VII

THE QUESTION OF FURTHER FEDERAL LEGISLATION TO REGULATE DEPOSITORIES

Contents

VII

THE QUESTION OF FURTHER FEDERAL LEGISLATION TO REGULATE DEPOSITORIES

BASIC approached the nation's securities paperwork crisis as an operational problem that the private sector could and must solve – and quickly. When CSDs emerged in BASIC's judgment as, when compared with alternatives, the most promising solution for both the near and long term, step-by-step BASIC set about to gain acceptance of the CSDS program by the nation's financial community, and to implement. BASIC from the beginning knew, of course, that CSDs, with their huge responsibility for accurately handling and accounting for tens – if not hundreds – of billions of dollars of securities, must operate under regulatory authority.

BASIC took action to solve the paperwork crisis through a CSDS on the basis that such a project could be carried to a conclusion under then existing regulatory law. The implicit assumption at that time (1970) that Washington would not try to change the ground rules – it turned out – could not have been wider of the mark.

WASHINGTON'S IMPACT ON DEPOSITORY DEVELOPMENT – 1970

Notices of BASIC's formation appeared in the press on March 12, 1970. A day later, the SEC issued a press release stating that the Commission "was most pleased by the appointment of the Banking and Securities Industry Committee. . .to expedite resolution of the substantial operational problems presently facing the securities industry . . . The Commission will closely follow the Committee's activities."

Several of those involved in BASIC's work believed that a meeting of the full Commission and the Committee would be fruitful. Accordingly, by letter dated July 1, 1970, BASIC invited the Commission to spend a day in New York, not only meeting with the Committee but seeing firsthand the operations of a transfer agent, a broker's back office, and CCS. Unfortunately, the Chairman replied that it was not feasible for the Commission to make such a trip.[7·1] An SEC staff member was designated to keep informed as to BASIC's work about November 1970. He received copies of BASIC's research studies and other reports, and telephoned BASIC's office periodically thereafter to receive an oral updating.[7·2]

Before BASIC's formation, one of the SEC Commissioners, Richard B. Smith, had shown considerable interest in the stock certificate problem and had written and spoken about it. During the second quarter of 1970, BASIC's Executive Director and a Task

---

[7·1] A similar invitation to the new SEC Chairman on July 1, 1971 resulted in a trip to New York by him, another Commissioner, and several of the SEC staff on November 26, 1971.

[7·2] However, on December 23, 1971 the SEC's Chairman wrote to BASIC that while there were copies of BASIC's studies and reports in the SEC files, the Commission itself did not have them. The Chairman requested that future BASIC reports be also sent direct to the Commission. This was done thereafter by sending each of the Commissioners a copy of any report issued by BASIC, in addition to the copies to the staff.

Force member conferred with Commissioner Smith in Washington on the paperwork problem and potential solutions. The exchange of views was helpful and led to other discussions with the Commissioner.

Other than that indicated above, BASIC received no expressions of interest in its work from Washington during the first ten months of its existence, i.e., by the close of 1970.

WASHINGTON'S IMPACT ON DEPOSITORY DEVELOPMENT – 1971

During the first four months of 1971, there were a few telephone conversations between the Executive Director and SEC staff, and one with Commissioner Needham, about BASIC's progress. The discussions with Commissioner Smith also continued during this period. At this point, as outlined earlier, BASIC was fast firming up a plan for locally owned and managed CSDs, to be subject to state banking regulation as trust companies.

Senator Roth's Bill

The first clue to BASIC that the Federal Government might question and interfere with BASIC's plan for state-regulated depositories came in a letter dated June 7, 1971 to BASIC from Senator William V. Roth, Jr. The Senator had been considering the desirability and feasibility of establishing a national Comsat-type corporation to do the work of present securities clearing corporations and depositories. One of the Senator's staff members shortly thereafter visited BASIC's office where he was informed of progress on a number of fronts, including the development of a CSDS. He, and the Senator in a subsequent conference, were offered the opinion that no regulatory authority beyond that presently reposing in the States and the SEC was needed for depositories.[7.3]

The SEC Hearing

Also in early June 1971, BASIC received an invitation to appear at a "Hearing on the Stock Certificate" on June 29 before the entire Commission. The purpose of the hearing, according to the SEC Chairman, was to inform the Commission as to what is being done to reduce operational difficulties in processing securities transactions, to explore even more satisfactory solutions, and to examine different systems to determine the best prospect of evolving a satisfactory nationwide securities handling system.

About a score of witnesses gave statements, or made comments during the discussion period. Many were those involved in the 1969 research projects mentioned in Chapter I. Other witnesses were from exchanges and NASD, lawyers, bankers, transfer agents, the Fed and the American Bankers Association. BASIC was represented by its Chairman and Executive Director. The latter was its spokesman.

Most of the witnesses dealth with concepts – of eliminating the certificate; of making it machine-readable; of automated systems linking the financial community

[7.3] Subsequently, there was an exchange of correspondence with Senator Roth on the subject – See Appendix O. The Senator introduced his Bill in the Senate on September 20, 1971 (S. 2551).

together. Many of the exchanges and the NASD gave progress reports on improvements that they were effecting.

With regard to a system for reducing certificate handling and expanding book-entry, both the Fed and BASIC went beyond system concepts to describe implementation that had already been carried out and that which was in the practical planning stage. The Fed reported on book-entry for Treasury obligations and BASIC on book-entry for fungible equities. Several of the speakers endorsed BASIC's program.

There is little evidence that the report of BASIC's work (covering some 15 months at the time of the hearing) made an impression on the Commission. On the contrary, there seemed at later dates more a willingness to start from scratch in developing the grand systems design which might or might not require scrapping BASIC's CSDS plan in favor of some alternative.

The Senate Hearings

The Senate Subcommittee on Securities, as a part of its "Securities Industries Study," held hearings on the industry's operational problems on September 30 and October 1, 1971. Witnesses included representatives of most of the organizations that had appeared before the SEC, plus some others. The Chairman and the Executive Director appeared for BASIC.

BASIC's position – BASIC's prepared statements for the Subcommittee[7.4] were confined largely to describing what BASIC had been doing, and what it planned to do, in solving the securities paperwork problem. BASIC's plan for the depository to have trust company status, and thus be regulated like a bank, was explained to the Subcommittee in a copy of a BASIC press release filed for the record:

> "The memorandum (of understanding) calls for a two-stage evolution of the present Central Certificate Service into an expanded depository system. In the first stage it is to become a direct, wholly owned subsidiary of the New York Stock Exchange, instead of a division of the Stock Clearing Corporation, as at present. The American Exchange, NASD, Clearing House banks and other users are to be represented on the board of directors of the subsidiary, which will seek a charter as a trust company incorporated under New York State banking law . . ."[7.5]

> "The plan calls for incorporating CCS, Inc. as a trust company under New York law, making it subject to regulation by the New York State Banking Department. . . ."[7.6]

The importance to fiduciaries of the safety aspects of a depository was made evident during the question period:

> "**Mr. Bevis** . . . The other point, extremely important, is that the securities that you are going to get into the depository to be transferred by book entry, will

---

[7.4] *Senate 1971 Hearings,* pp. 174-183.

[7.5] *Ibid,* p. 177.

[7.6] *Ibid,* p. 180.

go in either voluntarily, or involuntarily. And we are working on the voluntary deposit by the various depositors in a depository of those securities. Banks, insurance companies and others have a strong sense of fiduciary responsibility and the safety of those certificates is of paramount importance to them they think. We are trying to set up a structure which appeals to them and in which they voluntarily will place those securities.

We believe we are heading in that direction and will accomplish this. In the alternative, we would have to face the question of either their voluntarily doing this, or being made to – if you see my point.

Senator Williams. Or encouraged to do it voluntarily with some national expression, not permission, but national purpose to be served through this kind of system.

Mr. Bevis. It is the safety and the accuracy of the recordkeeping that would be of paramount interest to them. This is, as Mr. Meyer said, a nut-and-bolts kind of operation. It has to work down to the smallest detail. Whether or not a Federal agency could do as good a job as mutually owned instruments, such as we are talking about, would be a good question.

Senator Williams. Well, are there intermediate steps along the way? The appointment of those who run the institution could be at the national governmental level, not the operation, but the appointing power or part of it . . ."[7-7]

At this point in time, it will be recalled, BASIC was assuming that the private sector would be allowed to proceed with a solution under existing regulatory law and without further Federal intervention. However, comments by some witnesses and comments and questions by some Senators, quickly indicated that the Congress might well not allow BASIC to proceed unimpeded. The more important questions raised are described briefly below, but a reading of the entire hearings is necessary to get the full flavor.

Who will coordinate depositories? – BASIC explained in its prepared statement:

"The memorandum (of understanding) also looks to the development of a national depository system, possibly with regional depositories interconnecting with the one in New York. In anticipation of this, the Central Certificate Service is about to broaden its operation to include the Midwest and Pacific Coast Stock Exchange Clearing Corporations. It already is being used by banks in New York in connection with their collateral loans to brokers and is soon to be used by banks outside New York . . ."[7-8]

"BASIC believes that it is entirely fesaible, within the relatively near term, to have a nationwide network among financial institutions whereunder a significant percentage of certificates will be immobilized, and transfers of ownership of the immobilized certificates will be accomplished by book-entries . . ."[7-9]

[7-7] *Ibid,* p. 193.
[7-8] *Ibid,* p. 177.
[7-9] *Ibid,* p. 179.

"For about a year, the BASIC task force has held monthly meetings with representatives from the Boston, California, and Chicago financial communities. The head of the P-B-W exchange clearing corporation, from Philadelphia, recently joined these discussions. The purpose of those meetings has been to inform the out-of-state representatives of BASIC's thinking and planning and receive their suggestions – all to the end that other parts of the country could move as fast as possible in helping to build a national CSDS which would tie in with the one developed in New York. . ."[7.10]

The foregoing picture of an emerging national book-entry system without a Federal coordinator of some type clearly puzzled the Senators. For example:

"**Senator Williams.** In your projection here of a national depository with regional aspects, who would be in overall charge, so to speak?

Mr. Bevis. There would not be a single overriding governing body. As in Germany, the self-interest of all the depositors to accomplish as much as possible by book entry exercises a severe discipline on each of the depositories to do the most comprehensive and most accurate job possible.

Senator Williams. You are talking about voluntarism here, aren't you?

Mr. Bevis. Really, yes . . ."[7.11]

* * *

"**Senator Williams.** Mr. Bevis, what Government agency will be in charge of regulating the depository, the system you described?

Mr. Bevis. We are talking about a New York depository being incorporated as a trust company under New York bank law, which would mean that it would be under the jurisdiction and inspection of the New York State Superintendent of Banks. We would have the depositors who are eligible confined to those financial organizations that are under Federal or State supervision or authority. That would mean that the depositors would be under the jurisdiction of the Federal Reserve, the Comptroller of the Currency, FDIC, SEC, State banking authorities and State insurance authorities.

We would believe that each of these authorities, supervising depositors, could and should review the conditions under which the people under their jurisdiction deposit in a depository, as a condition under which they would allow them to give up the possession of their securities.

Senator Williams. This would certainly present, it would seem to me, a multitude of legal obstacles in getting to the end of the road to an efficient system . . ."[7.12]

* * *

[7.10] *Ibid,* p. 181.
[7.11] *Ibid,* p. 185.
[7.12] *Ibid,* p. 191.

"**Senator Williams.** You are describing a national system here and really coming down to basically the New York banking laws as the significant regulator of the operation. Do you think that is adequate, sufficient, or appropriate; or should there be national overview and regulatory jurisdiction?[7.13]

Clearly, from the foregoing excerpts, there was skepticism that the book-entry solution could be effectively implemented without some action by the Congress.

Isn't Federal legislation necessary? – This was a natural followon question.

"**Senator Roth.** Now, it is my understanding that BASIC feel that no legislation is necessary in this area, yet we have had other witnesses before the committee that feel otherwise, as you would expect, that it will be impossible to get a national system without Federal assistance.

On what basis are you optimistic that this can be accomplished?

Mr. Bevis. . . . Essentially, Senator, we have been trying to work against time to get the quickest possible, practical accomplishments to help the situation. We believe that we will have it in the approach that we are taking.

Personally, I would think that if an attempt were made under Federal law to establish a countrywide securities depository system, that would take longer and I think probably get you into more highways and byways in terms of every community wanting its depository, as opposed to establishing a depository system which is founded on existing procedures of banks, brokers, exchanges, and so forth, and merely tying them together, which is what we are trying to do without regard to State lines.

Senator Roth. If out-of-State banks and out-of-State exchanges are unwilling to join, won't you then need legislation to compel it.?

Mr. Bevis. Senator, it is possible.

I should mention that self-interest of the members of the financial community in cutting down their securities handling costs and problems and the opportunity to effect deliveries by book entry is going to be and is already a very strong incentive.

Insofar as New York alone is concerned, it presently does such a high percentage of its volume with out-of-State people, banks and brokers, if it eliminates the physical delivery from New York, it is interested in having the physical receipt eliminated out of State, because otherwise it has got to deliver it. So there is a strong self-interest here in cutting down the cost and the complexity of securities handling.

We have found actually eagerness on the part of out-of-State people to try to get into a compatible system . . ."[7.14]

* * *

[7.13] *Ibid,* p. 192.
[7.14] *Ibid,* pp. 189-190.

"**Senator Williams** . . . Well, it is a national system?

Mr. Bevis. Right.

Senator Williams. It would seem to me from where we sit here in Congress, that Congress might well feel that we should have a say, a significant say, in the creation of this and in the determination of who should run it.

Mr. Bevis. I can see your concern, of course, in view of the industry's problem of the past. I know you want to help. To me it is a question of what is the fastest course, always on a sound basis, to get action. From all of my studies — again, I am not connected with either industry — I would think this — what BASIC is doing in New York and encouraging others to do is probably the fastest course to get real effective relief.

More than a year ago I studied the matter of coming to the Congress for Federal legislation and, in relation with the alternatives, I finally concluded that the course we chose was the quickest way to do the job. It could be fanned out into the rest of the country probably quicker than any kind of an overall federally regulated organization could do it . . ."[7-15]

Isn't BASIC too much New York? — A couple of witnesses complained that other communities were not represented on BASIC. The fear was that New York would not take the interests of the other communities into account in solutions to the paperwork problem. The Senators picked up this point in their questions.

"**Senator Williams.** That leads me to a question. Do you feel the BASIC group is sufficiently representative of the securities and banking industries as a whole to make a determination as to how a national depository system should be set up?

Mr. Bevis. I would say . . . that BASIC operating alone in New York, in an ivory tower, could not accomplish this. This is the reason that we have set up and have been in dialog with representatives of the other financial communities for more than a year.

Senator Williams. You have been in dialog, and they have been informed. But have exchanges outside New York been invited to join BASIC, or the board of the new depository?

Mr. Meyer. May I answer that?

Mr. Bevis. Yes, sir.

Mr. Meyer. The direct answer to that question is no; they have not been invited to join. And there has been some discussion of that. There has been some feeling that perhaps we have made a mistake in not enlarging the group. We feel that up to this point we have not. Our reason is: First of all, we have to try to set our own house in order in New York.

[7-15] *Ibid,* pp. 192-193.

As Mr. Bevis mentioned, approximately 70 to 75 percent of security transactions are now settled in New York City. So we addressed ourselves to the securities and banking problem in the first instance that existed in New York. And until last week, until we had an agreement between the two exchanges, NASD, and the 11 banks, there wasn't very much we could do other than discuss with various people and keep them informed. And we have tried to keep them informed.

There may well be some who feel that have not been informed sufficiently. If that is so, we apologize for it; it was unintentional. But again the principal thrust of our work so far – and we had to start somewhere, this is an enormous project and a big ball of wax. And the place we chose to start was in our own backyard . . ."[7.16]

* * *

"**Senator Roth.** I have a number of questions here. I don't want them to be construed as being hostile to what BASIC is trying to do . . .

One of my concerns, though, (and some questions have touched upon this problem), is how will other financial centers have an effective voice in BASIC as it will develop? You have said that when it (CCS) is spun-off, the depositors will elect the directors, but I gather as a practical matter, they will be a minority, so there is no certainty that the other financial centers will have any voice. Do you think from a national point of view this is desirable?

I am concerned about these other financial centers and their development as well as New York.

Mr. Bevis. Well, the closest parallel to what I am talking about is in Germany where precisely this kind of arrangement works. Each of the seven depositories are locally owned and managed, and they are interconnected as being depositors in one another. So that Frankfurt can receive securities in Frankfurt, and if the depositor wishes them delivered in Hamburg, that is done by book entry, with Hamburg's delivery out being charged to the Frankfurt account.

I would expect that a Chicago and a California depository would also be owned and operated predominately by people in those communities and if the New York depository were a depositor of substantial size in them, it might well have a voice in their management and vice versa with regard to New York. But I think each will be primarily locally dominated. And where the shift of volume of transactions will go after you get a nationwide book entry is something that I wouldn't predict. It is concentrated heavily in New York at the present time because of the handling of physical certificates, and that makes it a necessity. When you no longer have to handle those physical certificates, I don't know what the shift will be."[7.17]

[7.16] *Ibid,* p. 185.

[7.17] *Ibid,* pp. 190-191.

BASIC quarterly reports to Senate Subcommittee covering period October 1, 1971 – June 30, 1972 – Toward the end of BASIC's testimony, the Subcommittee Chairman asked if the Subcommittee could be supplied with quarterly progress reports on BASIC's work. BASIC's Chairman and Executive Director responded that they would be glad to do so.

Three of such reports were issued, covering the last quarter of 1971 and the first and second quarters of 1972 (attached as Appendix P). The first report was inserted in the *Congressional Record,* along with some complimentary remarks about BASIC's work, by Senator Sparkman (*Congressional Record – Senate,* January 26, 1972, pp. S543-546).

