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PROPER REGULATION REQUIRES UNDERSTANDING AND COMMUNICATION

Address by

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I welcome the opportunity to participate in this annual meeting of your Association at this time because legislation awaiting the President's signature requires that the Securities and Exchange Commission and transfer agents enter a regulatory relationship. To a great extent, the success of that relationship will depend on how well we communicate with and understand each other. Having been a staff member of the Senate Committee on Banking, Housing, and Urban Affairs until March of 1973, I was present at the 1972 hearings, and I have reviewed the record of the 1973 hearings regarding proposed legislation designed to assist in resolving the lack of coordination among various systems for clearing and settling securities transactions.

During those hearings, witnesses representing transfer agents generally testified that SEC regulation of transfer agent activities was not only unnecessary, but could be counter-productive. Also, it was suggested strongly that, if Congress were to decide to include transfer agents in the legislation, there should be reasonable limitations on the requirements relating to new forms and compatibility of systems. Furthermore, there was apprehension that regulation of transfer agents by the SEC and the bank regulatory agencies could result in

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confusion, and that the SEC should not become involved in what were referred to as internal operations of transfer agents.

I understand the dislike for government intervention in one's business affairs, and I have always believed that such intervention should be limited to that action which is necessary to protect the public interest. Congress, having considered all of the views of interested parties, has determined that it is appropriate to authorize the SEC and the federal bank regulatory agencies to establish and enforce standards of operation for transfer agents. It is now the collective responsibility of the regulators and the regulated to begin a flow of information that is necessary in order to avoid undesirable regulatory action, and I hope my remarks will assure you that the Commission desires to make this step as painless as possible consistent with our responsibilities under the new law.

It may be helpful to review briefly the impetus that led to the adoption of this legislation. Generally, the securities markets of the 1960's are remembered fondly as liquid and exciting, however, it is recognized also that they exacerbated certain deficiencies that resulted in a crisis for the securities industry. The extraordinary high volume of securities transactions in the late 1960's culminated in a tremendous securities processing backlog in clearing and

settlement functions. Indeed, this so-called "paper crunch" caused broker-dealer firms to lose control of their operations as the securities to be transferred and delivered literally engulfed the back office, and in a number of instances firms subsequently lost financial control as well. This breakdown resulted in substantial losses of customer funds and securities, and public dissatisfaction was so widespread that Congress set about to prevent such losses from recurring.

The appropriate House and Senate Committees undertook extensive studies and hearings regarding the problem. It became evident that, while front office sales activities had increased extensively, back office operations had not been updated nor expanded and there was general agreement that securities processing systems should be improved. Most of the operations were manual and were conducted in the same pattern as they had been conducted for many years. It was reported that in some instances at least 30 different documents had to be prepared in transferring securities between buyer and seller for only one sale, and one firm indicated that at least 210 pieces of paper had been moved in connection with a single transaction.

A major deficiency was the nonexistence of a nationwide clearing and settlement mechanism, and the fact that each geographical system had its own peculiar chatacteristics. Instead of participating in only one

familiar system, broker-dealers were required to be members of several systems which increased their cost of doing business. Another deficiency was the lack of uniform methods of doing business and the failure to coodinate clearing and settlement operations between various systems. Perhaps the greatest deficiency, as far as Congress was concerned, was the absence of a mechanism to correlate various components of the clearing and settlement functions. In other words, it seemed essential that, in order for improvements to be implemented prudently, a rational regulatory framework had to be established for clearing agencies, depositories, transfer agents, and corporate issuers.

A great deal of effort has been expended in developing legislation to provide a basis upon which a sound and efficient securities processing system can be established. This legislation, which has now received Congressional approval, will affect those who act as transfer agents for issuers as well as issuers who act as their own transfer agent. Because the Commission has not yet developed a regulatory pattern under the new legislation and has not yet received for consideration any recommendations based on the legislation from our staff, I do not believe it would be appropriate for me to try to predict what the final regulatory pattern will be. I believe it only fair, however, to be sure you understand that the authority granted to the Commission is very broad and could result in a comprehensive

regulatory program for transfer agents, particularly in such areas as registration, performance standards, recordkeeping, and reporting, and I suggest that you make your views on these issues, along with supportive information, known to the Commission and the bank regulatory agencies.

In order to become registered, transfer agencies will provide on a form certain information to be required by the appropriate federal regulatory agency. The registration will automatically become effective thirty days after the application is filed unless the appropriate regulatory agency takes affirmative action to accelerate, deny or postpone it. Transfer agents organized as banks or as subsidiaries of banks will register with the appropriate federal bank regulators, non-bank transfer agents will register with the Commission, and each regulator will develop a registration form for those subject to its jurisdiction.

We intend to work closely with the appropriate federal bank regulators in order to ensure that the Commission and the federal bank regulators will be able to prepare and publish similar transfer agent registration forms. Registration is a threshold requirement that will serve two essential purposes. First, it will allow the regulators to identify those transfer agents who are subject to regulation. Second, it will assist the regulators in collecting the information necessary to develop appropriate regulatory standards.

