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United States General Accounting Office
Washington, DC 20548

July 31, 2001

The Honorable John D. Dingell
Ranking Minority Member
Committee on Energy and Commerce
House of Representatives

Dear Congressman Dingell:

This letter confirms our commitment to study the American Stock Exchange's (Amex) listing standards and SEC's oversight of their application in response to your letter to the Comptroller General. In our January 31, 2001 letter we outlined our approach to designing the study. Based on that design and discussions with your staff on May 30, 2001 and August 1, 2001, we will complete our work and issue a report to you by October 26, 2001. The enclosure to this letter sets forth the understanding reached with your staff on the key aspects of the study.

We look forward to working with you and your staff on this assignment. If you should have questions, please contact Richard Hillman at (202) 512-8678 or Cecile Trop at (312) 220-7705.

Sincerely yours,

Richard J. Hillman

Richard J. Hillman
Director, Financial Markets
and Community Investment

Enclosure

Terms of the Work

Objectives/Key Questions

Generally, before a U.S. company's stock can be listed for trading, the company must meet minimum standards that have been set by the cognizant exchange/market and approved by the Securities and Exchange Commission (SEC). The American Stock Exchange (Amex) departs from this practice by applying what it views as guidelines versus other exchanges minimum standards, in making its listing decisions. Concerns exist that Amex practices have allowed poorly performing stocks to be listed to the potential detriment of investors who believe that Amex guidelines are minimum standards. We agreed to provide information on the following three key questions:

1. What are Amex requirements for initially listing and continuing to list a stock and how does Amex ensure that these requirements are met?

2. How does SEC oversee the Amex listing process and what were the results of its most recent oversight efforts.

3. How do Amex guidelines and procedures compare with those of other U.S. exchanges/markets.

Scope

Our work will encompass SEC and Amex and other exchanges as necessary.

Methodology

We will meet with Amex officials to discuss the current listing guidelines as well as any changes that have taken place in the recent past. We will obtain and review inspection and other reports prepared by SEC that assess Amex's application of its initial and continuing listing guidelines. We will obtain and compare listing standards used by other exchanges with those of Amex. Finally, we will review prior GAO reports and determine the status of recommendations that we have made related to the exchange security listing process. The work will be done in accordance with Generally Accepted Government Auditing Standards (GAGAS)

Product Type

We will issue a letter report, and will obtain comments from the Securities and Exchange Commission and the American Stock Exchange on a written draft of this product prior to issuance.

Product Delivery Date(s)

Letter report issued by October 26, 2001

Reporting on Job Status

We will brief your staff on Amex's response to the SEC inspection as well as other issues that may arise.

U.S. House of Representatives
Committee on Commerce
Room 2125, Rayburn House Office Building
Washington, DC 20515–6115

September 18, 2000

The Honorable Arthur Levitt, Jr.
Chairman
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Mr. Salvatore F. Sodano
Chairman and Chief Executive Officer
American Stock Exchange LLC
86 Trinity Place
New York, New York 10006-1572

The Honorable David M. Walker
Comptroller General
U.S. General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Chairman Levitt, Messrs. Sodano and Walker:

Recent press reports, "Has The Curb Market Moved Into The Gutter?", Business Week, September 11, 2000 at p. 136 (copy enclosed), indicate that the American Stock Exchange (Amex) has developed a bad case of amnesia and may be in the process of repeating its Emerging Companies Marketplace (ECM) debacle. To refresh the Amex's recollection, I am transmitting to it copies of documents related to the Congressional investigation of that mess.

With respect to the current issues and concerns, I am writing to request that the SEC and the Amex look into the concerns raised in the Business Week article and provide me with a response by the close of business on Friday, October 20, 2000. Among other things, your report should address the SEC's oversight in this matter as well as the Amex's screening process for listing candidates and for a company to remain listed on the exchange. In light of the issues raised at the September 13, 2000, Finance Subcommittee hearing on organized crime's involvement in the markets for the smallest microcap stocks, please also advise whether Amex has an effective screening mechanism for identifying persons with questionable backgrounds.

