itself in a contradictory manner *vis a vis* its respective SROs due to resulting enforcement actions that may derive from inconsistent rules and interpretations.

Regional firms currently allocate a considerable amount of resources attempting to comply with the regulatory obligations imposed by multiple SROs rules having identical goals and underlying purposes but slightly different substantive requirements. Much of these costs and inefficiencies would be eliminated under the Hybrid model. The resulting savings would help to keep regional firms innovative and competitive, with all the benefits to investors and markets that this entails. In effect, the Hybrid model would place a regional firm at a leveled competitive playing field with its national firm counterpart by allowing resources to be distributed in a cost-effective and efficient manner across the entity in order to obtain the best results for the firm and investors alike.

The Hybrid model would also offer many advantages as compared to the increased cooperation and coordination efforts recently undertaken by the NASD, the NYSE and the SEC. Those efforts, while appreciated, are simply insufficient to address the needs of all securities firms. In addition, regional firms may also be members of one or more regional SROs that have not coordinated their efforts with the NASD and the NYSE, thereby resulting in continued inefficiencies and duplicative efforts for both the regional securities firms and the regional SROs. Continued reliance upon independent and often competing entities that focus on a limited number of areas does not result in efficient cross-market oversight. The Hybrid model would

eliminate these inefficiencies. Today, these problems are leading Regional Firms to seriously consider dropping NYSE membership simply to avoid redundant regulation. Some firms, like Ryan Beck, have chosen to access the NYSE market through other broker-dealers, in order to avoid duplicate regulation. This is demonstrative of a situation that should not persist. All firms should be subject to the same regulatory process; one that is efficient and non-duplicative.

Maximization of regulatory resources. The Hybrid model would also strengthen the effectiveness of the SEC and SRO regulatory oversight function by creating a single, comprehensive regulatory framework. The Hybrid model would substantially reduce, if not eliminate, inefficiencies that are born out of the current SRO rulemaking system. Under the current self-regulatory system, when there are substantially similar rules or interpretations that the SROs seek to adopt, generally each SRO submits a proposed rule change to the SEC for review and approval. The result is that not only are the SROs duplicating their own efforts, but the SEC's resources are also being inefficiently utilized and potentially drained. Every proposed rule change filed with the SEC requires that the SEC staff review proposed rule changes individually instead of having the ability to review and approve one filing submitted by the Single Member SRO that would apply to all broker-dealers. Similar inefficiencies born out of the current SRO examination and inspection process would be considerably diminished by the adoption of the Hybrid model.

Regulatory expertise. One of the many additional advantages of the Hybrid model is the concentration of regulatory expertise at both the Single Member SRO and the Market SRO level. In the SEC's SRO Concept Release, the SEC notes the potential for conflict that exists from the

current combination of regulation and market functions.[4] The Hybrid model would enable the Single Member SRO to maintain a talented and experienced regulatory staff that would be able to efficiently provide guidance as to the rules it imposes and enforces rather than having that talent and expertise fragmented across multiple SROs seeking to carry out the same substantive mandate. This is particularly important in the current environment where the availability to qualified staff to the SEC, SRO's and member firm compliance departments is very tight. In addition, the Market SROs would retain a specialized regulatory staff that understands the unique and specific trading rules under which the individual market center operates. The results are uniquely qualified regulatory staffs that are independent and free from conflicts in their understanding and regulation of the markets.

Minimizing conflicts of interest. Finally, the Hybrid model would eliminate many of the conflicts of interest inherent in the current SRO structure. The current self-regulatory model not only places burdens on the broker-dealer entities themselves—both national and regional—but also often leads to conflict of interests between an SRO's regulatory and market functions. The SEC has recognized that as a result of increased marketplace competition, an SRO's regulatory obligation may conflict with the interests of its own or its affiliates' market operations.[5]

Through the separation of regulatory and market operation functions, each marketplace and its corresponding Market SRO would be able to focus on their primary tasks and avoid potential conflicts of interest. The market center would be able to compete and innovate to produce a better marketplace for all investors. The Market SRO would act as an independent body without regard to the pressures of the need to attract order flow in order to maintain its

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[4] *Id*.

[5] *Id*. at 71261-2.

competitive advantage in the marketplace, thereby ultimately enhancing investors' confidence in the integrity of the securities market.

Oversight and Funding of the Hybrid SRO Model

In order to protect the interests of all member firms, the Single Member SRO would require significant involvement from both the investing public, and from the different member interests, based upon their size, client base, and overall business models. While non-industry representatives should comprise a majority of the SRO's board of directors, representation in the SRO's governance (e.g., on the board of directors and on advisory committees to the board) from the various segments of the industry would enable the Single Member SRO to successfully and efficiently regulate all member firms. Only through such representation can the Single Member SRO be embedded with the knowledge and expertise necessary to efficiently regulate both large national firms and smaller regional firms. Of equal importance, having participation in the Single Member SRO's governance by a broad range of industry firms will ensure that neither the rules nor the funding of the SRO is slanted in a way that unfairly disadvantages any type of firm. Through member involvement and cooperation, all securities firms would continue to protect their own interests, while simultaneously being cognizant of the unique aspects of other members' operations that benefits all market participants generally. In short, we must keep the "self" in Self Regulated Organizations.

Funding for the Single Member SRO should derive from two sources: (i) trading markets constituents within the marketplace SRO such as marketmakers and listed companies, and (ii) regulatory fees imposed by the Single Member SRO. Some level of funding from the marketplace SRO or its constituents is appropriate, since the increased efficiencies and burden reduced by the elimination of the duplicative and often times confusing current self-regulatory

model would benefit all market participants. However, the greatest level of funding for the Single Member SRO will likely have to come from regulatory fees borne by member firms. Since market data fees would no longer be used to subsidize SRO operations, it is likely that broker-dealers belonging to the Single Member SRO will experience a net increase in direct regulatory fees paid for SRO membership, even though they will eliminate the need to pay regulatory dues to two organizations. However, the long-term advantages of eliminating regulatory duplication (as well as the reduction in market data fees), outweigh the shorter-term monetary impact that may result. Of course, the regulatory fees associated with such sweeping reforms must be allocated on a fair and reasonable basis, such as a relative proportion of the costs to the Single SRO member to oversee a segment of the industry, in order to account for the diverse community of broker-dealers that service the securities markets.

Conclusion

The U.S. securities markets are still the most efficient, transparent and liquid in the world but we cannot grow complacent. The implementation of the Hybrid model will help to ensure that U.S. markets preserve their reputation in the years to come.

Mr. Chairman, I commend you for holding these hearings to discuss the impact of the proposed mergers on the U.S. markets and in particular the opportunity that has presented itself to create an efficient self-regulatory system that at its core ensures that investors are well protected and that the U.S. marketplace continues to function in a dynamic and competitive manner.

Thank you.