After the Senate passed its securities processing act in the third quarter of 1972, the reports were discontinued.

The Senate Subcommittee Report – The Senate hearings provided the basis for a Subcommittee report dated February 4, 1972.[7.18] The report dealt with several subjects besides the paperwork problem and depositories. In discussing the latter, the report was keenly disappointing to BASIC. It appeared to pose CSD and Continuous Net Settlement systems as alternative solutions to the paperwork problem, and to dismiss a CSDS as performing a minor custody function while CNS became the total system.

BASIC's Executive Director was so concerned with the misconceptions in the report – misconceptions both as to the potential of the CSDS and its ability to interface with a CNS system – that he wrote a 12-page letter of comment to the Subcommittee Chairman under date of March 3, 1972. The following quotation from the letter illustrates the problem:

> "This brings up a *serious* deficiency in the staff report. Besides the inapt comparison of CCS with a CNS clearing house, the report deals with CCS as is – not with CSDS at all. The whole point of CSDS, as suggested by BASIC and now generally endorsed within the nation's banking and securities industries, is to expand the list of depositors under the same roof, so that book-entry deliveries can be made among them. Banks, mutual funds, and insurance companies, at the least, must be included – along with brokers or clearing corporations representing them. Regional depositories must be tied together to have the effect, so far as the potential for book-entry delivery of securities is concerned, of putting all their securities and all their depositors under one roof."[7.19]

The Subcommittee report raised in a very real way the question of whether most of the results of BASIC's work might ultimately have to be scrapped to give way to some Congressionally directed system. The same question emerged on the House side.

[7.18] *Committee on Banking, Housing, and Urban Affairs* – "Report" (Containing a Report of the Subcommittee on Securities), U.S. Government Printing Office (1972).

[7.19] The entire letter is attached as Appendix Q. The quotation above is from pages 3-4.

The House Hearings

The House Commerce and Finance Subcommittee, in its "Study of the Securities Industry," held hearings on operational problems on October 18, 19 and 20, 1971. The witnesses were representatives of much the same organizations that had appeared in the Senate and much the same ground was covered.

BASIC's position – BASIC's Executive Director testified as to the progress to date in developing the CSDS and as to forward plans.[7.20] The opening statement included this excerpt:

> "**Mr. Bevis** . . . our objective is that all members of the financial communities in all cities should ultimately participate as direct depositors or via correspondents, and be able to accomplish the processing of securities transactions by book-entry.
>
> BASIC's first priority has been to try to establish a comprehensive depository in New York City. The perfectly logical reason for this is that some two-thirds to three-quarters of the securities handling problems of the entire country, so far as our studies show, are centered in New York City.
>
> Last month, a memorandum of understanding was signed by the American and New York Exchanges, NASD, and all 11 New York Clearinghouse banks, which we think is a significant practical forward step to bring this depository into being in the most effective way. It shows a common goal.
>
> Essentially, we are going to have the New York Stock Exchange spin off CCS, put it into a more comprehensive depository owned and managed by its depositors, which will at the outset mostly include banks, but it should be available for mutual funds and insurance companies as well, plus, of course, broker-dealers.
>
> We fully believe a New York depository can come into this expanded operation no later than the end of the first half of next year.
>
> In terms of interstate settling of securities transactions, CCS is also jumping ahead, but with the full applause of BASIC, into becoming an interstate operation. I am sure Mr. Howland will tell you about expanding of the facilities of CCS to out-of-State banks and also to nonmember dealers.
>
> The Pacific Coast Stock Exchange has established a depository which is heading directly in line with our views, and I am sure Mr. Delahunty will tell you about that . . .
>
> To me, the view is getting around and the conviction growing that these depositories offer a serious and real prospect of faster, lower cost handling of securities transactions by book entry without movement of certificates, but with the certificates immobilized.

[7.20] The prepared statement appears in *House 1971 Hearings,* pp. 1321-1325 and 1833-1837.

CCS has proved that this can work and is working, and I think it is becoming evident even to doubters that we are on the right track and well along to accomplishing what BASIC set out to do; namely, as I said at the outset, bring processing of securities transactions back within acceptable limits of time and expense . . ."[7.21]

During the discussion period, the question was raised as to self-interest of various groups in this fashion:

"**Mr. Painter** . . . it has been said, I believe in the statement of Mr. John Cunningham before Senator Williams' subcommittee — Mr. John Cunningham introduced a statement on September 30 of this year where, on page 13, he said that there exist today 'negative incentives' toward the development of efficient systems of dealing with stock certificates.

It was there pointed out that 'these negative incentives have to do with the impact of the certificateless system upon the use and revenues accruing to transfer agent function of banks, as well as the potential reduction in monetary float as a result of the operations of a national depository.'

Now, I would like to add one further thing. Dr. Lee Kendall, president of the Association of Stock Exchange Firms, said much the same thing in his appearance before Senator Williams' subcommittee on September 24 of this year . . ."[7.22]

The Executive Director of BASIC commented:

"**Mr. Bevis** . . . there isn't any question but that a depository is going to cut down transfer volume of transfer agents, and many of them are New York banks.

We estimated that a New York depository alone would reduce transfer volume as it exists today some 40 percent, and that a national depository would reduce the transfer volume by some two-thirds.

The banks know this. The banks that we are dealing with in New York know this. The banks in New York also know that some of their loans — a lot of their volume of handling securities transactions for out-of-State people and so forth — depends upon that physical certificate, and the fact that at the moment it is largely localized in Lower Manhattan.

They know this. I have not had to date a single question raised by any of the 10 banks in New York, at the policy level by officers of banks, any question about not going forward with the depository because it would have this impact on them.

And they are not stupid people, being where they are, and they know what is going to happen. I think the banks in New York, and it is commencing to spread across to bankers in other parts of the country, are convinced that the

[7.21] *Ibid,* p. 1320.
[7.22] *Ibid,* p. 1409.

depository is the prime hope of not having another near chaos such as we had in the past, and even though they are affected and their securities are a small part of their overall operations, nonetheless they are giving it full support . . ."[7.23]

Some of the witnesses expressed approval of BASIC's plans, while others either talked about alternative plans or raised questions about BASIC's organization. The following excerpts from testimony highlight some of the more important questions discussed which closely parallel those asked in the Senate.

Isn't BASIC too much New York? – One concern was whether BASIC was not too much oriented to New York. This question was explored more searchingly than in the Senate.

"**Mr. Painter.** Mr. Montross . . . expressed concern that decisions regarding a national depository system are New York oriented, he said, because of the composition of the BASIC committee and the proposed board of directors of CSDS . . . The criticism here . . . is that the BASIC proposal, the CCS operation and its planned CSDS operation will be essentially a New York operation having a distinctly New York flavor to it, and therefore, at least it is being urged by some, that we should give serious consideration to an approach which would give more equality of treatment to other parts of the country and place a greater emphasis upon regional depositories. This you might call, I suppose, a concept of intergrated pluralism, rather than having all of this, or a significant part of it, centered in New York . . ."[7.23a]

* * *

"**Mr. McCollister.** Mr. Montross . . . How would you propose that the partnership of the other regional stock exchanges be implemented in BASIC?

Do you propose that the number of seven be expanded to include representatives from Pacific Coast and Midwest Stock Exchange, or what proposals would you have?

Mr. Montross. Mr. McCollister, I am not terribly oriented to the numbers involved except to the extent that I think the other regions of the country, specifically the Midwest region and Far West region, should have appropriate and hopefully equal representation in the policymaking and directive functions of BASIC.

BASIC, which has been essentially a New York enterprise, I believe, up to the present time, could be expanded meaningfully to allow participation on an equal basis from the Midwestern sector of the country, from the far western sector of the country, and from the NASD. I don't think it is just a question involving two additional exchanges. I think bankers as well as the National Association of Securities Dealers are involved.

[7.23] *Ibid,* p. 1410.

[7.23a] *Ibid,* p. 1488.

Mr. McCollister. Has the Midwest Stock Exchange had any conversations along these lines with BASIC?

Mr. Montross. Recommending an opening of that specific membership?

Mr. McCollister. Or merely discussing the problem that you see existing in the concentration of New York interests to the exclusion of Midwest and Pacific Coast interests.

Mr. Montross. On a number of occasions, yes, we have had such discussions.

Mr. McCollister. Mr. Howland.

Mr. Howland. I think the record should show that Mr. Bevis and BASIC have had monthly meetings with representatives of the Boston, Midwest, and Pacific Stock Exchange communities now for about a year, and Mr. Bevis may wish to speak on that.

Mr. McCollister. If it is the ultimate goal of BASIC to have this serve as a model for a number of regional depositories, might it not be more agreeable to get their participation in the initial development of BASIC in order that when we get to the point that its principles are extended to other regional areas, that they would have felt a part of the regional concept?

Mr. Bevis. We don't conceive this national network of securities depository as being monolithic in the sense that any one area would impose its plan on everyone else . . .

We don't believe that we can get where we want to go quickly by establishing a national monolithitic enterprise with uniform internal procedures, uniform computers, and all of that, but rather that each region can shape the structure of its depository to meet its local needs. So we don't feel that BASIC in setting out the guidelines for the New York depository is imposing anything on any other region.

Our approach is to urge these other regions to get together and form theirs . . ."

* * *

Mr. Montross . . . The impact of a New York development is so pervasive because of the mere size of the securities activity in New York, that effectively it does become an imposition or imposing of a system on the rest of the country, unless the rest of the country is to go its own independent route and perhaps engage in continued redundancy of cost investment, which would really be coming from the same people.

So like it or not, it seems to me that it has to be recognized that New York by its mere size or the New York financial community's mere size effectively is dictating to the rest of the country, whether it is intentional or unintentional.

* * *

Mr. McCollister. But, Mr. Montross, Mr. Bevis says that is a simple matter of communication only, the interfacing. Do you agree?

Mr. Montross. Well, I can't agree and I can't disagree, Mr. McCollister, because I think Mr. Bevis would agree that there are a great many unknows in this so-called depository field. There are many questions about which we don't have answers.

Mr. Moss. The Chair would observe at this point that he would disagree that it is quite that simple. He thinks it is far more complicated, as you have indicated, and it is going to require the utmost cooperation and participationto effectuate interfacing in order to develop a totally compatible system.

It would be foolish and imprudent for the committee not to look at geographic distribution, because whatever is said here, the fact is that there is considerable feeling within the industry over the centering of too much policymaking, too much control, in New York, and I am not going to make the mistake, and I don't think the members of the committee are going to make the mistake, of not looking at this most realistically to determine the extent of it and whether or not it is desirable.

We are not going to brush it under the rug, in other words. We are going to look at it very carefully . . ."[7-24]

* * *

"**Mr. Bevis.** I intended when I have the microphone before to comment on the suggestion that I had oversimplified the interrelationship among regional depositories in the country.

I don't believe so. My principal basis of saying so, Mr. Chairman, is that I went over to Germany to study their depository system which has been in operation formally for some 40 years.

They have seven depositories in Germany, each locally owned and operated, but they do interface with one another by being depositors in one another.

They vary widely as to the volume that is handled locally, Frankfurt being the largest, about 45 percent of the total, they estimate, but they are depositors in one another and deliver and receive on behalf of one another. Their internal recordkeeping facilities vary all the way from sophisticated computer equipment in the larger, to plain bookkeeping machines in the smaller.

Nonetheless, in terms of effecting transactions among themselves by book entry, they are extremely effective and have been for many decades . . ."[7-25]

* * *

[7-24] *Ibid,* pp. 1491-1493.
[7-25] *Ibid,* p. 1503.

"**Mr. McCollister** . . .I would like to have Mr. Delahunty comment about this from the point of view of the West Coast Stock Exchange and your possible participation in the discussion now going on in BASIC.

Mr. Delahunty. Essentially our discussions are merely at the staff level and not at the policymaking level of BASIC. We felt that we were going to have very little say in the development of CSDS at the early stages. For this reason, we went our own route in the development of a depository in Los Angeles and San Francisco. This, in and of itself, would give us a meaningful participation in the depository network.

The development of a depository system in California was much easier than it was in New York environment . . .

I concur with Mr. Montross's statement that the sheer size of CCS will indicate the method by which depositories are going to be developed . . ."[7-26]

* * *

"**Mr. McCollister** . . . What I was leading up to Mr. Bevis, you have here the evident interest and willingness to participate on the part of the other exchanges . . .

I think with the small knowledge I have of the situation, it is foolish of BASIC to deny them meaningful participation in the original layout of it . . .

Mr. Bevis . . . I think you are quite right that if this effort were confined to New York, solving New York problems only, it would be only a half-way effort in tackling the whole problem of handling securities transactions.

My position is one of not having been associated with either industry, and working without compensation, I am beholden to no one, and I have never been asked to confine myself and that of my task force solely to New York.

I decided that New York problem had to be resolved and the guidelines for resolving them had to be established before we could go nationwide.

Among other things we must consider not only the exchanges in these other areas like Midwest and the Pacific Coast Exchange but the banks, the insurance companies, possibly mutual funds, all of whose securities should be in the same depository so that you can broaden your book entry transfer . . .[7-27]

Within two months after the House hearings, formation of NCG was announced (See Chapter I). Comprised of representatives of the California, Chicago, and New York communities, plus NASD, the existence of NCG seemed to dim the suspicion of BASIC expressed in 1971. Hearings in subsequent years concentrated on more pertinent matters.

Shouldn't there be one national system? — BASIC did not believe that a monolithic depository system was the solution to accomplish immobilization, and explained why at

---

[7-26] *Ibid,* p. 1501.

[7-27] *Ibid,* p. 1500.

some length in its prepared statement.[7-28] It stressed the construction of a CSDS in which fiduciaries would have confidence.

Commissioner Needham of the SEC seemed inclined to to give weight to industry efforts to solve problems, as well as to the need for a total systems approach. The Subcommittee Chairman, however, was very concerned about compatibility.

> "**Mr. Needham** . . . It seems to me, however, Mr. Chairman, that the broader question is one of mechanics. What seems to be lacking and probably disturbing to you in the Congress, as well as to us at the SEC, is a total systems approach to this matter, and to speak in terms of legislation without knowing specifically what is it we are going to legislate, it seems to me we get the cart in front of the horse.
>
> The reason, I believe, that the Commission has moved cautiously in this entire area is that there is so much going on that we did not want in any way to deter or impede the development of ideas and concepts.
>
> We think that the industry has come a long way in the last few years in the development of new ideas and technologies, and is showing a greater concerted effort toward the solution of the various problems that are under Category 1.
>
> So, Mr. Chairman, I would hope that as part of your record you would put the burden of proof on those people who advocate one system over another. Having done that if then you are able to reach a conclusion that one method is better than the other, it seems to me that through NASD or perhaps through SEC rulemaking authority, the system can be implemented without having to bother the Congress with the specifics of what a form should look like, how it should be routed, or so on.
>
> I think that is an expertise that should be left within the self-regulatory framework or in the SEC. A total systems concept is what is needed here. The question is, are we wise enough at the time to decide what it is?
>
> **Mr. Moss.** I think the things that have concerned the Congress, and one, of course, is the total systems concept – that is certainly the foundation of a proper system – but as the individual efforts are being made, is there sufficient coordination, is there a building in of compatibility? Can there be, if it develops it is desirable, a totally standardized system created from the various individual efforts now going on?
>
> Shouldn't there be at least an agency interest in assuring sufficient compatibility in the efforts so that the ultimate standardized system, if it is desirable, can be implemented at a reasonably early date?
>
> **Mr. Needham.** Well, Mr. Chairman, I think I have some expertise in the area of systems development. Systems development is predicated, in fact its only

[7-28] See, particularly, *ibid*, at pp. 1834-1835.

foundation, is a sound organizational system, and that, Mr. Chairman, is what in my opinion is lacking at the moment . . ."[7.29]

Montross stated:

"We recommend the formation of a national depository organization to oversee the development of a national system within which the eastern, midwestern, western — and perhaps other — regional depositories will be integral and interfaced parts.

The depository organization should be controlled initially by the three major financial centers — that is, Chicago, New York, and San Francisco-Los Angeles — and the National Association of Securities Dealers — as the national representative. As development and implementation progresses, participation should be opened to additional financial centers . . ."[7.30]

The Subcommittee's Special Counsel explored the national system approach with Mr. Sporkin of the SEC.

"**Mr. Painter** . . . do you envisage the need to develop a national system?

* * *

Mr. Sporkin . . . I personally have been a very pessimistic person when it comes to the industry and its ability to get out of its back-office problems. I think the chairman knows that from the conferences we had when we really had problems. I feel a little bit optimistic now, quite frankly. I think we are coming out of it in the sense of getting the system, and I am not one who in this area has felt that optimism was called for or could be justified I think prior to this time, but I really see possibilities for a system developing . . ."[7.31]

One of the Subcommittee members pursued the point with BASIC's Executive Director:

"**Mr. McCollister** . . . The problem is not so much hardware as software, and the biggest problem with software, it seems to me, is the customer's understanding of that software and the goals that are established that point that software in a given direction.

So that maybe the comments that Mr. Rowen has made about getting us one common goal to aim for would spur the development of a uniform method of doing this within the 2 or 3 years that Mr. Sporkin has referred to.

Maybe that becomes an argument for Federal legislation dealing with the subject, to enable us to set some goals that avoid some efforts.

Mr. Bevis. I should think that from the standpoint of the Federal Government if it approached this in terms of a national system it would have to approach it in terms of a uniform national system, as opposed to allowing a number of

---

[7.29] *Ibid,* pp. 1404-1405.

[7.30] *Ibid,* pp. 1343-1344.