I also am writing to ask that the General Accounting Office (GAO) update its May 1994 report, American Stock Exchange: More Changes Needed in Screening Emerging Companies for the Marketplace. The Amex Board of Governors voted to discontinue the ECM in 1995 but recent press reports suggest that Amex's new listings bear a striking resemblance to the companies that joined ECM. Accordingly, I request that GAO conduct an audit of the Amex listing department and provide me with information on (1) Amex's screening procedures for assessing the reputations of the management and stockholders of companies seeking a listing and (2) the extent to which Amex ensures that companies approved for listing meet all criteria required for such approval. We should discuss whether this audit needs to be extended beyond the Amex.

Thank you for your cooperation with these requests. I look forward to reviewing your reports. Maintaining the integrity of our securities markets and the protection of investors should be one of our highest priorities.

Sincerely,

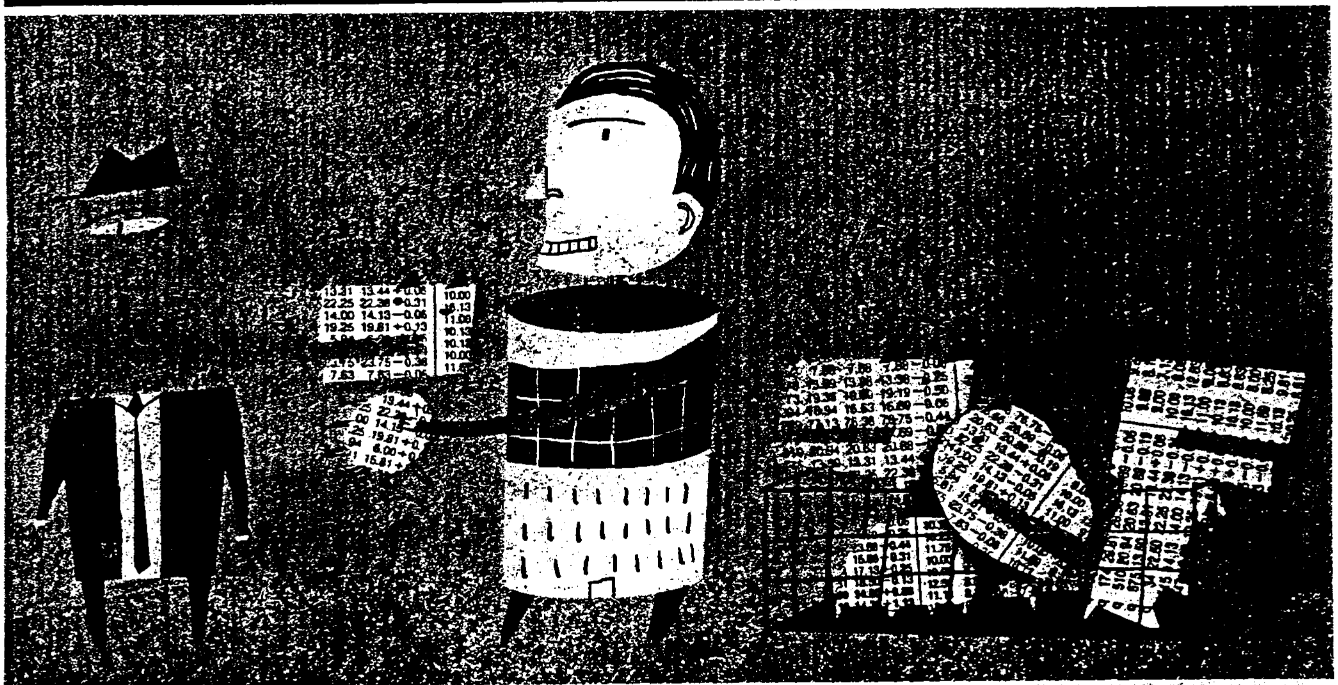
JOHN D. DINGELL
RANKING MEMBER

Enclosure

cc: The Honorable Tom Bliley, Chairman
Committee on Commerce

The Honorable Michael G. Oxley, Chairman
Subcommittee on Finance and Hazardous Materials

The Honorable Edolphus Towns, Ranking Member
Subcommittee on Finance and Hazardous Materials



JAMES YANG

COMMENTARY

By Gary Weiss

HAS THE CURB MARKET MOVED INTO THE GUTTER?

