

U.S. House of Representatives
Committee on Energy and Commerce
Room 2125, Rayburn House Office Building
Washington, D.C. 20515

March 6, 1992

The Honorable Richard C. Breeden
Chairman
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Dear Chairman Breeden:

Pursuant to Rules X and XI of the U.S. House of Representatives, and our continuing oversight of securities and exchanges, we are conducting an inquiry into regulatory failure at the Commission with respect to payment for order flow. Your agency has never dealt directly or responsibly with this issue. As the head of one Wall Street firm wrote to us, "That brokers divert their customers' trades from the central marketplace in order to line their pockets is reprehensible; that government authorities do not ban this practice is delinquent."

As you know, I have written to the Commission twice (July 7, 1990 and June 28, 1990) on payment for order flow. No action was taken on the May 1990 petition of the Midwest Stock Exchange for promulgation of a rule of general application. A later concept release written by the staff of the Division of Market Regulation disappeared down a black hole somewhere and was never published for comment. Recent press reports ("Investors Hurt When Trades Shift," New York Times, Monday, March 2, 1992 and "SEC to Review 2 Studies On Rebates Paid to Brokers," New York Times, Tuesday, March 3, 1992) disclose the results of University of Michigan and Wharton studies that confirm that investors are losing millions of dollars as a result of bounties paid to brokers to divert trades away from the central market. For example, the University of Michigan study concluded that in 1989, the last year for which data were available, the diversion of trades from the Big Board cost investors an additional \$47 million to \$55 million in trading costs. Honest brokers appear to have given up trying to hold the line against "everybody else is doing it" pressures.

The Honorable Richard C. Breeden
March 6, 1992
Page 2

I have instructed staff to draft appropriate legislation to protect investors and the integrity of the market. In the meantime, it is requested that you provide us with the following by the close of business on Friday, April 10, 1992:

- (1) Copies of any and all memoranda and drafts, either of rules or concept releases, prepared during the past three years by the staff of the Division of Market Regulation or any other Commission employees on payment for order flow.
- (2) The March 3 New York Times article quoted William Heyman, the director of your agency's Division of Market Regulation, as believing that "one could....conclude that a brokerage firm's order flow was 'a salable asset' on which it should be able to profit," and leaving open the possibility that he might endorse that view. Please provide the legal support for this position. We are unable to find any support at law for the principle that an agent acquires a property right in the agency that he can sell and retain the profits.
- (3) In the event you believe that a broker (agent) somehow acquires a proprietary interest in his customers' (principals') orders, do you also believe that an investment adviser exercising investment discretion for advisory clients acquires a similar interest – which, in effect, he may "sell" for compensation orders for those clients? In both cases, does your analysis apply equally to customers and advisory clients covered by the Employee Retirement Income Security Act of 1974 and other types of customers and clients?

Thank you for your cooperation and attention to this request.

Sincerely,

JOHN D. DINGELL
CHAIRMAN

cc: The Honorable Edward J. Markey
The Honorable Norman F. Lent
The Honorable Matthew J. Rinaldo