[7.31] *Ibid,* p. 1611.

interested groups in the regions to approach it, and they may not all have the same computer requirements or processing requirements, and certainly not the same volume.

It appalls me to think in terms of trying to develop a system for the whole country before you start in the place where it is needed most, and it is the time factor, I think, that is very important . . ."[7.32]

The SEC representative at one point was asked a question very pertinent to the historical lack of a broker/dealer systems solution to the paperwork problem:

"**Mr. Moss.** I would like to ask a question, Mr. Sporkin.

Do you have authority in the Commission to impose a requirement of interfacing and to require participation in a common system.?

Mr. Sporkin. I think we do, Mr. Chairman."[7.33]

Isn't Federal legislation necessary? — Again, as in the Senate, there was much consideration of whether Federal legislation was needed and, if so, what type.

BASIC's prepared statement included this sentence:

"We do not believe that a federal law regulating depositories is necessary."[7.34]

The federal legislation matter was explored by several questioners with several witnesses. For example:

"**Mr. Painter.** You have said in your statement that Federal legislation might impede efforts now underway in this area. In what respect do you feel that Federal legislation might impede the efforts that are now being considered?

Mr. Morgan. I do think that is a statement that does require some clarification.

As we mentioned in that testimony, we prefer to see the formation of the depository worked out at the industry level, but we certainly would be willing to go the legislation route if accord cannot be reached on such matters as ownership, representation, cost of ownership, and many of the problems which Mr. Bevis' testimony refers to as being very real and necessary to be overcome in order to get the job done.

* * * * *

We have felt that although Congress could certainly have a say in the creation of the system, we have also been very impressed by Congress' apparent attitude of wanting industry itself to take strong action.

With specific regard to the use of the word 'impede' the concern that we would have would be looking at the various efforts that have been cited to date, and the activities that have been taking place on the part of the various groups that

---

[7.32] *Ibid*, p. 1457.
[7.33] *Ibid*, p. 1505.
[7.34] *Ibid*, p. 1834.

this panel represents, the question of perhaps diluting or perhaps slowing down the momentum of the progress being made by changing horses in midstream could perhaps be of some concern.

I am not saying or suggesting that legislation would impede. The question is, Might the intervention of an entirely different game plan at this point act to slow things up?"[7.35]

* * *

"**Mr. Painter** . . . the question I asked to begin with was whether voluntary cooperation was going to produce the necessary uniformity, and I gather from your response that you probably were giving an affirmative answer to that question?

Mr. Howland. I think my testimony made entirely clear that the New York Stock Exchange does not feel that Federal legislation is required or necessary.

Mr. Painter. Do you feel that Federal legislation would stifle voluntary cooperation, or to put it differently, would a Federal legislation proposal in any way — I think the expression was 'impede' efforts now being done by the industry?

Mr. Howland. I think it would impede to the extent that CCS probably would not expand as rapidly as we now have the ability to do and as spelled out in the joint memorandum of understanding which has been introduced as evidence or as attachments to our testimony.

I think that we have a chart. We have charted a path as to how, within a period of 2 years, we can pretty well immobilize a great share of those certificates that are now causing trouble.

Mr. Painter. Why would the introduction of Federal legislation somehow mean that the CCS effort would not expand as rapidly?

Mr. Howland. I don't think you continue spending money in developing sophisticated computer programs and so forth without knowing where you are going . . ."[7.36]

* * *

"**Mr. Moss.** We are faced with a fact then that, because of this mix, perhaps any final entity should be federally chartered rather than incorporated under the laws of the State of New York. If it is going to perform this vital function of a national system of broker-dealers of banks, insurance companies, and other user institutions, perhaps then we should examine very carefully the desirability of a Federal charter rather than a State charter.

Mr. Howland. I think that is a very good question, Mr. Chairman. I think in the early days of BASIC one of the first things we did was to look to find should we go the Federal route or should we go the State route and it was felt, because

---

[7.35] *Ibid,* pp. 1402-1403.

[7.36] *Ibid,* p. 1408.

of the complexity of the problems, and I will let Mr. Bevis elaborate, that we should probably go initially the State route. Let's get New York going because we can do it fast and hopefully we could prevent from happening again what happened in 1968 and 1969 in our industry when we just about came apart at the seams.

So we are trying to go down two routes. I think we envision a New York depository plus Pacific and Midwest depositories linked together in an overall depository.

Mr. Moss. But each subject to a differing oversight?

Mr. Howland. If Federal oversight is necessary, I am sure that none of us would have any objection.

Mr. Moss. Then won't you agree with me that that becomes an issue which this committee must look at with a great deal of care or thoroughness.

Mr. Howland. I think it definitely should be examined, sir.

Mr. Moss. Certainly we shall. Mr. Bevis?

Mr. Bevis. May I add a comment, Mr. Chairman; please. Mr. Howland is right that more than a year ago, when we started dealing with concepts with regard to the comprehensive depository, our first thought was Federal legislation.

At that point we were thinking of a series of directly owned and operated depositories across the country under one corporate umbrella. We concluded that it might be simpler, and certainly would be quicker, if we attempted to incorporate the depository now with multiownership in New York under the State banking law, making it subject to the supervision of New York State Banking Department, to make it look and act like a bank to develop the confidence of the fiduciaries in it but limit its ownership only to those who were under regulation, State of Federal.

This would involve the Federal Reserve, Comptroller of the Currency, FDIC, and State bank and insurance departments. It would allow those regulatory authorities, who should, and I think would, examine the conditions under which those under their jurisdiction deposited in the depository, to exercise their influence in that respect.

We are moving very fast and have moved very far on this particular line of reasoning and our assumption was that in due course the same kind of set up would be developed in other centers of the country.

If any serious attempt were made in Congress to pass a bill in this area whereby some Federal organization would promise to have jurisdiction, I believe BASIC's efforts would come to a halt because I think the nonexchange people would probably sit back — they are having enough trouble now examining this proposed animal — would sit back and say let's first see what the nature of the creature is; they would stop creating the comprehensive depository in New

York which is well along and will become operational in the broader sense by June of next year.

Mr. Moss. Let me say, and again if there are members of the committee who disagree with me I would want them to indicate their disagreement, that in fact I don't think this would deter the committee if it determines that is is a wiser course to propose a Federal charter.

It might have a very brief time frame but when we complete the study and when we come up with our findings, our conclusions and our recommendations, we are going to attempt to deal with a longer period of time than just the immediate short haul.

So that would not be persuasive to us . . ."[7.37]

* * *

"**Mr. Howland** . . . you will note in the memorandum of understanding that we are suggesting that CSD be organized as a trust company under New York banking law which would mean that there is going to be oversight, at least in the New York area, whereby CSDS would come under the control of the State superintendent of State banks in New York.

It would be subjected then to regular auditing procedures as a bank is and this was purposely done to answer that.

Mr. Moss. I am somewhat parochial in reverse. I feel where we have a broad national impact, that perhaps we should have some entity other than that of just one of the States undertaking this oversight function.

I am open to being persuaded to the contrary but I would assure you it would be most difficult to persuade me."[7.38]

* * *

"**Mr. Painter.** If we have a depository which is incorporated as a trust company under New York State law, and if the holders of the beneficial interests in those shares are scattered throughout the 50 States, does this not point up a need for some type of Federal regulation in order to make sure that the companies can still communicate effectively with their shareholders scattered throughout all of these 50 States?

Shouldn't there be Federal regulation here, not merely regulation under the banking laws of New York State or whatever you are talking about? . . ."[7.39]

* * *

[7.37] *Ibid,* pp. 1506-1507.
[7.38] *Ibid,* p. 1508.
[7.39] *Ibid,* p. 1516.

"**Mr. Painter.** Aren't we then really reaching a situation that would possibly suggest Federal legislation in order to accomplish effective regulation in this type of area?"[7.40]

* * *

"**Mr. Moss.** Does anyone feel that the problems of the back office can be solved without some form of Federal action to standardize?"[7.41]

With all the time spent in the House Hearings on the need for a national system, no clear outlines of such a system emerged – other than BAISC's immobilization plan. To a suggestion, however, that the problem needed further study, the Chairman of the Subcommittee shot the idea down rather directly:

"**Mr. Moss** . . . Just a little earlier I made a reservation in the record for the inclusion of a great many prior studies if the committee determines. These aren't all of them. You are familiar with them. It is characteristic of many of the facets of this business that it has been studied endlessly but decisions have not been made, and I wonder if we shouldn't direct the creation of an entity and instruct it to develop and implement a system within a fixed period of time and charge it with the responsibility of keeping the system adequate to meet the needs of the industry, all aspects of the industry.

Mr. Sporkin. I think clearly the first part of it is in order. In other words, to determine what that system is. As to who–

Mr. Moss. Well, I think the key is whether we direct it only to study or both to study and to 'implement.'

Mr. Sporkin. Right.

Mr. Moss. And I think there is a great difference, really as to the course of action determined upon by the Congress or any recommendations to be made by the Commission to the Congress on whether we just continue to study it. I am very impatient with studies."[7.42]

The House hearings, along with those previously held in the Senate, greatly disturbed the Chairman and Executive Director of BASIC on at least two counts: (1) it appeared that the relatively simple and straightforward depository immobilization solution might become entangled with a wide range of other (and separable) securities industry problems, with unknown consequences; and (2) the state banking regulation of depositories envisioned by BASIC might be replaced by some as yet unclear form of regulation from Washington.

These possibilities threatened to slow down BASIC's depository plan – perhaps ultimately abort it. The Executive Director, after clearing the matter with the Committee at its November 1971 meeting, dispatched a 10-page letter dated December 30, 1971 to Chairman Moss making the following points:

[7.40] *Ibid,* p. 1517.
[7.41] *Ibid,* p. 1603.
[7.42] *Ibid,* p. 1602.

"I. The question of securities depositories should be considered on its own merits, and apart from other questions which concern the securities industry.

II. Prompt implementation of the plan for regional depositories, user owner and operated, should be encouraged because:

A. Operationally and financially, the private sector is best able to expand the present system quickly and effectively. It has a genuine and demonstrated interest in doing so.

B. Coordination and interconnection among user owned and managed regional depositories are already shaping up.

C. Immobilization of certificates in a series of such depositories can decrease the geographical concentration of securities transaction settlements now caused by the need to physically move certificates.

D. The depositories can be organized and operated under the existing regulatory authorities. In any event, one of the most effective disciplines on depositories will be that exercised by their depositors and owners.

E. Substantial progress has been made since mid-October in furthering the implementation of user owned regional depositories."[7.43]

The Chairman responded that it was too late to include the letter in the hearing record, but that it was being passed on to the Subcommittee's staff and would be given the most careful consideration.

Assessment of the position at year-end 1971

BASIC had believed as late of the middle of 1971 (some fifteen months after it started work) that it was fast on its way to solving the securities industry's paperwork crisis — using existing regulatory mechanisms and clearly benefiting the public interest. The hearings in the last half of 1971 and their resulting reports suggested strongly that such a direct approach to the solution of a problem might well be complicated by the Federal Government. There simply was disbelief in Washington that an immobilization and book-entry solution could be implemented by a number of diverse private parties — even though they were in agreement — without "help" from the Congress. The 1972 developments confirmed this.

WASHINGTON'S IMPACT ON DEPOSITORY DEVELOPMENT — 1972

SEC's Unsafe and Unsound Practices Report

The principal 1972 activities involving BASIC's depository development plan actually commenced on December 9, 1971. On that date, with two days' notice, Messrs. Bevis,

[7.43] The entire letter appears in Appendix R.

Howland, and Macklin met with the full Commission to comment on a draft of part of the report from the SEC to the Congress on Unsafe and Unsound Practices.[7-44]

Of particular interest to BASIC was a paragraph in the draft involving depositories which, after stating the authority that was sought, stated that the SEC would use this authority to –

> ". . . Retain full jurisdiction over all entities and organizations performing clearance or settlement functions, including securities depositories . . ."

BASIC's Executive Director and Howland, having for almost two years sought to overcome the resistance of banks to placing their securities in depositories, pointed to lack of bank-type regulation as an obstacle to depository development if the SEC maintained "full jurisdiction." It was observed that the SEC's main concern should be that depositories are appropriately regulated both in the public interest and for their successful development, and that this need not call for "full jurisdiction" by the SEC if the latter had some"over-sight" authority. A modification in wording along the following lines was accepted:

> "The Commission will determine that securities depositories are effectively regulated, and will seek to insure that a system of such depositories is expeditiously developed to meet the nation's needs."

Subsequent events showed that the foregoing development only deferred the question of full jurisdiction over depositories by the SEC.

The Unsafe-Unsound Practices report contained in its 283 pages very little discussion about depositories. The equivalent of about 10 pages was devoted to this subject. About three-quarters of this space dealt with descriptions of the existing depository system, or plans for a CSDS.[7-45] There were a few references to consultants' ideas for solving the paperwork crisis in which depositories figured.[7-46] Finally, there were several statements as to the need for the SEC to keep or expand its authority over depositories.[7-47]

Nowhere in the Unsafe-Unsound Practices report was there a suggestion that depositories had contributed to the paperwork snarl, nor that inadequate regulatory authority over them was a problem. Any references to depositories were either favorable or descriptive. Nonetheless, depositories become entangled in the securities industry's operational problems, in a manner like this:

> "The securities industry's operational problems are evidence that there is need for increased regulation by the Federal government of the transaction handling process . . . In order to ensure that the transaction handling process can be made to function efficiently as a whole, the Commission recommends that it be

---

[7-44] *Securities and Exchange Commission,* "Study of Unsafe and Unsound Practices of Brokers and Dealers – Report and Recommendations." U.S. Government Printing Office (1971). This report had been required in the SIPC legislation to be submitted by the SEC to the Congress by December 31, 1971.

[7-45] See e.g., *Ibid,* pp. 5, 34, 36, 168, 171, 172, 175, 184, 197, 202, 221, 225, and 226.

[7-46] See *Ibid,* pp. 20, 170, 179, 180, 190, 191, and 201.

[7-47] *Ibid,* pp. 1, 6, 36, 37, 39, 173, and 202.

given authority over the qualifications, performance, business practices and rules of entitites performing transfer and depository functions . . ."[7.48]

A large part of the SEC's request to retain or expand its jurisdiction over depositories, however, seemed to turn on its foreseen responsibility to oversee development of the total system. For example, after referring to improvements by CCS, some exchanges and NASD, the report states:

"Each is performing a valuable function which should be further developed. However, such development must be controlled and directed in a manner which would keep each system open-ended and compatible with other systems so that, together, they can evolve and be combined into the kind of a national system which modern technology makes possible and the public is entitled to expect . . ."[7.49]

At the same time, the report indicated that the SEC sought something less than *full* jurisdiction over depositories, for these remarks were included:

"The Commission, in seeking this authority, is not desirous of expanding its jurisdiction to conflict with that of Federal or state bank-regulatory agencies. Economic regulatory authority is not being sought. Rather, the Commission is merely desirous of having all necessary authority to oversee the development of a unified securities processing system and the establishment of the performance standards and access practices necessary for the development and proper functioning of such a system . . ."[7.50]

SEC drafts of a regulatory bill

The December 9 meeting on SEC jurisdiction over depositories brought home the necessity of a full understanding between the SEC and BASIC of each other's viewpoints and considerations. In particular, BASIC felt that the SEC should appreciate the importance *to the securities industry of which it is the regulator* of constructing depositories that sufficiently engendered the confidence of banks that they would participate.

Accordingly, on January 5, 1972 BASIC's Chairman addressed letters to the SEC Chairman (William J. Casey) and the Chairman of the Clearing Committee of the NYCH banks (David Rockefeller), suggesting a conference. The result was a meeting on January 17, 1972 at Chase. Attending were the Chairman, Commissioner Needham and Lee A Pickard of the SEC; the heads of the eleven NYCH banks; Perkins of Continental Illinois and Chairman of NCG; Stewart of Bank of America and a member of NCG; the Chairman and Executive Director of BASIC; and John F. Lee, Secretary of the NYCH Association.

The principal question discussed was the SEC's approach to the regulation of depositories and transfer agents. (BASIC never commented upon, nor took a position as to, regulation of transfer agents, but this subject was of interest to the banks represented

[7.48] *Ibid*, pp. 5-6.
[7.49] *Ibid*, p. 36.
[7.50] *Ibid*, p. 6.

at the meeting.) The SEC Chairman said, with respect to the securities handling system, that the Commission's aim is to improve performance standards; create and preserve interface capabilities between clearance mechanicsms and transfer mechanisms; maintain free and open access to the securities system; impose registration requirements; and establish new recordkeeping and reporting requirements. With regard to the line of demarcation between Federal and State authorities over depositories and transfer agents he believed that the SEC should concentrate on performance and the States on financial responsibility and security.

The meeting concluded with agreement that the SEC would submit a draft of its regulatory bill, now well along, to the NYCH banks and BASIC for comment. (Thenceforth, the NYCH Association commented specifically on the regulation of transfer agents, and BASIC as to depositories. In the bills introduced in the Congress, the regulation of the clearing corporations of exchanges was coupled with the other two subjects. Neither the NYCH Association nor BASIC ever commented on this third area; it was and is intra-brokerage-industry.)

Three days after the meeting at Chase, Pickard forwarded a preliminary SEC draft of a regulatory bill. The draft would give SEC full jurisdiction over registration, rulemaking, examination, and enforcement as to any depository and any person associated therewith. The draft did not mention the assignment of jurisdiction in any subject area to a bank regulatory authority. However, the accompanying draft explanatory statement stated that the Commission was not desirous of expanding its jurisdiction to conflict with of Federal or State bank regulatory agencies. Particularly, primary standards and controls involving security could be left to bank regulatory agencies, the draft comments stated — but the draft bill did not.

