Securities Industry Association
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April 15, 2003

The Honorable Sheldon Silver
The Assembly of the State of New York
State Capitol
Albany, New York 12224

Dear Speaker Silver:

As members of the Securities Industry Association[1], we appreciate your support of the securities industry in New York over the years. At the recent SIA New York District Albany Day, you made clear your opposition to a number of tax raising proposals specifically targeting the securities industry. We respectfully urge you to continue rejecting any consideration of these proposals as they would have a damaging effect on the industry and would jeopardize the future recovery of the State and City economies.

Specifically, we are concerned about proposals that would restore the Stock Transfer Tax ("STT"), alter the current treatment of the investment income, and scale back the application of the Investment Tax Credit ("ITC"). We firmly believe these proposals would add significant disincentives to operate in New York and lead to the further erosion of the industry's job base.

The financial services industry is one of the major drivers behind the State's economy, historically accounting for 10-20% of the State's tax receipts. On the back of a strong and vibrant national and global economy, securities jobs in New York reached an all time high of 216,700 jobs in December 2000. However, since that time the securities industry suffered a significant erosion of its job base. Securities firms presently employ 178,000 people, a loss of almost 40,000 jobs from the peak. Based on available forecasting data, we expect that further employment reduction in the sector will continue unabated through 2003[2]. With that in mind, we believe these proposals would further damage the State's already fragile economy.

- The Stock Transfer Tax

The STT was eliminated in 1981 in recognition of the reality that increasingly transient and highly competitive markets might take their business elsewhere if subjected to this costly tax. We believe that any revenue benefits derived from the STT would surely be dwarfed by overall loss in business activities and personal income taxes from job relocations. We have taken the liberty of including SIA's rebuttals to specific arguments proponents of the STT have sought to advance. As you will see, proponents for the tax lack an understanding of the detrimental impact the STT will have on the industry and the State's and City's economies.

[1] The Securities Industry Association, established in 1972 through the merger of the Association of Stock Exchange Firms and the Investment Banker's Association, brings together the shared interests of more than 600 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. According to the Bureau of Labor Statistics, the U.S. securities industry employs more than 700,000 individuals. Industry personnel manage the accounts of nearly 93-million investors directly and indirectly through corporate, thrift, and pension plans. In 2002, the industry generated $214 billion in U.S. revenue and $285 billion in global revenues. (More information about SIA is available on its home page: www.sia.com.)
[2] SIA expects another 5000 securities industry jobs will be lost in the first quarter of 2003.

- Treatment of Investment Income

In addition to opposing the reinstatement of STT, we are equally concerned about calls for reforming the current tax treatment of the investment income under the guise of “corporate loopholes.” This is a mischaracterization. The present treatment of investment income is a direct result of New York’s desire to encourage the concentration of the securities industry in the state. The securities industry’s tax base already includes payroll, property and receipts due to business in the state. Due to the high concentration of corporate headquarters in New York, which was encouraged by the investment income tax provisions, New York State and City already receive substantial revenues from our industry in the form of payroll tax, property and commercial rent tax. We believe that any proposal to alter the present treatment of investment income would undermine a rational state tax regime that has given certainty and support to the industry remaining and doing business in New York.

- Investment Tax Credit

Finally, we request that you reject any effort to scale back the application of the Investment Tax Credit. Last year, you enacted legislation that extended the ITC until October 1, 2008, making the credit available for securities broker/dealers and qualified banks. This economic development policy embraced by ITC was and continues to be of vital importance to the industry during this critical time of recovery.

In conclusion, if adopted, these proposals would be disastrous for the State and City economy. Tax policy should encourage the continued concentration of the securities industry in New York rather than discourage it, as these proposals would unquestionably do. We respectfully urge you to reject calls to adopt these harmful proposals. Should your staff have any questions, please contact Nancy Donohoe Lancia or James Chin at 212-608-1500.

Sincerely,

James E. Cayne
Chairman & Chief Executive Officer
Bear, Stearns & Co., Inc.

Richard S. Fuld, Jr.
Chairman & Chief Executive Officer
Lehman Brothers Holdings Inc.

John J. Mack
Chief Executive Officer
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Henry M. Paulson, Jr.
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Rebuttal to Arguments To Reinstate the Stock Transfer Tax (STT)

- **Proponents argue STT is "huge potential revenue source" and STT "is very, very low."**

SIA's Rebuttal: SIA believes that the any revenue benefits derived from STT would be dwarfed by overall loss in business activities and personal income taxes from job relocations. Securities firms must adhere to "best execution" rules mandated by regulatory authorities. Faced with the STT, these firms are likely to gravitate towards Electronic Crossing Networks (ECNs), Automatic Trading Systems (ATSs)[1] and other alternate trading platforms, which are not within the tax jurisdiction of the State. With the migration of trading to ECNs and ATS, projected volumes on the NYSE, on which any revenue projections are being based would be reduced, ensuring that the State's revenue projections would not be met.