In the near future, the Commission will publish a proposed registration form for public comment. Since the new legislation for transfer agents becomes effective one hundred and eighty days after enactment, it will be necessary for all transfer agents to be registered by that time. I anticipate that the registration form will request, among other things, such information as the principal office or offices for transfer agent activities, the length of time the entity has been acting as a transfer agent, the identity of the issuers and issues of securities for which it is then acting as transfer agent, and the amount of fidelity bond coverage carried by the transfer agent. Because the Commission realizes that unnecessary or duplicative paperwork requirements do not serve a public interest, the form will request only the information we need to discharge our regulatory responsibilities.

This Association has expressed the concern of its members with the effect of registration and reporting requirements on costs and, referring to requirements on some members who are registered as broker-dealers, has suggested that "a review of the efforts and resources dedicated to compliance with these requirements is not only staggering but appears to be an example of bureaucratic expansion far above and beyond any reasonable need, use or necessity." This criticism is not without merit, and, accordingly, in early 1974, the Commission established an advisory committee to

help us eliminate unnecessary and duplicative paperwork and reporting burdens on broker-dealers.

Although the legislation vests the Commission with broad rulemaking authority over transfer agent activities, in my opinion, the timeliness with which transfer agents perform their function is the most appropriate area to be regulated. I believe we should set performance standards in terms of a maximum time for processing as measured from the time the old certificate is received by the transfer agent to the time the new certificate is available for delivery. Recognizing the need to treat special situations differently from routine transfers, I anticipate that performance standards will take into account problems that may arise in connection with legal transfers, record dates, or urgent transfer requests, as well as the need for transfer agents to respond readily to requests by auditors and members of the securities industry for verification of open transfer items. In the past we have received numerous verification complaints, and hopefully these complaints can be reduced.

We will also have to review the need for standards for the safekeeping of certificates and records in the custody of transfer agents and may find it necessary to set minimum standards of safekeeping with respect to unissued certificates, those in process, and those awaiting pickup.

I anticipate that the Commission will consider prescribing standards in the area of financial responsibility through bonding requirements, and it will be necessary for us to decide whether it is appropriate to develop examination or other standards regarding qualifications of transfer agent employees similar to those presently applicable to broker-dealer employees. The Commission will consider the need for recordkeeping requirements, as well as requirements for early warning reports to notify us of potential problems being experienced by transfer agents before such problems become critical.

You can be sure that in the areas where the Commission decides to draft proposed rules, we will be sensitive to the differences that exist among the community of persons who participate in the transfer agent business. Different requirements and standards might be appropriate for issuers, as distinguished from banks, and for transfer agents handling a heavy volume of work, as distinguished from those which may have only a small single issue to transfer. Additionally, some standards may contain exemptive provisions subject to the Commission imposing appropriate terms or conditions.

Efficient transfer agents probably already meet any standards we will eventually adopt. To the extent, however, that that transfer agents do not meet such standards, it will be necessary for them to upgrade their operations. The

establishment of uniform standards should permit transfer agents to operate more efficiently, and thus, better serve the public and investment community. In adopting new rules, consideration will be given to the existing capacities of transfer agents, and the economic impact of any proposed course of action will be evaluated. The Commission, as required by the Administrative Procedure Act, will publish proposed standards for public comment and will analyze carefully the comments received. We hope that the views of groups such as the Western Stock Transfer Association, as well as individual transfer agents and other interested persons, will be made known to us before and during the public comment period.

In the process of defining standards, the SEC will also work closely with the federal and state bank regulators. Through this coordination, cooperation, and consultation, we should be able to avoid duplication and unnecessary regulation and still be able to satisfy our mutual regulatory objectives.

There are three other aspects of the legislation which I would like to discuss with you. The first relates to missing, lost, stolen or counterfeit securities, the second relates to the study of street or nominee name registration, and the third relates to the movement of stock certificates.

The new law authorizes the Commission to adopt rules requiring persons involved in the handling of securities transactions to report information about missing, lost, stolen

or counterfeit securities to the Commission or to such person as the Commission may designate and to adopt rules requiring such persons to make inquiries to determine whether transactions in which they are participating involve securities that have been reported as missing, lost, stolen or counterfeit. Any rules adopted in this area would be to assist in eliminating careless, unlawful, and criminal conduct from the securities business.

The new law also contains provisions directing the Commission to study the practice of registering securities in a name other than that of the beneficial owners so that we can determine whether such registration is consistent with the policies and purposes of the Exchange Act, and, if consistent, whether steps can be taken to facilitate communications between corporations and their shareholders, while, at the same time, retaining the benefits of such registration. The Commission must make its preliminary findings to Congress in six months and its final conclusions and recommendations within one year.

The Commission is directed also to use its authority under the Exchange Act to end the physical movement of stock certificates in connection with the settlement of securities transactions among broker-dealers and is required to report in its annual report to Congress on steps it has taken and progress made towards eliminating the physical movement of the stock

certificate and to recommend to Congress any legislation which the Commission considers necessary to eliminate the stock certificate.