For the next two months, the shape of SEC-proposed legislation affecting depositories was the subject of intensive and extensive discussion between the Chairman, Executive Director and legal counsel of BASIC, on the one hand, and the Chairman and Pickard of the SEC, on the other. BASIC's depository plans now had to accommodate the emerging authority and responsibility of the SEC to develop a modern securities handling and transaction processing system for the country, of which a CSDS would be an important part. On the other hand, the SEC had to recognize that effective CSDs had to involve banks and other non-broker/dealers to whom bank-type regulation for safety was essential.

The first proposal to the SEC staff (February 3, 1972) was that its draft bill exempt depositories subject to regulation or supervision by federal or state banking authorities if such depositories were in substantial compliance with minimum standards established by the SEC on access, audits, interface, financial condition, and management and employee structure. The suggestion of an exemption was not accepted.

The next SEC draft received (February 11, 1972) retained in the SEC full jurisdiction over depositories but specified that the Commission shall consult with Federal and State banking authorities having supervision over banks (presumably, with final decisions by the SEC). SEC's rulemaking authority over depositories in this draft would run to standards for the performance of functions, measures for safe handling and custody of

securities and funds, interface with other securities handling facilities, and non-discriminatory access.

As to this draft, BASIC's counsel again proposed to the SEC staff that State banking authorities acceptable to the SEC have jurisdiction over depository banks chartered by them, except for initial registration and rulemaking in the areas enumerated in the SEC draft.

The next draft received from the SEC (on February 25) was little changed in the respects in which BASIC was interested. A paragraph had been added to the effect that nothing in the bill impaired the authority of any State banking authority with regard to its exercise of regulatory or supervisory oversight. But there was no diminution in SEC's jurisdiction.

The SEC bill was introduced into the Senate on March 23, 1972 (S. 3412). None of BASIC's substantive recommendations regarding depositories had been accepted.

BASIC's Executive Director sent a memorandum dated March 20, 1972 to its Chairman commenting on the SEC draft of the bill that was introduced. He stated:

> "It is my judgment that the bill, as it stands, threatens CSDS with serious delay – if not extinction."[7.51]

During the four months after the SEC bill was introduced, BASIC's Chairman and Executive Director had several conferences with the SEC Chairman (Pickard was also usually present). There were also many telephone conversations. The objective was to attempt to find some common meeting ground on legislation.

BASIC proposed that legislation give SEC the final authority over depository rules having to do with reasonable non-discriminatory access, operational compatibility, and minimum general standards of performance capability. BASIC agreed that, for the SEC to discharge responsibility for modernizing a nationwide securities processing system, it needed authority over depository rules in these areas. At the same time, BASIC persevered in the belief that it was essential that examination and enforcement for depositories that were banks be carried out by bank regulatory authorities.

At one point, the SEC Chairman accepted this as a reasonable disposition of a complicated regulatory situation. However, he reported back later that a majority of the Commission and the SEC staff were unwilling to accept a diminution in the SEC's jurisdiction over depositories that were banks.

During the discussions in March and April of 1972, BASIC was continuing to propose that the SEC share responsibility as described above with the several State banking authorities who might charter depositories. SEC strongly objected to such fragmented regulation, stating that the problem required regulation at the Federal level. At this point, BASIC's Chairman, who had been in discussions with officials of the Fed, learned from them that the Fed had authority to charter as a member of the Federal Reserve System a depository that was a limited purpose trust company.

[7.51] The entire memorandum is attached as Appendix S.

Pursuant to the Committee's approval at its May meeting, BASIC's Chairman then proposed to SEC's Chairman in a letter dated May 29, 1972 that the Fed be designated the Federal bank regulator for depositories that are its members.[7.52] This would simplify the coordination of regulatory authority. A copy of the SEC's bill (S. 3412), marked to give the desired authority over member bank depositories to the Fed was sent to the SEC on June 19, 1972. Also under date of June 19, SEC's Chairman wrote that substituting the Federal Reserve for state banking authorities was, to the Commission, still "unnecessary layering." BASIC's Chairman, under date of July 11, 1972, wrote in reply and asked that the Commission reconsider this matter. There was no reply.[7.53]

This pretty much brought to an end BASIC's attempt to persuade the SEC to agree that CSDS should have a strong flavor of banks and of bank regulation. It seemed clear that the SEC would not initiate language to concede any authority in the new legislation to bank regulatory authorities.[7.54] It would agree to consult with them, and would agree that its full jurisdiction should not impair any of their existing authority. It would concede in statements — but not initiate language in the bill — that it would rely heavily on examinations and enforcement of bank authorities to assure safety of securities and funds. It seemed that the SEC could not bring itself to admit that its "full jurisdiction" over securities depositories could make them appear more like a securities industry vehicle than a banking institution; and that the result would then be failure to alleviate broker/dealers' securities handling problems.

The SEC's search for the master plan for handling securities transactions

The SEC Chairman convened a three-day meeting of experts at Harrison House, Long Island, on April 21-23, 1972. The purpose of the conference was to search for guidelines for a "million dollar systems study" which would (1) project how the securities transfer and payments process should function in America in 1978, and (2) evaluate the steps necessary to achieve that system and, at the same time, continue to improve the handling of stock transactions in the interim.

Attending the meeting were the SEC Chairman and Commissioner Needham, several of the SEC staff, representatives of SIA, the Fed, some of the organizations that had researched the securities industry's problems in 1969, other consultants, a lawyer who had written on the stock certificate problem, and the Executive Director of BASIC.

Nothing clear-cut seemed to emerge from the conference. The SEC Chairman followed up by transmitting to the participants on June 23, 1972 two staff memoran-

---

[7.52] The office of the Comptroller of the Currency had previously indicated that it could not charter a securities depository as a national bank. This left the Fed as the one logical Federal bank authority for depositories.

[7.53] The July 11 letter is attached as Appendix T. The other correspondence referred to in the above paragraph is reproduced in *Senate 1972 Hearings,* pp. 904-911, and 958-999.

[7.54] This was notwithstanding the SEC Chairman's statement to the Senate Subcommittee on May 9, 1972 that "We would be prepared to see S. 3412 modified further to give bank regulators authority over securities' safe keeping and the financial responsibility of depositories." *Senate 1972 Hearings,* p. 93.

dums on systems studies and requesting comments. The Executive Director of BASIC responded under date of August 4, 1972 with a 16-page memorandum to which were attached 10 appendices. In the covering letter, the Executive Director stated:

"I offer you these recommendations:

1. First, utilize your staff to collect and objectively analyze all the studies of the securities transaction processing problem that have to date been made by NASD, exchanges, BASIC, consultants, firms, industry committees, SEC, Congressional staffs, etc. Have your staff identify problem areas and proposed solutions on the basis of this effort in a writing that can be circulated to interested parties. I suspect that the amount of material available, and the amount of progress in fact and in plan, would be enlightening and hopefully time saving to all concerned.

2. Ask the staff, in performing Step 1., to identify specifically at this stage the organizations that will be expected to implement the improvements to reach the 1978 goals and who logically, therefore, should be involved in any additional research leading toward those improvements. (See particularly pages 7 to 16 of the attached memorandum.)

3. Hopefully before Step 2. is completed, if not now, have the SEC endorse unequivocally and strongly encourage immobilization of certificates and deliveries by book-entry in a system of regional depositories, owned and operated by their users."[7.55]

The last recommendation above was made because at the Harrison House conference, as before and after it, there seemed little disposition at the SEC to endorse BASIC's CSDS plan as a part of the system of the future, even though the plan was currently being implemented. If anything there seemed a readiness at the SEC to consider that some total systems concept might call for scrapping the CSDS.

Senate 1972 Hearings

On March 6, 1972, Senator Williams introduced S. 3297 on behalf of himself and three other Senators. The bill dealt with the regulation of clearing systems and depositories, all authority for which it would assign to the SEC.

On May 9, 10, and 11, 1972, the Senate Subcommitee on Securities held hearings on the three bills before it: S. 3297, the Roth bill (S. 2551) and the SEC bill (S. 3412). Some 35 witnesses appeared and, as might be expected, differing views were expressed on a number of topics.

BASIC's position — BASIC recommended to the Subcommittee (May 11, 1972) the essence of the compromise that it was then trying to work out with the SEC:

"**Mr. Bevis** . . . we have appended to my statement a revision of the SEC bill that would permit a banking authority to be the prime regulator of a depository and, at the same time, give SEC 'oversight' in certain areas; namely,

---

[7.55] The entire exchange of correspondence is attached as Appendix U.

reasonable nondiscriminatory access; operational compatibility among depositories and other persons in the securities handling process; and minimum general standards of performance capability. This has been done as one way of reconciling the varying viewpoints — but not out of any conviction that the depository book entry system needs or would profit from such oversight to solve the securities transaction processing problems of the future . . ."[7.56]

Should SEC alone regulate depositories, or should bank regulatory authorities participate? — A number of witnesses took the position that structuring the national securities handling system, including depositories as an integral part thereof, should be the responsibility of one Federal agency. Most said that this agency should be the SEC (including the SEC itself):

"**Mr. Casey** . . . my statement details the alternative direction in which depositories and transfer agents and the relation between them may evolve, and the need for a central authority to guide this development into a working system with other aspects of the securities transaction process over which the Commission now has authority.

Competing systems are also involved in the clearing area. Although discussions have begun and certain basic steps have been taken to interface these systems, a single, national system of clearance and settlement is not yet a reality. We believe that the public interest calls for authority not only to implement such a system on a timely basis, but to insure unification between such a system — a national clearing system — and transfer agents and depositories as well.

What is needed is a public entity having a national focus with the authority to insure that standardization and automation within the limits of technical feasibility can be accomplished as rapidly as possible, and to oversee the development of a nondiscriminatory nationwide approach to the processing of securities transactions which will serve the needs of industry participants and the investor . . ."[7.57]

Giving the SEC sole regulatory responsibility over the universe of securities transaction processing was endorsed by the Securities Industry Association[7.58], Lybrand, Ross Bros. & Montgomery[7.59] Arthur Young and Company[7.60] and the Stock Clearing Corporation of Philadelphia[7.61]

The foregoing approaches seemed to follow the logic that securities handling problems are securities industry problems only and that, therefore, the SEC, as the securities industry's regulator, should have sole jurisdiction over all aspects of the solution

---

[7.56] *Senate 1972 Hearings,* p. 410. The marked-up copy of the SEC bill referred to and related documents appear at pp. 431-489 and the Executive Director's written statement at pp. 418-430. The compromise had been presented by BASIC's Chairman to the Fed in a letter to Mr. Robert C. Holland dated May 2, 1972, reproduced in *ibid,* pp. 495-497.

[7.57] *Ibid,* p. 90.

[7.58] *Ibid,* pp. 140 and 143.

[7.59] *Ibid,* pp. 170 and 175.

[7.60] *Ibid,* p. 502.

[7.61] *Ibid,* p. 836.

to securities handling problems — including the contribution of securities depositories to the solution.

Others were more receptive — with varying degrees of emphasis — to a sharing of the regulation of depositories between the SEC and bank regulatory authorities.

FDIC:

"... we believe that the rationale underlying delegation to the Federal bank regulatory agencies of enforcement jurisdiction with respect to the transfer agency function of insured banks applies with equal force to the extent banks might become involved in 'depository' or 'clearing agency' functions related to the securities settlement process ..."[7.62]

NYSE:

"**Mr. Howland** ... We conclude and propose, therefore, that the primary oversight of depositories, and the power to make rules, should be exercised by the appropriate state banking authorities where depositories are formed as trust companies or banks — with the Commission perhaps retaining authority to initiate rule changes in certain specified areas.

As a practical matter, this would mean that primary oversight of CCS, Inc. would be exercised by the New York State Department of Banking ..."[7.63]

* * *

"**Senator Williams.** As I get the feel of your statement here this morning, in your situation you are really recommending dual regulatory authority by the SEC and the State banking commissions.

Mr. Howland. That is correct.

Senator Williams. You must like the Government-looking-over-your-shoulder — overview of things.

Mr. Howland. When you live with it everyday, I guess you do not mind Government overview.

Senator Williams. I gather this is one of the major points of contention here, if that is the proper word, or at least difference. It does not register to me at this point that it is a question of that great moment. Probably it is arguable either way. There are shades of preference one way or another, but it is not a major matter; is it?

Mr. Howland. Oh, I would beg to differ, sir. I think we are on the threshold right now — Congress saw fit to pass the amendment to the 1940 act with the amendments of 1970 which allowed investment companies to come into a depository as of last December 15. The first pilot of this is going on right today with State Street Bank in Boston and one fund there.

[7.62] *Ibid,* p. 54

[7.63] *Ibid,* p. 191.

If you are going to eliminate the risks that we all went through back in the 1967-1970 period, the best way to do it is to immobilize that certificate.

To do that, we must get banks, insurance companies, investment companies, et cetera into that depository. My reading is that they are not going to come in unless, No. 1, they have a little bit to say in the management and probably a say equivalent to the amount of shares they have on deposit.

Senator Williams. I am glad I stumbled into this inquiry because nobody is suggesting that they not have a voice in the management. They are participants; they would be participants in the system, and would have a voice in the system.

Our difference here is really the governmental authority, regulatory authority, and whether it should reside in one place or whether it should be fragmented. That is the only question.

Mr. Howland. I do not think any of us would be adverse, for examples, if the FDIC or the Federal Reserve Board of the Comptroller of the Currency were to be given this jurisdiction. I do not think that any of us would be upset on that. I think it is a question that this thing has got to look and act like a bank; it has got to have that banking look. I am not sure we in our own industry have the greatest reputation —

Senator Williams. I have heard that 'look alike' — what is it again?

Mr. Howland. Look like, act like — I do not want to steal anyone's thunder who will be testifying tomorrow.

Senator Williams. Someone has said that. That is not the first time we have heard that. I guess it was Mr. Gardiner. It is the preservation of the mystique here.

Mr. Howland. You said it. I did not . . ."[7.64]

ABA:

"**Mr. Cookenbach** . . . The next major concern of banking is the treatment of depositories. If a depository system is to have significant impact in immobilizing certificates, banks must place securities held in a fiduciary, or other capacity, in the custody of depositories. Banks are held to a high standard of care in the protection of trust assets and they cannot be expected to place such assets in depositories, unless they have the utmost confidence in their operation and management.

Under the bill, depositories have a flavor of strictly securities institutions because they are registered and regulated by the SEC. It is our belief that banks would more readily participate in depositories with regard to trust assets if they more closely resembled banks, and if in their day-to-day operations were subject to banking regulators, and bank examiners.

[7.64] *Ibid,* p. 197.

Thus, we suggest that depositories organized as banks, be directly regulated by banking authorities with final control in the SEC, so that operational compatibility can be assured where it is needed. Such a system could be established by requiring depositories to comply with rules of procedure which they have adopted and which have been approved by the appropriate banking agency and the SEC. Enforcement should be in the hands of the appropriate banking authority . . ."[7.65]

NCG:

"**Mr. Perkins** . . . Insofar as these bills relate to depositories, we as a group, support the concept that regional depositories should be organized as special purpose trust companies to be regulated by one of the existing Federal bank regulatory agencies.

The proposed function of a depository, in connection with securities transactions, most clearly parallels the check processing and bookkeeping function of the banking industry.

The Federal bank regulatory agencies, by reason of their expertise and accumulated experience in this area, would seem to offer the most logical source for uniform supervision and examination of the depository function.

I might add that I think it is important to distinguish between the broker-dealer trading questions and the depository function which we feel, while related, is quite different.

However, the authority to review and approve the rules adopted by the depositories, and to promulgate any additional rules or regulations which may be necessary concerning depositories, would rest with the Securities and Exchange Commission, as it presently does in connection with securities exchanges . . ."[7.66]

NASD:

"**Mr. Morgan** . . . By way of final comment, our last paragraph in the written testimony states: To the extent that conflicts arise in respect to regulation pertaining to banks, we support an arrangement which will accomplish nationwide uniformity. We assume that the industries involved will agree to that cooperation necessary to meet mutual regulatory purposes.

There is no question that the placement and even definition of the regulatory function is difficult to answer. As a member of BASIC, we recognize its position in favoring a state approach for New York CSDS. We have favored the SEC's desire to regulate depositories and tend to agree that the combination of Commission and State banking authority oversight over depositories could be cumbersome . . .

If modifications could be worked out to the satisfaction of the SEC and the various bank regulatory authorities, such should be acceptable. Whatever is

[7.65] *Ibid*, p. 279.

[7.66] *Ibid*, p. 408.

done in this area, Congress no doubt will exercise caution. At this point in time, many have questioned whether or not sharing of responsibilities by more than one governmental agency would insure that clearing agencies, depositories and transfer agencies in different locations throughout the country could be melded into an effective nationwide securities processing system . . ."[7.67]

Will banks and other fiduciaries use a depository that is SEC regulated? – The question as to whether banks and other fiduciaries would use a depository if the SEC were the sole or prime regulator was raised directly.

A letter from BASIC's Chairman to the Fed, inserted into the record, contained this statement:

"Banks, insurance companies and their regulators, while not immune from error, are not unmindful of the unfortunate fact that the securities industry has not been without major problems. BASIC doubts (doubts that have been confirmed by banks in San Francisco, Chicago and New York) that banks or other fiduciaries are going to let securities for which they have responsibility get very far away from a fiduciary type of operation and regulation (i.e. bank regulation) as distinct from the concept of a security industry oriented type of regulation . . ."[7.68]

BASIC's Executive Director stated:

"Securities held by banks and delivered against payment through banks *must* be attracted into CSDSs in order to solve this country's securities paperwork problem. To do this, the regulatory atmosphere must take into account that banks have a strong sense of fiduciary responsibility. Institutions and people who use banks do so in reliance on this and banks will not lightly give up to another possession of certificates for securities for which they are accountable having market values ranging from hundreds of millions to tens of billions of dollars. Insurance companies and mutual funds will probably follow their lead.