Visitors to the American Stock Exchange building in lower Manhattan are greeted by a sign with a simple message: "Put Your Business Where the Future Is." For the third-largest U.S. stock market, a powerhouse in options but a perennial also-ran in equities, the sign is not so much a slogan as a plea. The Amex needs business—stock listings, to be exact—if the word "stock" in its name is to have any meaning. Well, two years after its merger with the National Association of Securities Dealers, the Amex is getting business, all right—from the smallest, least attractive stocks in existence.

At the venerable old exchange, once known as the Curb because its traders stood outdoors, officials take pride in the pace of new listings. A total of 73 companies joined the Amex this year, vs. the 83 companies that listed during all of 1999. But these numbers aren't so cheery as they appear. The roster of new listings is dominated by the very smallest microcap stocks. The median market cap is $66 million, meaning that half the new Amex issues are among the puniest stocks around.

The numbers are bad—and get worse. These stocks have been generally poor performers. There have been a few winners (table), but the exchange's laggards have suffered dizzying declines. Amex officials shouldn't be proud. They, and their bosses at the NASD, should be ashamed. They should get the Amex out of the microcap business, and fast—to keep it from squandering its reputation and lending its considerable cachet to marginal stocks.

For the Amex, which has been casting around for a role for itself, microcaps fill a crucial void—a "niche" that Amex officials feel has been neglected. Perry Peregoy, the Amex' senior-vice president for equities, says small companies "have been overlooked from a visibility and awareness standpoint, and we thought that the auction market offered the benefits of good market structure" as well as the "service offerings" the Amex could provide—such as investor relations support.

But the Amex' emphasis on microcap stocks flies in the face of history. Even a casual reader of the financial pages knows that microcaps are a perennial headache for regulators and above all for investors, because they have been prone to abuse by stock manipulators. And Amex officials are blithely ignoring their own history—their doomed experiment in microcap stocks of the early 1990s, the Emerging Company Marketplace.

The ECM was created in 1992 by former Amex Chairman James Jones as an "incubator" for what were billed as "some of the best companies in the country." ECM stocks were picked by a "blue-ribbon committee," and were supposed to benefit from association with the Amex—specifically by changing to the specialist-centered trading system used at the Amex, as opposed to Nasdaq's dealer market. ECM companies were also supposed to get help from the Amex staff with investor relations. They would get more visibility, Amex officials said at the time.

BOTTOM OF THE BARREL. Sure, the stocks got "visibility," but that didn't prevent the ECM from being a disaster. For one thing, the stocks were, by and large, dogs. Of the 65 companies that listed on the ECM, just under a third were tiny, illiquid stocks from the bottom of the barrel of the world of equities, the OTC Bulletin Board. The average stock price was under $5, and the average market capitalization of ECM stocks was $29 million. And the Amex specialist system—a

Of the 83 stocks of operating companies that listed on the Amex during 1999, 50 have declined so far this year

selling point—did not prove very effective for the stocks. "For small-cap stocks, you need the sponsorship of a market maker to put out research reports and attract investor interest. The specialist doesn't do that," notes Reena Aggarwal, a Georgetown University professor who has studied the ECM. The principle of "adverse selection" also hurt the ECM, she notes. It became a repository for poor-performing stocks, with the best stocks moving elsewhere.

Alas, the Amex' past failures are just ancient history to its current managers. Asked to explain how his listing strategy differs with that of his predecessors, Peregoy at first declined to do so at all, saying "I can't go back and understand why Jim Jones wasn't successful." But he later e-mailed a statement saying that "the most important differentiating factor is that this phase of our equities revitalization strategy focuses on small and midcap companies." He went on to emphasize the efforts of the Amex sales staff, and noted that "we are now rolling out an investor relations support program that provides direct assistance to companies."