Although equity trading activity has increased twenty fold over the past 20 years, within the industry, equity business at best has remained stagnant during recent years. With profit margins on trading commissions already measured in pennies, traders and investors would naturally look to alterative trading platforms to find the "best price" to execute trades[2]. This would further depress the equity business (especially since investors have a myriad of alternative investment choices, i.e., debt, options and futures). Consequently, we firmly anticipate that firms would then allocate resources accordingly, including relocating personnel outside New York to meet new administrative demands that these alternative trading platforms require. Also, STT has a high implementation costs associated with "back office" operations, requiring that the STT be added to each trade, and the reprogramming of extensive reporting systems for trade settlement processes and confirmation and notices for customers. To avoid these additional costs, trading activity will migrate to areas outside New York, shifting trading business away from firms that do not have subsidiaries outside the State or that simply cannot afford to relocate. In fact, NYSE member firms are no longer required to maintain their corporate headquarters within a one-mile radius of Wall Street, a requirement the New York Stock Exchange ("NYSE") once imposed. The STT was phased out in 1981 in recognition that increasingly transient and highly competitive markets might take their business elsewhere if subject to this costly tax. By reinstating this tax, we believe firms will have another reason to relocate out of the State or "dematerialize" where firms "book" their equity trades.

- **Supporters of the STT claim, "The tax applies to any shares listed in NYSE," regardless of the location of the investor.**

SIA's Rebuttal: This is a misunderstanding of the capital markets and the rules that govern them. For instance, in May 2000, the NYSE rescinded Rule 390, which originally prohibited NYSE listed stock from being traded on other exchanges. Without that rule, NYSE listed companies could be traded on any trading platform, including any other national and international exchanges. This would have a negative effect on the NYSE and would affect New York City's reputation as the "financial capital of the world."

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[1] Although ECNs and ATSs operate in a virtual world, some are headquartered in New York but many have multi-city and state locations.

[2] Gross commissions on trading are already as low as a single penny per share (with profit margins a small fraction of that gross commission).

- **Proponents also contend STT is paid only by shareholders**.

SIA's Rebuttal: This is not the basis for sound tax policy. SIA has always maintained that STT is unfair since it would not be distributed evenly over a broad base.

This tax singles out one segment of the financial services industry, which has had progressively lower profit levels as compared to three years ago. STT looks to tax equity investors, including governments, public pension funds and the securities firms that trade stocks for their proprietary accounts[3]. The securities industry is quite often the shareholder, taxed on one side of the transaction with its customer on the other. Firms are holding inventory as "market makers" or following mandates as "specialists" will feel the brunt of the tax. By discriminating against equities as compared to other financial products, the equity business would be further depressed, leading to unnecessary distortion in the flow of capital. We also believe any "flat figure" per transaction would unduly penalize lower priced stocks, which in turn, might encourage "reverse stock splits[4]" to lessen the impact of the costs. This could lead to an overall lowering of trading volume and further reduce the State's expectation of revenue estimates. In short, STT is biased against small broker-dealers and certainly to small investors, who are already disenfranchised about returning to the markets.

- **Some have urge New York to follow other international financial centers which tax stock sales**

SIA's Rebuttal: While this is true, two important points must be made. First, in other countries, these taxes apply on a nationwide basis, so that it is not possible to avoid the taxes simply by executing the trade on another exchange in the same country (if indeed other exchanges in the country exist, which is not always the case). Second, as one might anticipate, offshore trading often develops specifically in an attempt to avoid these taxes.

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[3] First, the Federal Reserve's latest figures on ownership of <u>all</u> US equities (regardless of where these companies are) show that large institutions own nearly two-thirds of all stock in the United States, including pension funds, governments, insurers, certain equity and hybrid mutual funds (although often these institutions have guidelines on what kinds of stocks they can own, i.e., lower "cap" and "penny" stocks). SIA estimates that institutions hold 75% of all NYSE listed stocks (and the following percent holdings of all stocks by instructional type will likewise be somewhat higher for NYSE stocks). Also, over the past five years, the % of NYSE volume that is institutional ranged from 81% to 87%, depending on the year (45% to 52% of total volume were block trades alone which could easily be effected off the NYSE since they were not done on "the floor").

[4] This is a process in which a listed company reduces the overall number of outstanding shares; typically the price per share increases.