Moreover, banks could not, even if they wished, give up possession of a large portion of the securities they hold because of restrictions in fiduciary laws of most states. Those fiduciary laws must be changed before they can do so. It is a certainty that state legislators will not change these laws except at the urging in their respective states of banking, fiduciary or trust associations and the surrogates and surrogates committees of the bar associations. Even then, the changes may not be easily made.

Neither these groups nor state legislators can be expected to be enthusiastic about transferring institution-held securities to a depository that looks, acts, and is regulated less like a bank than banks themselves. This goes double for transferring securities to a depository that is looked upon primarily as an integral part of the brokerage industry. Thus, if depositories do not emerge as essentially banking institutions, the fiduciary institutions which must deposit

[7.67] *Ibid,* p. 398.
[7.68] *Ibid,* p. 496.

their securities in them in order to make them operate successfully, very probably will not do so.

That is the plain, unvarnished reason why the early solution to the securities handling problem in this country requires immobilization of securities in depositories that are regulated by banking authorities . . ."[7.69]

* * *

"**Senator Roth.** I have asked the other witnesses, how we are going to get the wholehearted cooperation of all participants in the industry, including the financial institutions.

And, most of them have stated that unless we give either State or Federal banking agencies a primary role, it is going to be very difficult to get the cooperation and participation of financial institutions. Yet if we don't have their participation, we are not going to achieve our goal.

Now, do you think there is legitimate concern?

Mr. Peake. It seems to me, Mr. Chairman, that if a proper body is created or exists and is additionally charged with dealing with the problem and there is Federal legislation, that inherent within that legislation would be the requirement that all broker-dealers and all banks would deal with the system. That would remove totally the problem of voluntary cooperation . . ."[7.70]

* * *

"**Senator Roth.** The statement has been often made here that unless these depositories look and act like banks, many financial institutions, banks and others, are not going to participate voluntarily. Are you aware of any flat refusals by members of the banking community if SEC jurisdiction is too strict?

Mr. Perkins. Surely.

Mr. Meyer. I can answer one part of that, sir. As far as the New York Clearing House Banks are concerned, they have participated in the drafting of the amendments to the SEC bill which we have submitted with Mr. Bevis' statement. It was cleared with all the counsel for the banks and with the heads of most of these banks. I think from a fiduciary standpoint, and that is terribly important where you are talking about billions of dollars' worth of securities, it is quite clear, at least in my mind from my discussions with these poeple – I used to be chairman of the clearinghouse committee, so I think I can read their temperature to some extent – is they feel very strongly from a fiduciary standpoint and as a custodian that for the sake of their customers that these securities should be transferred to a third party from their own vaults, from their own day to day regulation to a depository only where that is regulated by

---

[7.69] *Ibid,* pp. 427-428.
[7.70] *Ibid,* pp. 511-512.

banking authorities to which they have been accustomed, and more importantly to which their customers have been accustomed.

As far as custody of securities is concerned, there, too, the amount is enormous, and each bank which has some prudence, and I like to think most of them have, I hope all of them have, before transferring securities they hold in custody they would have to write their customers and explain to them and seek their formal permission before so transferring them. I think our contention is a better one. It is that the customers of banks would be far more inclined to do that if the statement could be made that we are transferring these securities to another entity and that entity is subject to bank examination.

Senator Roth. Let me ask the question from the other side of the coin. If depositories do take the form of banks and are regulated by banking authorities, either Federal or State, do you think this would be a major step in getting wholehearted support from the financial community?

Mr. Meyer. I think it would, sir.

Mr. Perkins. Senator, I think I could add one other point to that. I share Mr. Meyer's views. But just before coming down here, I got together with some attorneys who would be the ones involved, say, with our bank on this. Not being an attorney, I don't understand a lot of these things. But I have a feeling that there would be a tremendous reluctance for them to advise us as fiduciaries that it was all right to do this because it is a whole new situation, it is not what we are used to. There is not any precedent. There hasn't been litigation and I suspect that the delaying aspect of that would be tremendous based on my limited experience in that kind of an area . . ."[7.71]

Can depositories be distinguished from clearing corporations? – Proposals that the regulation of depositories be different from the regulation of clearing corporations caused a problem for the Senators. They wanted to know whether the two could be distinguished, and received different answers.

BASIC's Executive Director:

". . . Certain of the steps from the beginning to the end of most securities transactions are solely within the broker-dealer community and their clearing corporations, namely:

Taking the order
Executing the trade
Comparing trades among broker/dealers
Netting these trades
Issuance of instructions to broker/dealers to deliver or receive securities from one another and receive or pay cash.

[7.71] *Ibid,* pp. 416-417.

It is at the point when instructions to deliver securities is reached, whether against payment or 'free', that we must broaden our vision beyond the securities industry . . ."[7.72]

* * *

"We are proceeding on the basis that the following will be the main functions of a comprehensive securities depository:

1. Receipt of certificates for deposited securities, holding them in custody as a fungible mass in nominee name, and maintaining a record of depositor security positions.
2. Delivery of certificates for withdrawn securities upon instructions of depositors.
3. Delivery of securities by book-entry between depositors upon instructions of delivering depositors.
4. Netting and settling the cash side of transactions described in 3. above when requested to do so by delivering depositors.
5. Recording by book-entry the pledging, substitution, and release of collateral upon receipt of appropriate instructions (and including the cash side of loans in the cash settlements if so requested).

Because certificates are held in nominee name, the following ancillary services must presently be included:

6. Receipt of dividends and distribution thereof to depositors.
7. Processing of proxies and other corporate mailings (until corporation laws are changed to permit substitutions of depositors' names for that of the depository nominee on stockholder lists, which I think would be desirable) . . ."[7.73]

* * *

"**Mr. Peake.** I would just like to make one comment on the question of where clearance and settlement begin and the depository takes over.

It seems to me you cannot separate the two. The writing of a check is the cause, and the balance or overdraft in your account is the effect.

Therefore, the purchase or the sale of a security is the cause, the transaction, and then the balance in the depository is the effect.

I don't see how you can separate those at all.

Senator Roth. In other words, you disagree with those who say you can divide responsibility for regulating the two phases?

[7.72] *Ibid,* p. 418.

[7.73] *Ibid,* pp. 421-422.

Mr. Peake. Yes, I do . . ."[7.74]

* * *

"**Senator Williams.** On this oversight question, you take the position that the SEC should have primary regulatory oversight over clearing agencies but not over depositories.

I wonder if you could rather define the difference between a clearing agency and a depository.

Mr. Howland. In our mind, the clearing function commences with the immediate posttrade process, whereby a brokerage firm submits to the clearing house trade information, in other words, the amount of shares of the issue at hand, the price and both sides to the trade. The clearinghouse then compares this information, sends it back to the brokerage house, confirms it, the brokerage house resubmits to the clearing corporation; they then net down whether to a balance order or to a continuous net system. And delivery takes place, let's say, on trade date plus 5 business days, 'T plus five.'

We say that the depository starts on T plus five or the delivery stage, and that everything up to then is clearance . . ."[7.75]

* * *

"**Senator Roth** . . . my question is, is it really possible to clearly distinguish between clearing agencies and depositories? If so, what are the specific responsibilities of each?

Mr. Morgan . . . I guess this is a difficult one to answer, as I mentioned, but I don't really think there is that great a distinction in certain areas and certain functions to be made between the two . . ."[7.76]

Who has greater expertise in examining depositories? – One of the questions the Senators asked of witnesses was: Who has the greater expertise in examing securities depositories, the SEC or bank regulators? The SEC replied that it did, to which position BASIC's Chairman and Executive Director took strong exception. This is an excerpt from a letter dated June 20, 1972 from the latter two to Senator Williams which was inserted in the record:

> "BANKING AUTHORITIES HAVE GREATER CAPABILITY AND MORE EXPERIENCE THAN THE SEC IN EXAMINING AND SUPERVISING FINANCIAL INSTITUTIONS LIKE DEPOSITORIES.

According to the SEC's letter of June 2 to you (p. 2), you addressed the following question to the SEC:

[7.74] *Ibid,* p. 512.
[7.75] *Ibid,* p. 194.
[7.76] *Ibid,* p. 399.

'Does the Commission, or do bank regulatory agencies, have the greater *capability* for regulating securities depositories?'

(Emphasis added)

and received, in part, the following reply:

'The Commission has had greater *experience* in regulating depositories, *all depositories* being adjuncts of self-regulatory organizations.'

(Emphasis added)

To the best of our knowledge, 'all depositories', referred to in the answer consist of Central Certificate Service (CCS), dating from 1968, and Pacific Coast Depository, a few months old and just now getting into volume operation. While what constitutes an inspection may be a matter of definition, it is our understanding that there has been only one formal SEC inspection of CCS to date.

The fact of the matter is that no agency has had experience in regulating or examining securities depositories as such. But many banks are close to being securities depositories. If we disregard the power to effect securities transfers by book-entry, these banks carry out the essence of a depository's functions and procedures. For many years banks have held securities extensively for others, receiving them, holding them, presenting them for transfer, delivering them out upon customers' instructions, and collecting and crediting dividends and interest.

The capability of bank authorities to regulate such financial institutions is well documented out of long experience . . ."[7-77]

There followed in the letter several pages of detail on bank regulators and the scope of their examinations.[7-78]

At the time of the Senate hearings, CCS had been in operation about 4 years, during which period securities on deposit had grown from zero to over 1.2 billion shares.[7-79] Notwithstanding the huge value of these deposits, during the four-year period, the SEC had made an inspection trip or two to CCS but had made nothing resembling a bank-type examination. (Nor is there evidence that the SEC paid much attention to CCS rules during its first four years.)

The passage of S. 3876 – After the hearings, the Senate Subcommittee, then the full Committee (on Banking, Housing and Urban Affairs), revised the previous Subcommittee bill. The revision (S. 3876) was introduced into the Senate on August 2, 1972 and passed on August 4.

S. 3876 was a notable improvement over all previous draft bills from the standpoint of the depository development plan envisioned by BASIC. While registration of depositories would be with the SEC, who would pass upon or be empowered to originate rules,

[7-77] *Ibid,* p. 941-942.
[7-78] *Ibid,* pp. 942-950.
[7-79] *Ibid,* p. 229.

examination and enforcement for depositories that are banks would be the responsibility of bank regulatory authorities. Even with respect to rulemaking, proceedings, and orders, any regulatory authority was required to consult with the others before taking action.

The House Subcommittee
Report of August 23, 1972

Under date of August 23, 1972, the House Subcommittee reported to the full Committee on its 1971 hearings and other studies.[7.80] The report covered a wide range of securities industry problem areas. As to depositories, after describing the progress of NCG and BASIC in developing depositories (pp. 64 and 65), the report goes on to say:

> **"3. DEFICIENCES IN PRESENT APPROACH TO SOLUTIONS**
>
> While the Subcommittee recognizes that the industry is attempting to solve these problems, it is concerned that there has been insufficient coordination between the Commission and the various cooperative regulatory organizations, as well as between broker-dealers and other affected groups, such as the banking industry. As a consequence, there is no assurance that the systems currently under development will interface and operate effectively once completed. Further, under the present approach, there may be a tendency on the part of organizations in developing a system (for clearance and settlement, for example) to be unduly influenced by their vested interests rather than focusing on the needs of the industry as a whole.
>
> In commenting on the need for cooperation in developing new systems, the Chairman of this Subcommittee stated:
>
> > 'I think the things that have concerned the Congress, and one, of course, is the total systems concept – that is certainly the foundation of a proper system – but as the individual efforts are being made, is there sufficient coordination, is there a building in of compatibility? Can there be, if it develops it is desirable, a totally standardized system created from the various individual efforts now going on?
> >
> > Shouldn't there be at least an agency interest in assuring sufficient compatibility in the efforts so that the ultimate standardized system, if it is desirable, can be implemented at a reasonably early date?'
>
> **4. RECOMMENDATIONS**
>
> The development and implementation of a national system of clearance and settlement integrated with a network of depositories is urgently needed to remedy the problems associated with the physical handling of stock certificates. In dealing with this problem, the Subcommittee's principal concern is that there be sufficient coordination and cooperation among all parties in-

---

[7.80] *Subcommittee on Commerce and Finance of the Committee on Interstate and Foreign Commerce,* "Securities Industry Study – Report", U.S. Government Printing Office (1972).

volved to insure that, when completed, all systems interface and operate effectively . . .

* * *

During the Subcommittee's hearings on the stock certificate in October 1971, representatives of the Midwest and Pacific Coast Stock Exchanges expressed concern that they were not being given adequate representation in the national depository planning effort of BASIC. They feared that the Comprehensive Securities Depository System being planned for New York might unduly influence the nature of the national system unless all potential members were afforded greater participation . . .

* * *

A national depository system should therefore be developed on a regional basis with the depositories initially located in New York, the Midwest and on the Pacific Coast. In that manner, the existing depositories of the New York and Pacific Coast Stock Exchanges will be utilized and the system expanded to include the central United States, thereby servicing the areas of greatest trading activity. Membership in these depositores should be open to all institutions and organizations that qualify to participate.

The planned comprehensive securities depository system in New York will seek a charter as a trust company incorporated under the banking laws of that State. This was chosen rather than a Federal charter because BASIC and the New York Stock Exchange believed that it would be simpler and quicker to make it subject to the oversight authority of the New York State Banking Department.

The national depository system, however, should be federally chartered since its operations will involve broker-dealers, banks, insurance companies, transfer agents and other user institutions throughout the United States. If each depository were subject to the oversight authority of the State of its location, differing laws and procedural requirements could result in uneven regulation and create administrative problems. This Subcommittee's chairman expressed his support for a federally chartered national depository system as follows:

> 'I feel where we have a broad national impact, that perhaps we should have some entity other than that of just one of the States undertaking this oversight function.'

Therefore, as proposed in its Study of Unsafe and Unsound Practices of Brokers and Dealers, the SEC should be given authority over entities performing transfer and depository functions. Such authority would not expand the jurisdiction of the Commission to conflict with that of Federal or State bank-regulatory agencies. In other words, no economic regulatory authority would be granted. The sole purpose of this authority would be to permit the Commission to oversee effectively the development of a unified securities processing system." . . .[7.81]

[7.81] *Ibid,* pp. 65-70.

The House Subcommittee in its report, while willing to entrust to the SEC the authority "to oversee effectively the development of a unified securities processing system", at the same time voiced some misgivings:

> "The Commission has a tendency to decide, after problems or crises have emerged and substantially passed away, that it had not been able to act effectively because its authority was limited.
>
> Sixteen different years of amendments make clear Congress' readiness to assure the Commission the power to protect investors, but no amount of legislative tinkering can build within the SEC the commitment and vitality to make full use of the tools Congress provides. Nonetheless, the Commission's authority with respect to cooperative regulatory organizations should be broadened and made more explicit . . ."[7.82]
>
> And, in connection with another subject:
>
> "It is often said that while most industries study problems to death, the securities industry studies solutions to death . . .
>
> The time for study has ended. The time for action has arrived . . ."[7.83]

House 1972 Hearings

There was introduced in the House on May 8, 1972 a bill on the regulation of securities depositories, clearing corporations, and transfer agents, by Mr. Moss for himself and Mr. Broyhill (H.R. 14826). The bill would give to the SEC, as regards depositories, full jurisdiction. Bank regulatory authorities were not mentioned. The SEC bill had been introduced on April 20, 1972 as H.R. 14567.

The House Subcommittee held hearings on August 14 and September 8 and 11, 1972. Before it were three bills: The SEC bill (H.R. 14567); the Moss-Broyhill bill (H.R. 14826); and the bill which had been passed by the Senate (S. 3876). Representatives of most of the organizations that had previously appeared at Congressional hearings either appeared or submitted statements. The Chairman of the Subcommittee stated in his opening remarks:

> "I should note parenthetically that this latter bill, H.R. 14826, was introduced in order to focus discussion on what I regard as the central issue in this legislation, and that is: Whether regulatory authority and responsibility for developing a modernized, nationwide system for effecting securities transactions should be concentrated in a single Federal agency or divided among several. The introduction of this bill should not in any way be looked upon as a prejudgment of the issue on my part or on the part of Mr. Broyhill . . ."[7.84]

BASIC's position – BASIC was represented by its Chairman, who testified that S. 3876 was preferred over H.R. 14826 or H.R. 14567.

[7.82] *Ibid,* p. 108.

[7.83] *Ibid,* p. 141.

[7.84] *House 1972 Hearings,* p. 1.

"**Mr. Meyer** – In brief, S. 3876 gives to the SEC rule-reviewing and rule-making authority over depositories, and gives banking authorities examination and enforcement powers over depositories that are banks.

No one can say for sure at this point whether this regulatory arrangement will or will not produce depositories of the type that engender the complete confidence of, and so induce their use by, the entire financial community. Much will depend, I believe, on the SEC's approach to making rules regarding financial and operating risks which a depository (and hence its depositors) take.

In this connection, it is noted that Section 17A(n) of S. 3876 requires the SEC and the banking authorities involved to consult with each other concerning proposed rules or regulations 'so that rules and regulations applicable to bank clearing agencies may be in accord with sound banking practices and fulfill mutual regulatory needs to the extent practicable.' It is profoundly hoped that the contemplated procedure will produce depository rules that gain the confidence of fiduciaries.

Neither H.R. 14826 nor H.R. 14567 give banking authorities strong influence or regulatory control over depositories. Sole compliance authority and regulation would be vested in the SEC. S. 3876 provides for drawing directly and fully on bank authorities' capability to supervise and examine depositories. The fact of the matter is that to date no agency has had experience in regulating or examining securities depositories *as such.* But many banks in part are close to being securities depositories. If we disregard the power to effect securities transfers to book-entry, these banks carry out the essence of a depository's functions and procedures. They hold, and for many years have held, securities extensively for others, receiving them, holding them, in their own vaults, presenting them for transfer, delivering them out upon customers' instructions, and collecting and crediting dividends and interest.