Sound familiar? If so, the point seems lost on Amex officials. Asked about the similarities between the current crop of listings and the ECM's, Peregoy demurred, noting that he has only been at the Amex for a year. And the subject, it seems, doesn't especially interest him. "I haven't done any critique or history of [the ECM]," he says.

"DOG FACTOR." Perhaps he should. He would find that the Amex' new listings, though not quite as small on average, bear a striking resemblance to the companies that joined the ECM. Indeed, tiny OTC Bulletin board stocks actually are a greater source of new listings for the Amex than they were for the ECM. So far this year, more than half of the new Amex listings—45 of 73—were OTC stocks. The ECM drew criticism for its ex-OTC stocks, which were just a third of its listings.

The "dog factor" is another ECM similarity. Of the 83 stocks of operating companies that listed on the Amex during 1999, 50 have declined so far this year, and another four have been delisted. The comparable numbers for the "Class of 2000" are 35 decliners out of 73. And this hasn't been a terrible time for microcaps. The Russell 2000 index of small caps gained 4% during that same period, and the Amex composite index was up a healthy 7%.

SUBPAR PERFORMANCE. Peregoy is not troubled by the awful numbers—and he released numbers of his own. They show that, on average, new listings this year have fallen 23% since they joined the Amex—which, he notes, is the same subpar performance recorded by the tiny companies that join the Nasdaq Small Cap market. But it's hard to see how matching the losses of new entries to Nasdaq's lower tier—that market's version of the ECM—bodes well for the Amex. Increasingly, the Amex is loading up on losers, just as the ECM did. And that, Aggarwal notes, was one of the factors that hurt the ECM.

All this has some veteran Amex watchers shaking their heads. "They tried this before—they tried to go for some of the very small stocks," says Nathan Most, a former high-level Amex executive who designed the Amex' successful exchange-traded funds and is now chairman of Barclays Bank's ETF unit. In the early '90s, he "watched all this going on and I just concluded that it just wasn't going anywhere because there was no basic place for the exchange in equity securities."

The Amex is not necessarily at the end of the road as an equities exchange. Its obituary has been written many times, always prematurely. The Amex has a long, often troubled, sometimes glorious history. The new guard at the Amex should read up on it one of these days.

Senior Writer Weiss covered the ECM debacle.

THE AMEX' NEW LISTING LEADERS...

Best and worst performing stocks listing on the Amex since Jan., 1999, excluding stocks delisted or acquired.

COMPANY	MARKET CAPITALIZATION (MILLIONS)	PRICE (8/28)	2000 % CHANGE
GENSTAR THERAPEUTICS	$195	$8¾	1358%
ALTEON	51	2⅝	200
DATALINK.NET*	227	16 1/16	195
AMERICAN TELESOURCE INT'L	198	3 1/16	157
PHOTOELECTRON	46	5⅞	135
LIFEPOINT	143	4¾	124
VIALOG	64	6¾	116
ACCESS PHARMACEUTICALS	48	4	100
QUICKSILVER RESOURCES	154	8½	94
FTI CONSULTING	62	9½	90

*Listing changed to Nasdaq National Market System

...AND LAGGARDS

COMPANY	MARKET CAPITALIZATION (MILLIONS)	PRICE (8/28)	2000 % CHANGE
MYWEBINC.COM	$8	$¾	-97%
CYBERSENTRY	11	½	-93
UNIDIGITAL	2	⅜	-91
IPARTY CORP.	5	7/16	-89
COLLEGELINK.COM	13	⅛	-88
ON2.COM	92	3.41	-88
FRONTLINE COMMUNICATIONS	8	1½	-83
CHEQUEMATE INT'L	17	1⅛	-82
THERMOVIEW INDUSTRIES	6	¾	-81
SONICPORT.COM	23	⅞	-80

DATA: BLOOMBERG FINANCIAL MARKETS