Brokerage firms facilitate the processing of securities transactions by holding certificates in street name and thereby reduce the need for physical delivery of certificates. Brokerage firms, and more recently banking institutions, also seek to immobolize stock certificates by placing them in depositories which hold the certificates in their own nominee name. The growing use of securities depositories is a major development in the elimination of certificate movements and the establishment of transfer agent custodian ("TAC") and transfer agent depository ("TAD") programs is a logical extension of the depository concept. Although it is too early to predict whether the TAC, with a jumbo certificate held at the transfer agent level and participant accounts covering the jumbo certificate maintained at the depository level, or the TAD, a certificateless approach with ownership records maintained at the transfer agent level, will ultimately predominate, there is a significant potential for certificate movement reduction inherent in both concepts.

While the use of street names and nominee names reduces the need for physical movement of stock certificates, their use also separates beneficial owners of securities from the issuers, thus making the flow of information between them

them more difficult. The Commission has been increasing its efforts to strengthen the channels of communication between issuers and their shareholders. In order to ensure that shareholders receive proxy materials and annual reports, the Commission recently amended its proxy rules to require issuers to ask nominees whether there are other persons who are the beneficial owners of such securities. If there are, the issuer corporation is required to forward the appropriate number of proxy statements and annual reports to the nominee for dissemination to the beneficial owners. Brokerage firms, in turn, are subject to various rules of the exchanges or the National Association of Securities Dealers which are designed to ensure that shareholder information is transmitted to beneficial owners when received from the issuer corporations.

Channels of communication between corporations and their shareholders can be maintained only by the mutual cooperation and efforts of corporations, brokerage firms, and other institutional holders of securities. The transfer agent, who in some cases may be part of the issuer corporation, is a vital link in this process, and it is essential that there be prompt registration and recordation of corporate securities as ownership changes.

In late 1974 the Commission held public hearings regarding beneficial ownership, takeovers, and acquisitions by foreign and domestic persons. The hearings provided an

opportunity for the Commission to consider a wide range of topics, including the matter of issuer-shareholder communications.

Several witnesses suggested the need for issuer corporations to know the true identity of corporate shareholders so that corporations could communicate directly with their true owners. At the same time, however, if a list of shareholders were produced by a brokerage firm, witnesses suggested that there would be a need to maintain its confidentiality because it is the equivalent of a customer list which, understandably, is considered by brokerage firms to be their stock in trade. Moreover, there was a question as to whether the costs and burdens of such a procedure would be outweighed by its benefits. It was also indicated at the hearings that investors may wish to protect their privacy. In light of the information we gained from these hearings, as well as from our ongoing review of this area, the Commission will be reconsidering some of our existing rules and the need for additional rules.

Apart from the new legislation, I would like to comment on an apparent misunderstanding by some transfer agents and some members of the public generally regarding the role and function of our staff's no-action letter process. As you know, the Commission's staff has developed a practice of offering informal advisory views to private persons

contemplating particular securities transactions. These views are expressed most frequently in no-action letters which indicate the staff's probable enforcement recommendation to the Commission if the proposed transaction is consummated. The Commission intends for its staff no-action letter process to function as a rather modest enforcement review mechanism. The no-action letter is useful to the Commission's staff as an informal compliance procedure which minimizes the expenditure of staff resources in monitoring securities transactions. In addition, it is useful to private persons as a means by which to secure assurance that, if the transaction is effected as represented in the no-action request, the staff will not recommend enforcement action. Because the no-action letter is merely an expression of enforcement intent by the Commission's staff, it cannot, nor is it intended to, affect the rights of private persons among themselves.

Yet, despite our modest conception of the role and function of no-action letters, we continue to find that many private persons, such as transfer agents, brokers, private counsel, and company counsel, participating in securities transactions have a much broader view of the Commission's staff no-action letter process. Some persons seem to view the no-action letter as a talisman which will protect a securities transaction from any challenge of illegality. Others seem to be acting under the belief that a transaction cannot be

effected legally without a staff no-action letter concerning the matter. These two erroneous views, while at different ends of the spectrum, share a common ground. Both assume that the staff no-action letter process is meant to resolve the issues regarding the application of the federal securities laws to a particular transaction.

The Commission does not intend to have the no-action letter process place the burden of ensuring compliance with the federal securities laws on its staff. The responsibilities of participants in securities transactions to see that the federal securities laws are complied with cannot be sidestepped through misguided reliance on one of the several limited tools the Commission has fashioned to assist its enforcement of the federal securities laws.

Although the new regulatory relationship between transfer agents and the SEC is not one which you entered voluntarily, it is now virtually a fact. Therefore, it is in the best interest of transfer agents to assure that we understand your operations and your views and without your input it would be difficult, if not impossible, for us to properly fulfill our regulatory responsibility. Working together we can resolve problems and improve transfer agent performance.

We solicit your assistance in this endeavor and believe that through cooperation we will be able to streamline

clearing and settlement functions without undue government interference in your business affairs. Our doors are always open and we welcome your views regarding matters affecting your activities. May the future be productive and our regulatory efforts enlightened.