The capability of bank authorities to regulate such financial institutions is well documented out of long experience, as described in the Appendix.

Because S. 3876 involves banking authorities in the rule-making process and draws directly on their capabilities to supervise and examine depositories and because neither H.R. 14826 nor H.R. 14567 do so, we urge the Subcommittee to adopt, with the three changes mentioned below, the regulatory approach concerning depositories taken in S. 3876 . . ."[7.85]

The three suggested changes mentioned had to do with (a) duplicate enforcement authority, (b) eligibility of participants in depositories, and (c) role of participants in adoption of a depository's rules, selection of its officers and directors, and administration of its affairs. All were fully explained in the written statement submitted.

The position of others on single-agency v. joint regulation of depositories. – Most of those testifying either directly recommended in varying degrees that examination and enforcement of depositories that are banks be carried out by bank regulatory authorities,

[7.85] *Ibid,* p. 182. The full statement appears in *ibid,* pp. 180-187.

or stated that they were in agreement with BASIC's statement. These included: the FDIC[7.86]; the Fed[7.87]; the Comptroller of the Currency[7.88]; NCG[7.89]; the NYCH Association[7.90]; the NYSE[7.91]; the ABA[7.92]; the AMEX[7.93]; and the PSECC[7.94].

Those urging a single authority for bank depositories (and clearing corporations and transfer agents) were SIA[7.95] and Peake[7.96].

SEC's Chairman again seemed willing to listen to proposals for shared responsibility providing they did not nullify the basic purpose of a central authority.

> "**Mr. Casey** . . . The Senate bill applies this approach of shared responsibility and extends such approach to the regulation of depositories and clearing agencies. In our deliberations, we have been sensitive to the reluctance of banks to become subject to multiple regulation in their transfer functions and of their desire that a depository to which they entrust the securities that they hold as fiduciaries 'look like a bank, feel like a bank, and be regulated like a bank.' We are willing to go as far as possible to accomodate those concerns without nullifying the basic purpose of a central authority over all phases of the securities transactions process . . .
>
> As to depositories, while the Commission has greater experience in regulating them, all depositories presently being adjuncts of securities industry organizations, the bank regulatory agencies do have greater experience in assuring standards of safekeeping, and, to the degree their expertise can be utilized within the framework of the Commission's primary responsibility for the regulation of depositories, we welcome such assistance . . ."[7.97]

Chairman Moss expressed a desire to hold only one agency responsible for future securities transaction problems in these words:

> "**Mr. Moss.** It is very interesting to me that during the time of the crunch, that the criticism was directed at the Securities and Exchange Commission and the securities industry and not the banks, the transfer agents, or others. It was directed at the SEC. The public finger was pointed to that agency, and that agency was asked time and time again, why haven't you acted?
>
> The failure was ascribed to that agency, not banking officials, not banks or trust companies, but it was placed directly upon the securities industry as that

---

[7.86] *Ibid,* pp. 79 and 123.
[7.87] *Ibid,* pp. 81 and 121.
[7.88] *Ibid,* pp. 130-131.
[7.89] *Ibid,* p. 173.
[7.90] *Ibid,* p. 199.
[7.91] *Ibid,* pp. 233 and 236.
[7.92] *Ibid,* p. 242.
[7.93] *Ibid,* p. 252.
[7.94] *Ibid,* p. 269.
[7.95] *Ibid,* p. 223.
[7.96] *Ibid,* p. 274.
[7.97] *Ibid,* p. 102.

conjures up an image in the public mind, and I don't recall the representatives of other financial groups, institutions, coming forward and saying, no, it is not just their fault, it is ours also.

Now, this committee is the Subcommittee on Commerce and Finance, and it has a very grave responsibility to see to it that those steps are taken. This is not a Committee on Banking and Currency. It must act from the lessons it has learned as a result of rather extensive hearings, and I think that would be stipulated by almost anyone, that it exercised great care in holding those hearings. It must act from the information garnered from those hearings to be able to finally say to the Commission, ' You are empowered now with sufficient authority to prevent what happended in the past and we therefore expect that you prevent it.'

Surely the committee has made it clear in its report that it wants to do this with a minimum impairment of self-regulation, a minimum interference with competitive enterprise. But I am not certain that we want to do it through abandoning SEC responsibility and our responsibility to other institutions or to other committees of the Congress because we would be aware surely and inevitably that a repeat of the last experience would cause the finger again not to be pointed at the banking officials or the banking community but at the securities industry and at the Securities and Exchange Commission.

So, when we act we have to make certain that there is at least the authority there finally, however we arrive at it, for them to insure that the transfer agent function is performed properly and that depositories do operate . . ."[7.98]

Immediately after BASIC's appearance before the Subcommittee, the Executive Director expressed the opinion to the Subcommittee's Counsel that a few problem areas had not been adequately treated in the testimony of the several witnesses. These had to do with the making, enforcement, and objectives of a depository's exclusionary rules on access; whether eligibility rules among depositories would be the same; and how stock ownership of depositories would be apportioned.

At the Subcommittee Counsel's suggestion, the Executive Director wrote to the Subcommittee Chairman on these matters under date of September 27, 1972. This letter is attached as Appendix V.

The Subcommittee revised bill and report – The Subcommittee introduced its revised bill in the House on October 2, 1972 (H.R. 16946). According to the report dated October 5, 1972 that accompanied the bill, its purpose and a brief summary (as affecting depositories) were:

"This legislation would strengthen federal control over the clearance and settlement of securities transactions for the purpose of developing a modernized national system for the prompt and accurate processing of transactions in securities. This bill seeks to accomplish that end by focusing in the Securities and Exchange Commission decision-making responsibility and broad authority

[7.98] *Ibid,* pp. 205-206.

to control every facet of the securities handling process – corporate issuers, transfer agents, clearing agencies and securities depositories.

In its barest terms this bill would – (1) give to the Securities and Exchange Commission direct rulemaking authority over all participants in the clearance and settlement process; (2) require clearing agencies, securities depositories and transfer agents to register with and report to the Securities and Exchange Commission . . ."[7.99]

* * *

"The central question in the Committee's consideration of the various legislative proposals before it has been whether clearing agencies, securities depositories and transfer agents which are organized as state or national banks should be regulated by the Securities and Exchange Commission or by bank regulatory authorities. Several participants in the Committee's hearing argued that entities organized as banks should be regulated as banks and therefore recommended that the Committee assign rulemaking and enforcement responsibility for such entities to the Federal bank regulatory agencies. Others argued that only by centralizing decision-making responsibility and authority in a single Federal agency can the objective of developing a comprehensive national system for securities processing be realized. The Committee has attempted to fashion legislation which seeks an accommodation between these opposing positions.

Thus, the reported bill proposes to give direct rulemaking authority to the Securities and Exchange Commission for all clearing agencies, securities depositories and transfer agents. In addition this bill clarifies and in some cases augments the Commission's power to regulate all aspects of the clearance, settlement, payment and delivery functions of brokers and dealers in order to assure that the Commission's authority will extend over the entire spectrum of the securities handling process. In the case of clearing agencies, securities depositories and transfer agents which are organized as banks, however, this bill would delegate responsibility for inspection and enforcement to the Federal bank regulatory agencies. The Committee expects that this regulatory scheme, among other things, will encourage bank custodians to participate in securities depositories. In testimony before the Committee, several banks argued that they would hesitate to deposit securities with a securities depository unless it 'looked like a bank, felt like a bank, and was regulated like a bank.' Under the regulatory mechanism recommended by the Committee, securities depositories which are organized as banks would be regulated by the Federal bank regulatory agencies who, through the conduct of routine and periodic inspections will be in a position to assure that such entities observe proper procedures to safeguard cash and securities in their custody.

It should be noted that the Securities and Exchange Commission is to assume a role of primacy even with respect to clearing agencies, securities depositories and transfer agencies which are organized as banks. In the case of any disagree-

---

[7.99] *House Report No. 92-1537,* "Securities Processing Act," p. 1.

ment between the Securities and Exchange Commission and the bank regulatory authorities, the Commission is to be the determinative authority as to the application of any rule promulgated by the Commission which prescribes requirements with respect to such entities. Also, while the Commission is directed to rely on the bank regulatory agencies for the conduct of routine or periodic inspections of such entities, the Commission is given authority to make special or other examinations and to require reports of such entities in those situations where the Commission determines that such action would be appropriate. In this regard the Committee agrees with the observations made by the Securities and Exchange Commission in its Report on Unsafe and Unsound Practices which noted that bank regulatory agencies have different regulatory objectives than those of the Commission. Banking agencies are primarily concerned with maintaining the financial integrity of the banking institution and in preserving depositors' assets. The Securities and Exchange Commission, on the other hand, is charged by the Congress with the responsibility for preserving the vitality and viability of the securities markets. Accordingly, the Commission must retain authority to conduct inspections and require reports of clearing agencies, securities depositories and transfer agents which are organized as banks in order to assure that such entities are carrying out their functions in a prompt and expeditious manner and that their operations are compatible with a national system for securities processing . . ."[7.100]

The failure to obtain legislation in 1972

H.R. 16946 was passed by the House on October 13, 1972. There was not time to reconcile the differences between the Senate and House bills before the Congress was adjourned, so that both the Senate and House bills died. There was a bit of heat, however. Senator Bennett commented on the Senate floor the same day H.R. 16946 passed the House:

> "**Mr. Bennett.** Mr. President, it was with great regret that I read in this morning's Wall Street Journal that Mr. Moss of the House Committee on International and Foreign Commerce has rejected working out a compromise with the Senate on a bill to regulate securities depositories, clearing agencies, and transfer agents. The article which I would like to include at this point in the Record, quotes Mr. Moss as saying with reference to the House bill:
>
> > 'It should be crystal clear to them (the Senate) that this is as far as we are willing to go.'
>
> The article also states that Mr. Moss said he was leaving for California tonight at 5:45, so that there would be little time for negotiation . . .
>
> Mr. Moss should know that the Senate is not disposed to accept ultimatums from Members of the House. Certainly he cannot think it is the Senate's responsibility that the House committee did not take action on this legislation

[7.100] *Ibid,* pp. 3-4.

early enough in the session to make it possible for him to have a day or two after the House passed the bill so that a compromise could be worked out . . .

While Mr. Moss may well think that his bill is satisfactory, it gives little consideration to the banking relationship involved. Perhaps this is understandable, since the House Committee on Interstate and Foreign Commerce does not have jurisdiction over banks nor is it reasonable to expect that they would have expertise in that area. The situation is different, however, in the Senate. Our Banking, Housing and Urban Affairs Committee has jurisdiction over legislation affecting both the securities industry and the banking industry . . .

The compromise which we are offering to the House is a reasonable one, and for a Member of the House to say that the House is not willing to make any changes in their bill is in my view irresponsible. We in the Senate Committee on Banking, Housing and Urban Affairs stand ready and willing to negotiate the differences, but I, for one, cannot accept a poorly drafted House bill instead of a carefully thought out Senate bill balancing the equities and establishing a pattern which would result in the cooperation of all Federal agencies and industries involved. I felt sure that Mr. Moss was misquoted in the newspaper and that we would be able to work out something that incorporates the best of both bills. Apparently he was correctly quoted, and I understand that he has today stated that he does not even want to discuss compromise language. I hope that Mr. Moss will reconsider, but if that is the way he feels about legislation for the regulation of securities depositories, clearing agencies, and transfer agents, and the House Committee abides by his decision, then in the words quoted in the article on Mr. Moss, 'It should be crystal clear' who made it impossible to work out a reasonable compromise on this important legislation. It was not the Securities and Exchange Commission, it was not the Federal Reserve Board, it was not the FDIC, it was not the White House, nor was it any of the various industry groups involved or the Senate Committee on Banking, Housing and Urban Affairs. It was a member or members of the House Commerce Committee . . ."[7.101]

Senator Williams added much the same thoughts on the Senate floor later in the day:

"**Mr. Williams.** Mr. President, I was very sorry to see Congressman Moss' statement that he is leaving for California at 5:45 this afternoon and refuses to make any attempt to work out any differences between the House and Senate bills on clearance and settlement of securities transactions. The development of an effective regulatory system in this area is an important practical problem that should not be made the subject of moral posturing or ultimatums. Mr. Moss' attempts to create the impression that the House bill represents an accommodation between his view that the SEC should have sole jurisdiction over all clearing and settlement activities and the Senate approach which provides for coordination between the SEC and the Federal banking agencies.

[7.101] *Congressional Record — Senate,* October 13, 1972, pp. S. 17912-3.

While the House bill does assign certain functions to the banking agencies, it does so in a mischevious way which will have the effect of diluting the SEC's authority without giving the banking agencies any effective power to participate in the regulatory process . . .

The truth of the matter is that the House bill is a hastily prepared patchwork job, which would soon be back in Congress for repairs if it was enacted . . .

The source of these problems is the difference in the way in which the House and Senate bills were enacted. The Senate bill was introduced and acted upon in an orderly manner which enabled us to work out the mechanical problems and gave opportunity for all interested persons to be heard. The bill grew out of the interim report of our securities industry study which was issued on February 4 of this year. A bipartisan bill to implement those recommendations was introduced on March 6, and a bill incorporating the SEC's recommendations was introduced on March 23.

After 3 days of hearings in May, the subcommittee on June 27 reported out a bill combining its proposals with those of the SEC in a coherent pattern. The bill was reported out by the full Banking Committee on August 2 and passed by the Senate and sent to the House on August 4.

In contrast, no hearings were held on a House bill, until August 14, after the Senate bill had already been passed. On September 28, the House subcommittee finally approved a bill, which differs in structure from any of the bills previously introduced. This bill, which was not available until last week, is the one which the House now expects us to adopt without critical examination . . .

"It is not the House subcommittee's function to make unilateral decisions about how the view of its members should be reconciled with those of the Senate. The House of Representatives is not a court of appeals which sits in judgment on the Senate's decisions. Its Members have no closer access to sources of divine wisdom than do Senators. When Mr. Moss and his colleagues are ready to sit down and discuss our differences in a sensible fashion we shall be more than happy to meet them . . ."[7.102]

Assessment of the position at year-end, 1972

By the end of 1972, BASIC had been at work some 34 months. For a good part of this time it had been working on the CSDS and, as outlined earlier, by December 31, 1972, had made considerable progress. However, at that point there persisted the nagging uncertainty as to whether new Federal intervention in the CSDS plan would set the program back — or even cause it to collapes. It was not yet clear whether steps would be taken in Washington which would impair confidence in depositories on the part of the non-broker/dealer members of the financial community.

[7.102] *Ibid,* pp. S 18152-3.

From both the Senate and the House, there were assertions that legislation regulating depositories (and others) would be introduced in the new Congress early in 1973. NCG and BASIC had to decide at year-end 1972 whether to go full steam ahead on the CSDS program, in the hope that nothing from Washington would ultimately kill it, or to mark time until the regulatory picture was clarified.

They decided to go ahead.

WASHINGTON'S IMPACT ON DEPOSITORY DEVELOPMENT – 1973

BASIC's depository regulation bill

Throughout 1972, BASIC was reacting to proposed regulatory bills drafted by others, suggesting changes in their various provisions. Much of this effort, as has been stated, was expended in trying to reach a compromise position with the SEC.

After the 1972 Congress adjourned, BASIC attempted to assess the regulatory situation. One of the problems with the 1972 bills, it was believed, was that they were unduly complicated by trying to embrace three substantially different types of entities: transfer agents, clearing corporations, and depositories.

The Committee decided at its October 1972 meeting that BASIC would draft a bill dealing only with the regulation of depositories to simplify and focus on that problem alone. The draft would be used in an attempt to reach agreement on depository regulation among all the diverse interested parties, including the SEC and SIA which had theretofore differed with BASIC as to approach.

Such a bill was drafted.[7.103] It was presented to and discussed with most of the actively interested parties, including SIA and Commissioner Owens and Pickard of the SEC. Some persons stated that they would not wish to see depositories handled in a separate bill, although they had no objection to considering the draft as a model to help in shaping up appropriate regulation for depositories.[7.104]

There is no evidence that BASIC's draft bill received any serious consideration at the SEC. Its approach may have played some part in altering SIA's attitude toward the regulation of depositories, explained later.

Senate 1973 Hearings

Senator Williams, for himself and three other members of his Subcommittee, introduced a bill to regulate "clearing agencies" and transfer agents on June 22, 1973 (S. 2058). The Subcommittee held hearings on S. 2058 on July 11 and 12, 1973. Represented by witnesses or through statements submitted for the record were, again, much the

---

[7.103] The draft is reproduced in *House 1973 Hearings,* pp. 1899-1911.

[7.104] On the other hand, the NYSE later offered an opinion that legislation on regulation of clearing corporations should be separated from that concerning depositories. *Senate 1973 Hearings,* pp. 316, 318, and 342.

same organizations as in previous hearings. BASIC's witnesses were its Executive Director and legal counsel.

As regards depositories that are banks, S. 2058 assigned registration and rulemaking authority to the SEC, enforcement and normal examination authority to the relevant Federal bank authority (which, in the case of DTC and all other depositories then in prospect, would be the Fed).

BASIC's position – BASIC had emphasized in previous hearings the necessity of attracting bank-held and other institutional securities into the CSDS and, to do so, of having the prime regulator a banking authority. This position seemed to have been misinterpreted by some as a kind of hard-to-get play by the banking industry when, in fact, it was advocacy that the principle of "safety first" be accorded prime importance in depository regulation. Put in these terms, few – in the Congress or elsewhere – would disagree. Banking authorities were generally recognized to have had more experience in regulating to carry out this principle than the SEC.

BASIC pitched its recommendations in these terms, recommending that the Fed be given rulemaking authority in S. 2058 where safeguards over securities and funds were involved. BASIC also recommended that depositories be given more latitude in screening prospective participants (subject to regulatory review) because this was related to safeguards. Changes were also suggested in a couple of other points.[7.105]

The position of others – The same position on the division of authority as that of BASIC was taken, or BASIC's position was supported, by: the FDIC[7.106]; the Fed[7.107]; the Treasury Department[7.108]; the ABA[7.109]; NCG[7.110]; NYCH[7.111]; NYSE[7.112]; SIA[7.113]; the American Society of Corporate Secretaries[7.114]; AMEX[7.115]; and PSE[7.116]. Even the SEC seemed more receptive to a sharing of bank depository regulation. Commissioner Evans testified:

> "When the Commission testified before this subcommittee last year, it stated its preference, and we continue to subscribe to the view that our regulatory authority should include a right to periodic examination of depositories and clearing agencies and authority to enforce compliance with the minimum standards established by the Commission pertaining to these entities.

7.105 The written statement submitted by BASIC appears in *Senate 1973 Hearings,* pp. 387-427.
7.106 *Ibid,* p. 34.
7.107 *Ibid,* p. 37. (The Fed actually went further by asking for its concurrence in *all* bank depositories' rules.)
7.108 *Ibid,* pp. 40-42.
7.109 *Ibid,* p. 179.
7.110 *Ibid,* pp. 199-200.
7.111 *Ibid,* p. 308.
7.112 *Ibid,* pp. 316-317.
7.113 *Ibid,* p. 431.
7.114 *Ibid,* p. 455. The ASCS actually opposed the adoption of S. 2058 except for Sections 8 and 9.
7.115 *Ibid,* p. 468.
7.116 *Ibid,* p. 505.

> However, the Commission believes that legislation in this area is vital. Consequently, we support S. 2058 as an acceptable proposal and if it is adopted by the Congress, we will naturally cooperate with the bank regulatory agencies in this joint effort to see that it is successful.
>
> The legislation should be revised, however, to provide the Commission with inspection power over clearing agencies, depositories, and transfer agents organized as banks to aid us in determining appropriate performance standards and recordkeeping requirements. I would emphasize that these inspections would not be for enforcement purposes, but rather to provide us with a continuing understanding of the working of these agencies in aid of informed rulemaking . . ."[7.117]

The position of the Securities Industry Association was of particular interest, since it represented a change from the all-SEC-jurisdiction position of previous years. The pertinent sentences are:

> "**Mr. Birk** . . . Section 17A of the bill deals with depositories and clearing units under a single set of legislative provisions. It is imperative that the main effort in the banking area be to get securities held by banks and bank trust companies into a common depository with those held by broker-dealers. Nothing in S. 2058 should deter the earliest possible action here. The comments of BASIC strike us as a reasonable approach to the depository issue and we would have no objection to separate treatment for depositories . . ."[7.118]

Opposing the sharing of regulation over depositories were the Investment Company Institute[7.119] and Peake[7.120].

The "safety first" principle – Ultimately, the Subcommittee Chairman directly embraced the "safety first" principle:

> "**Mr. Bevis.** If I may, Mr. Chairman, you will see that we have tried our best to throw under the jurisdiction of the SEC all the matters that we have heard of in which they would be interested in connection with membership and establishing a national system for processing securities transactions and have tried to confine the Federal Reserve Board's jurisdiction to those areas tying in closely with their examination and supervisory requirements in connection with safety and operations. It seems to us that this is workable and attempts to accomplish what your committee has been trying to accomplish except that it does emphasize more than we see in S. 2058 the safeguarding of securities and funds and responsibility for that.
>
> **Senator Williams.** You know, most of our discussion yesterday and today seems to be – a great deal of it – about rules regarding safeguards for securities and funds. Am I right on that?

[7.117] *Ibid,* p. 46.
[7.118] *Ibid,* p. 431.
[7.119] *Ibid,* p. 502.
[7.120] *Ibid,* p. 516.

Mr. Bevis. I think that is right.

Senator Williams. That is your major concern here. Well, it is a reasonable concern in my judgment, and I appreciate it and I know how much time you have put in on this and worked with out staff, too, and we certainly appreciate that full measure of cooperative creativity . . ."[7.121]

Screening of depository applicants – Unlike S. 3876 in 1972, S. 2058 included a provision permitting depositories to screen applicants for "operational capacity." BASIC recommended that depositories also be allowed to screen for character and financial condition[7.122]. This subject of access was related to that of "safety first", for it was pointed out that participants could cause lossses in a depository. This position was supported by others and by the Subcommittee Chairman himself:

"**Mr. Potter.** But there is more and more elimination of certificates and less and less opportunity for theft of them, and we want to be sure that the depositories at least where the certificates are lodged and where the transactions are effected are regulated with the same thoroughness and safety-first orientation, if you will, as the banks in whose vaults they are lodged now are themselves regulated.

Senator Williams. Speaking for the depositories, you are expressing their view that, by God, it's their responsibility and they want to have something to say about who is participating is that right?

Mr. Bevis. They do not wish to be precluded from screening people. No one can tell you in advance what applicant they would challenge and probe deeply, I'm afraid. They would not like their hands tied in doing that probing, and if the occasion required, saying 'I'm sorry, but we can't accept you as an applicant.' Now they would not have sole authority in that, of course, because the applicant could appeal to the appropriate regulatory authority.

Senator Williams. That is essential. We all agree . . ."[7.123]

* * *

"**Senator Williams.** Well, I'll tell you, these days – I share your concern. I'll tell you, we don't need any more equity funding. You know what I mean? This is a very sensitive area, from the viewpoint of the consuming public and I share your concern. The next time we have one of those – we have a bad market now – we will have a much worse market later. So this has got to be dealt with in some depth and you, Mr. Bevis, will be talking about this tomorrow?

Mr. Bevis. Yes, sir.

Senator Williams. Well, I'll tell you, I want to confer at greater length with you on this. I think you have touched something that is of great concern to this Congress.

[7.121] *Ibid,* p. 386.

[7.122] *Ibid,* pp. 389 and 406-409.

[7.123] *Ibid,* p. 384.

Mr. Perkins. I think it is a big concern from that standpoint and from all of our standpoints, too, in terms of building depositories that are going to have acceptability by the entire financial community. This becomes a part of that, too.

Senator Williams. That is true; that is part of our consideration. You use the words 'fairness of access.' Certainly we have to have that. But we also have to do as much as we can to purify those who have access.

Mr. Potter. That is it and our proposal essentially would provide the latitude, subject as I have mentioned to appropriate regulatory review first at the regulatory level and if necessary at the court level."[7.124]

* * *

"**Senator Williams.** You know, I have no real argument with the substance of your comments on qualifications. I think you are solid . . .[7.124a]

BASIC also recommended that it be made clear that any examinations carried out by the SEC under Section 21 of the 1934 Act not be routine but only under unusual or exceptional circumstances. The same position — or stronger — was taken by others, including the Treasury Department[7.125] and the ABA[7.126].

SEC and the future "national system" — Having in mind the "systems approach" discussed at the SEC conference at Harrison House and in Congressional testimony, referred to earlier, BASIC's Executive Director took note of this line of thinking in his prepared statement:

"One can understand the ' systems concept' that suggests that one agency — the SEC — should have sole authority over programs to solve the nation's securities handling problems. One can also understand a Congressional desire to hold only one federal agency responsible for all securities handling matters. However, as any experienced manager knows, not all concepts can be followed straight through to desired procedural improvements. In our view a sounder and more effective pattern of regulation would result from the allocation of responsibility we propose . . .[7.127]

The SEC had consistently taken the position that it had to retain or have additional authority over all elements of the securities handling process to see that the system was modernized.

"**Mr. Pickard.** I think that is one of the reasons we are here today because we need the additional authority which this proposed bill would grant us in order to have the ability to move in the event the industry fails to move. As Commissioner Evans pointed out in his statement, progress toward interface has been slow and difficult. It has been literally months or perhaps more than

---

[7.124] *Ibid,* p. 203.
[7.124a] *Ibid,* p. 383.
[7.125] *Ibid,* pp. 41-42.
[7.126] *Ibid,* p. 180.
[7.127] *Ibid,* p. 405.

months, perhaps a year, in which the Depository Trust Co. and the National Clearing Corp. have been trying to establish a modest interface.

We have seen time and time again difficulties on the part of the various clearing agencies and depositories in their attempts to interface, perhaps attributable to their desire to preserve their own prerogatives. We would like to have the authority in order to expedite this interface and to expedite the development of national systems . . ."[7.128]

However, it seemed that the Subcommittee Chairman had difficulty envisioning how this would come about. For example.

"**Senator Williams** . . . Given that this legislation is enacted into law, I get the impression that you would see the Commission's role primarily as one of reacting to developments rather than initiating changes in the system, more in the nature perhaps of resolving differences in conflicts rather than affirmatively establishing policy and leading the industry toward a national clearing system.

Now, is there a way that you can express this to alleviate this apprehension that I get from your statement?

Mr. Evans. Well, I hope so, Mr. Chairman. I guess you are taking this from the top of page 2 in my statement where I talk about the—

Senator Williams. It is throughout. I get this flavor of reaction rather than action . . ."[7.129]

* * *

"**Senator Williams.** Now, that is it. That is the whole troubling problem of the lack of affirmative leadership as I see it.

Mr. Pickard. Yes.

Senator Williams. Study, review, and reject and revise. You know, leadership is what we need.

Mr. Evans. This is why we need specific authority in this bill. We need this legislation now so that we can coordinate that.

Senator Williams. What we see is you not reacting to their studies and disagreements, but not only guidelines, but leadership direction. That is the way I look at the problem if we are going to get this done in our time.

Mr. Pickard. Mr. Chairman, I think one of the problems we have is that often it is the case – although we would argue specifically against such a proposition if we got into a court – that we do not have the direct authority in many of these areas necessary to create these interfaces. I think your legislative proposal gives us that authority.

[7.128] *Ibid,* p. 53.
[7.129] *Ibid,* p. 52.

Senator Williams. I was trying to project that situation where we had this as law, and then try and determine your approach . . ."[7.130]

* * *

"**Senator Williams** . . . I had certain reservations of his (Commissioner Evans') interpretation of the Commission's role if this bill becomes law. I was a bit surprised that he did not accept for the Securities and Exchange Commission quite the leadership position that I believe the bill assumes this Commission will fill. His view was more of a guideline and an oversight function for the SEC . . ."[7.131]

The Senator's question and observations seemed particularly pertinent to the Chairman and Executive Director of BASIC. At that point, they had for two and one-half years observed real progress in implementing a constructive solution to the paperwork crisis of the securities industry. But the SEC had yet openly to endorse the CSDS. On the contrary it seemed to be still looking – via a "million dollar study?" – for that elusive systems solution (which might or might not involve depositories?)

The passage of S. 2058 – The Senate Subcommittee marked up S. 2058 to give bank regulatory authorities a role in rulemaking for safeguarding the securities and funds of depositories that are banks. The Committee report explained:

"The Committee concluded that the bill should expressly recognize the responsibility of the banking agencies to assure the safeguarding of funds and securities held by banks. Accordingly, the bill provides that a bank may not be registered as a clearing agency if the appropriate banking agency finds that the bank cannot assure adequate safeguarding of funds and securities within its custody or control or for which it is responsible. Similarily, a bank clearing agency cannot change its rules in a way the appropriate bank regulatory agency finds to be contrary to appropriate standards of safeguarding, nor may such a bank operate in contravention of rules the banking agency finds necessary or appropriate for the adequate safeguarding of funds and securities.

The bill's recognition of the important role of the bank regulatory agencies in overseeing the standards and procedures employed by banks for safeguarding of funds and securities is in no way intended to dilute the Commission's overall rulemaking authority or general policy responsibility for the development and regulation of a national system for the prompt and accurate processing of securities transactions. The banking agencies' authority over the safeguarding of funds and securities by banks is an existing and appropriate authority. By acknowledging this authority in the bill, the Committee is not recommending an expansion of the authority of these agencies beyond traditional banking concerns, or a grant of general rulemaking power with respect to the securities processing activities of bank clearing agencies, or the power to veto legitimate

---

[7.130] *Ibid*, p. 173.

[7.131] *Ibid*, p. 340.

> Commission determinations. The manner in which banks assure the safeguarding of funds and securities, as that phrase is commonly understood, has always been subject to the regulation by the bank regulatory agencies. The bill merely makes clear that this situation does not change by virtue of a bank registering as a clearing agency . . ."[7.132]

The Subcommittee added to the bases on which depositories could screen applicants "financial responsibility and business experience" (it could not bring itself to include "character", as requested by BASIC). The report stated:

> "The rules of the clearing agency may condition participation upon compliance with standards of operational capacity, financial responsibility and business experience provided that the Commission has found such standards to be necessary to the prompt and accurate processing of securities transactions and the protection of investors, the clearing agency, and its participants. This provision is designed to assure open access to clearing agencies to the maximum extent consistent with the necessary protection of the public, the other participants and the clearing agency. The SEC is required to give an explanation of its reasons for finding any condition on participation to be necessary . . ."[7.133]

The report also made clear the limited conditions under which the SEC could make "reviews" of bank depositories:

> "The bill provides that inspection of clearing agencies and enforcement of the legislation and the rules promulgated thereunder are the primary responsibility of the ' appropriate regulatory agency'. . .
>
> Under the bill, the Commission has the right to review the operations of clearing agencies for which it is not the appropriate regulatory agency, if such review is necessary, to fulfill its rulemaking and other responsibilities. The authority is carefully circumscribed to assure that any such Commission review will occur only after consultation with the appropriate bank regulatory agency and only with respect to matters which are germane to proposals then before the Commission . . ."[7.134]

Before the revised S. 2058 was brought up in the Senate, the staff of the Subcommittee asked BASIC representatives for its position. The essence of the reply was this: If it is assumed that there will be new legislation on regulating depositories, S. 2058 as now revised is the best approach that we have seen proposed in the Congress. We refer to the assumption only because we feel that no legislation regarding depositories is needed at all. Certainly, S. 2058 is far better for depository growth than H.R. 5050.

S. 2058, as revised, was passed by the Senate on August 1, 1973.

[7.132] *Committee on Banking, Housing and Urban Affairs, United State Senate,* "Report No. 93-359", July 30, 1973, (to accompany S. 2058), U.S. Government Printing Office (1973), pp. 7-8.
[7.133] *Ibid,* p. 14.
[7.134] *Ibid,* p. 8.

Advance comments on H.R. 5050

Congressman Moss, on behalf of himself and every member of his Subcommittee, introduced an omnibus securities industry bill in the House on March 1, 1973 (H.R. 5050). Title IV dealt with "Securities Processing." Under date of March 9, 1973, BASIC and others were requested to submit comments on H.R. 5050 prior to commencing legislative hearings. (A deadline of April 9 for comments on Title IV was later reestablished as May 7.)

As regards depositories, H.R. 5050, like its counterparts in the 1972 House bills, gave authority to the SEC for all aspects of regulation – registration, rulemaking, examination, and enforcement. Two brief references therein to bank regulatory authorities were not of substance. Those subject to SEC's disciplinary review extended beyond depositories and their directors, officers, and employees to the directors, officers, and employees of participants such as banks and insurance companies.

BASIC's draft of extensive comments on Title IV was circulated for comment not only to its Committee members but to a number of other interested organizations. Title IV was so unsatisfactory from the standpoint of the development of a CSDS that it was felt that every suggestion should be solicited for giving the House a clear picture of depositories' regulatory needs.

BASIC's "Memorandum of Comment" on Title IV of H.R. 5050, submitted to the Subcommittee under date of May 11, 1973, ran, with attachments, to 36 printed pages.[7.135] In summary, the memorandum stated that (a) no additional legislation is needed for regulation of depositories at this time; (b) H.R. 5050 would hinder – rather than help – creation of a comprehensive securities depository system; and (c) if federal legislation regarding depositories is to be enacted, it should follow the lines of BASIC's draft bill (which was attached). The latter was the draft bill dealing only with depositories, described earlier.

All of these points were documented extensively in the memorandum. In particular conflict with Title IV with respect to depositories that are banks were BASIC's proposals that (a) rulemaking authority be delegated to the SEC for certain specified subject areas and to the Fed for others; (b) that the Fed be given responsibility for examination and enforcement; (c) that the Fed have jurisdiction over disciplinary measures for depositories and their officers and employees, and over participants that are banks. More flexibility for depositories to screen applicants was urged, and several other specific problems were dealt with.

House 1973 Hearings

The House Subcommittee held hearings on Title IV of H.R. 5050 on September 11-14, 1973. The Executive Director and legal counsel testified for BASIC on September 12. Many of the organizations represented at earlier hearings either provided witnesses or statements for the record.

[7.135] Reproduced in *House 1973 Hearings,* pp. 1876-1911.

BASIC's position – Having already provided comments on Title IV, BASIC's representatives submitted a copy thereof and, with one important exception, made the same points. The exception had to do with S. 2058, which had passed the Senate after BASIC's "Memorandum of Comment" on Title IV was submitted. Instead of the recommendation in that memorandum that the House Subcommittee gave favorable consideration to BASIC's model depository bill, it was recommended that the House adopt S. 2058, which, as noted above, would give banking authorities an important role in regulating bank depositories.[7.136]

Among the important questions covered in the testimony before the House Subcommittee were these: Should there be joint regulation of depositories that are banks? If the Fed had authority over a depository's rules to safeguard its securities and funds, how far would this authority extend? Why should a depository screen applicants that had already been screened before being licensed or chartered? Will banks use a depository not regulated as a bank?

Should there be joint regulation of depositories that are banks? – BASIC's position on the joint regulation question was put by the Executive Director as follows:

> "Mr. Chairman, banks and other non-broker-dealer fiduciary financial institutions, whose participation in any nationwide system of depositories is essential, want 'safety first' as the regulatory cornerstone before they relinquish possession of assets they hold for others. They consider that 'safety first' as a regulatory matter is something to be addressed before the event; the approach should be preventive and precautionary rather than remedial. To them, this means that depositories should not only look like banks, but be regulated like banks.
>
> I think the Congress should recognize this desire for assurance of safety – I believe the Congress shares it – and, if it is decided there should be legislation, should select the Federal Reserve Board as the prime Federal regulator for depositories chartered as member banks in view of its experience, capacity, and philosophy in regulation where safety and financial integrity come first, especially in the areas of safeguards, protection of securities and funds and related matters such as access."[7.137]

The SEC took the position that S. 2058 had gone too far in dividing rulemaking between the SEC and Federal bank regulators for depositories (and others) that are banks. It proposed that the legislation merely not preempt responsibilities of the bank regulators. Commissioner Evans stated:

> "The approach embodied in S. 2058 provides for rulemaking power shared by the Commission with the Federal bank regulators in the establishment of standards applicable to banking entities involved in the processing of securities transactions. This dividend rulemaking authority, we believe, could prove unwieldly at a time when cogent, decisive action is essential . . .

[7.136] BASIC's prepared statement appears in *ibid,* pp. 1872-1912.

[7.137] *Ibid,* pp. 1872-1873.

Without precluding supervisory oversight by banking authorities where a depository is a bank and, in fact, recommending cooperation between the Commission and the bank regulatory authorities, the Commission believes that it should retain authority to inspect depositories, to require reports from them, and to enforce compliance by depositories with regulations to be promulgated by the Commission.

Where depositories are organized as banks, however, the Commission believes that bank regulators should not be preempted from responsibility in such areas as safekeeping of funds and securities, security and financial responsibility . . ."[7.138]

Frederick Solomon of the Fed stated:

"The preferable regulatory structure . . . should reflect the traditional skills of the bank supervisory agencies in both the rule-writing and enforcement functions. Such an arrangement would give recognition to the SEC's legitimate interest in providing for order in the securities business while utilizing the specialized knowledge of the bank regulatory authorities. One important result which we expect from this structure — besides administrative efficiency — is the greater acceptance of the new securities depositories by other institutions, particularly banks, whose cooperation is vital to achieve the worthwhile goal of an integrated national securities processing system."[7.139]

The SIA was even more explicit in urging shared regulatory oversight than when testifying in the Senate. Robert M. Gardiner of SIA stated:

"It is a fact that banks and bank trust companies hold today a high percentage of equity securities. It is imperative that these securities be attracted into a common depository network with those held by broker-dealers. We recognize the reluctance of banks to commit securities, many of which they hold in fiduciary capacities, to entities that do not have the familiar characteristics of banks and are not subject to banking-type regulation. If these conditions are necessary to obtain full bank participation in the depository network — and it certainly appears that they are — then some accommodation must be reached.

Therefore, we would endorse a framework of regulation in which the banking authorities participate with the SEC in drawing and enforcing regulations governing bank depositories registered with the Commission. We feel that the leadership for initiating regulations over depositories in most instances should be vested in the SEC. For regulations over the safeguarding of securities and funds in a depository's custody or control, however, we feel Federal banking agencies could appropriately take the lead.

We further believe that regulations applicable to those banking institutions can be properly and effectively administered through the already established lines of examination and enforcement of the Federal Reserve, the Comptroller of

---

[7.138] *Ibid*, p. 1780.

[7.139] *Ibid*, p. 1818.

the Currency and the FDIC. Shared regulatory oversight, properly structured, should not be detrimental to the efficient operation of the system. Indeed, the Congress can help by stating in the clearest terms its direction that the system shall be made to work through full cooperation among the SEC and the Federal banking agencies."[7.140]

Samuel B. Stewart, Senior Vice Chairman of Bank of America and a member of NCG testified:

"H.R. 5050 would have the depository look a great deal like a securities firm with the SEC being involved in all aspects of the depository – beginning with the rulemaking role, through and including the supervisorial role. It is clear to us, as we have stated before, that securities held by banks and trust companies, particularly in a fiduciary capacity, will be entrusted only to a depository operating in a regulatory atmosphere similar to that in which banks and trust companies now operate.

Although our Group does not feel that additional legislation is needed for regulation of depositories, we welcome the continued interest and concern of this committee and others with respect to depository developments. If, however, legislation is deemed necessary we cannot endorse the sole SEC rulemaking and supervisory provisions outlined in H.R. 5050. As an acceptable alternative, we can and have endorsed legislation such as S. 2058 . . ."[7.141]

Other testimony before the Subcommittee also advocated that examination and enforcement for bank depositories, as well as rulemaking authority where safety of securities and funds was involved, be carried out by bank regulatory authorities. In fact, the sole dissenting voice seemed to be that of the SEC.

If the Fed had authority over a depository's rules to safeguard its securities and funds, how far would this authority extend? – One Subcommittee concern appeared to be that he who had jurisdiction over safeguard rules would have jurisdiction over all depository rules, because the safeguard question is so pervasive. One approach suggested in the questioning was that the SEC have authority to establish, along with all other rules, *minimum* safeguard rules with the bank regulators establishing higher ones if they wished. Excerpts from the record on these points follow:

The SEC's position was:

"**Mr. Pickard.** I think one of the problems embodied in the Senate bill before your committee is that they divide the rulemaking authority between the Commission and the Federal bank regulatory agencies. The Commission has the authority to set the rules for operational compatibility and the prompt processing of securities transactions. The bank regulatory authorities have the responsibility to set the rules regarding adequate safeguards and security of funds. It we analyze these two areas, I think you will quickly see they are inextricably

[7.140] *Ibid*, p. 1946.
[7.141] *Ibid*, p. 1826.

related and to try to separate the two on any given question is close to impossible.

Mr. Evans. The Commission is not saying we think the bank agencies which may have greater expertise in these areas should be preempted from safeguarding responsibilities. If our standards in those areas were not satisfactory to them, as stated earlier, they have plenty of authority under present law to set them higher. And we wouldn't object to higher standards being set as long as they didn't disrupt our being able to fulfill our responsibilities of assuring the development of an integrated national system for processing securities transactions with reasonable nondiscriminatory access.

Mr. Curtis. Maybe, to state my understanding of your last comments, it would be the SEC's opinion that the rulemaking authority to establish standards with respect to the safekeeping and custody of cash and securities, these entities should be delegated to the SEC with recognition that the banking regulatory agencies may establish additional and higher standards so long as they are consistent with those which the SEC has prescribed, is that correct?

Mr. Evans. I think that would accurately state my position and I think that would be the Commission's opinion. We do not think the legislation should restrict their present authority. There seems to be a concern that if safekeeping authority for bank regulatory authorities were not specifically granted in this legislation it would restrict present authority."[7.142]

The Fed's representative testified:

"**Mr. Curtis.** Let me ask about a different aspect of it. In the testimony before the subcommittee yesterday, the SEC indicated that it has had some second thoughts about the division of rulemaking responsibility contained in S. 2058 and they suggested it may be appropriate to delegate to the SEC authority to establish rules pertaining to safekeeping and custody but to permit the banking regulatory agency to establish additional and higher requirements as long as they are consistent with the minimal requirements established by the SEC.

That would have the effect, arguably would have the effect of giving the bank regulatory agencies an override so as to take more conservative measures to assure that these entities are operating in a safe manner. What would the Board's reaction be to that proposal, or what would your opinion be?

Maybe we could secure the Board's reaction to that proposal later.

Mr. Solomon. I don't think the Board has had an opportunity formally to consider it. My own reaction to it would be along this line. At first blush it has a great deal of appeal. Why not have the preliminary standards set by one group and, if somebody wants a higher standard, very well, let them just add to those requirements.

I think the difficulty of the thing is, as I say, we are dealing here not with one little segment of the operation of an institution, we are really dealing with the

[7.142] *Ibid,* pp. 1799-1800.

total operation and it isn't that simple, that you just lay on a requirement and you just build it a little higher. These things could come into conflict with each other and you can get problems of whether the income of the institution is to be spent largely in this area or largely in that area, whether it is to press forward in expanding its operations in order to be very quick in moving into an area or whether it should be more cautious in proceeding more systematically and with greater safeguards.

I think it would be fine if you could just treat these as additive one to another. Really, I don't think it is quite susceptible to that."[7.143]

The foregoing testimony was followed up by a letter stating the Fed Board of Governors position:

"The Board has considered this question and is sympathetic to the objective of providing the simplest and most effective methods of coordinating the efforts of the Securities and Exchange Commission and the bank supervisory agencies toward attaining maximum safety, soundness and effectiveness in the operation of those banking institutions that are engaged in some aspects of the processing of securities transactions.

The Board believes, however, that attainment of this desirable objective would not be facilitated by authorizing the SEC to establish rules regarding safekeeping and custody, and merely permitting the bank supervisory agency to establish additional and higher requirements established by the SEC. A difficulty inherent in this 'additive' approach is illustrated by that portion of the proposal which would specify that requirements imposed by the bank supervisory authority must be 'consistent' with those established by the SEC. While various safeguards respecting safekeeping or custody may be consistent with each other and merely cumulative, this is not always the case. One system or set of controls may differ from another in such fundamental ways as to present definite questions of consistency or inconsistency; and if one of these was required of a bank by a nonbank agency, it could raise difficult problems of possible conflict with the bank supervisor's responsibility to insist upon safeguards which the supervisory agency deems to be appropriate in institutions under its supervision. Accordingly, the Board would not favor the proposal in question."[7.144]

BASIC's representatives testified as follows:

"**Mr. Curtis.** Mr. Bevis, in your statement you set out some examples which I believe in any case illustrate the interrelationship of the issue of safeguarding and safekeeping with those other aspects of tieing together a nationwide system of clearing and settling securities.

Would it be correct, if the bank regulatory agencies, most specifically the Fed, were given sole authority with respect to safekeeping, that this authority would

---

[7.143] *Ibid*, p. 1821.

[7.144] *Ibid*, p. 1822.

be the overriding principal or could be exercised, or you would expect it to be exercised in a manner to overrride security policies with respect to various phases of the system and other practices of the system?

Mr. Bevis. I would answer that question, Mr. Curtis, this way: Resolution of issues such as I have posed hypothetically would not be easy. But if there were a choice between, let us say, moving fast and far to try to expand a modern securities processing system, that choice on the one-hand versus running serious risk of loss of securities or funds, I would think the latter would have to prevail without any question. Otherwise, I am afraid the whole depository system would lose the confidence of its participants.

Mr. Potter. This is essentially where S-2058 comes out because it provides that the banking authority makes the rule with respect fo safeguards. The safety first feature is built into that bill as it stands and, quite frankly, that is what we would like to persuade you on this Committee to accept as a point of departure.

Mr. Curtis. What I am trying to make clear for the record is your opinion that, in so doing, the bank regulatory agency would be in a position of controlling all aspects of the operation of that depository because it is your argument that all aspects of its operation relate to the safety first issue.

Mr. Potter. I don't believe that is a correct reading of Mr. Bevis' statement or the colloquy here today.

The only point at which a control by the bank authority would be imposed would be in those situations where the two agencies were unable to resolve, after consultation, a difference that centered on what the Federal Reserve Board considered to be an issue of safeguards. It is only in that aspect.

* * *

Mr. Bevis. Mr. Chairman, I concur in Mr. Potter's remarks. I think it is too broad a generalization to say that he who watches after the safeguarding of securities and funds would thereby have jurisdiction over all a depository's operations, its character, and so forth. Issue by issue the matter could come up but I think it is too broad a generalization to say that covers everything.

Mr. Curtis. But there are significant aspects of the operation of a depository which are interrelated with the issue of safekeeping, is that correct?

I hope you understand I am not quarreling with your position. I am trying to identify the primacy of the safekeeping issue and what type of efforts and supervision you expect from the Fed if the Committee were to assign this sole authority to it as you have suggested?

Mr. Bevis. I understand. I can illustrate the problem. It is the natural desire of everyone and particularly I should think would be the desire of SEC to have a depository expand in some given area awfully fast. Fast expansion can involve problems, including loss of money and securities.

We have seen CCS start up in 1968, going wild in expansion and it had very severe digestive problems and almost had to freeze the situation until it worked out of its troubles.

The Pacific Depository jumped very quickly up to eligible issues in the neighborhood of 8,000 or so. This was awfully fast, and too fast in my judgment, and that then caused them to have difficulty in processing their securities transactions.

An agency charged with widening the system, a modern system for processing securities transactions would probably — and I would if I were in their position — put pressure on for fast expansion.

If I were a bank regulator with my great concern for the financial integrity and soundness of that institution, I would say let's make sure we don't bite off more than we can chew. These questions would not be easy to resolve but both are very important. That is my whole point.

Mr. Curtis. The effect of this system then would be to deal great authority to the SEC to tie the system together but to give to the Fed the ability to say, no, that is unsafe, and, in effect, to stop the proposed ordered interface that the SEC may have made.

Mr. Bevis. I think that is a fair summary and, with the Chairman's permission, I will ask Mr. Potter to comment.

Mr. Moss. Indeed, we would be most interested.

Mr. Potter. I think that is fair. It is where the consideration of safeguards rubs up against a proposed rule that the Senate S. 2058 would give primacy to the Federal Reserve Board.

Mr. Curtis. The last thing I would wish to explore, Mr. Chairman, is the suggestion that the SEC made in testimony before the Committee yesterday that it be given rulemaking responsibility to establish standards for safe custody of funds and securities but to permit the bank regulatory agencies for those entities organized as banks to engage in these functions to establish additional standards.

If Mr. Stewart is correct, and he probably is, when we put the national system together, all segments are going to be members of the Federal Reserve Board, don't we arrive at the same result?

Mr. Bevis. Mr. Curtis, it sounds awfully good to say the SEC would establish minimum standards and if the bank authority established higher standards, of course no one would expect the SEC to object to higher standards. That sounds fine. The higher standards may get into precisely the point I was talking about earlier, you don't move this fast, or you don't give credit immediately to this participant, all of which could either slow down or have some impact on the movements of a processing system which would be SEC's primary concern.

So, I don't think we should be under any illusions that the setting of higher standards, because it sounds like being for motherhood, would not raise some questions about the other side of the coin, namely, a system for processing securities transactions . . ."[7.145]

The SIA representatives testified as follows:

"**Mr. Curtis** . . . As I understand your statement the position of the Association is now that you would recognize and accept a delegation of rulemaking authority to the bank regulatory agencies to prescribe rules relating to the safety of the system for depositories which are organized as banks. Is that a correct summary of your position?

Mr. Gardiner. That is correct.

Mr. Curtis. The testimony of the BASIC before the subcommittee suggested that the safety issue is so interrelated to other aspects of putting together a nationwide system of securities processing that the bank regulatory agency should and would have authority in the exercise of their safety rulemaking responsibility to prevent a compelled interface or other compelled expansion of listing or capacity that the SEC may have ordered under rulemaking authority granted to them.

In questioning I think we agreed this would give the bank regulatory agencies a veto over a forced interface between various segments of the securities processing system. In that context, does the association have any difficulty with the assignment to the Fed in this case or the bank regulatory agencies that that veto power on the basis of their discernment of what is needed to preserve the safety of the system?

Mr. Gardiner. I would object to that because I don't think that the regulatory authority should have a veto over — I am not quite sure where practically that comes out. I can, of course, see where a banking authority might not want the direct representation of, let us say, a broker-dealer whose financial position they were concerned about, but in the concept that we have outlined here under the national securities processing system our thought is that all of those broker-dealers would deal directly with the entity itself, and I cannot foresee where a banking regulatory authority would have any problem interfacing with the entity.

Mr. Curtis. To use an example, Mr. Gardiner, the Pacific Securities Depository is a segment of the nationwide system of processing securities.

Mr. Gardiner. Right.

Mr. Curtis. Should the SEC order Depository Trust to interface with the Pacific Securities Depository, the suggestion is that the Federal Reserve Board in this case would be able to veto or prevent that compelled interface upon its

---

[7.145] *Ibid,* pp. 1918-1921.

determination that there was some risk to safety of the system involved in so doing.

Mr. Gardiner. Well, my answer would be that what you have just outlined is exactly what we are trying to achieve; namely, a coordinated system of national depositories all across this Nation. So I would like to prevent anyone from having that veto power but again I go back to the rule of reason that if there were some financial problem with a particular depository that had been ordered into the system that there would have to be awfully good reason to have it prevented from joining or given time to right its ways to meet whatever the standards. I think the standards of entry into any system are very important but I think that it would be incumbent upon the system itself and upon the regulatory bodies to give the entity a chance to meet its standards, and once it met the stadnards there should be no veto power over its inclusion in the system.

Mr. Scribner. That is the difference between having legislation granting a veto power and the kind of practical reluctance you would find on the part of organizations to deal with somebody that they thought was unsafe or unsound. I think just as a practical matter you probably could not force somebody into a system if their business judgment told them that was dangerous ground, so you may have a form of veto no matter what kind of system you construct.

Mr. Curtis. We are talking about assigning to the bank regulatory agencies authority to establish substantive rules which would prescribe standards relating to the safety of the system.

Mr. Gardiner. If I could interrupt for 1 second, we want the same type of standards in the national securities processing system. We want that entity to be able to set standards as to whom it will accept business from, just as the NCC, for example, now has to set those standards which are largely financial for protection of the entire system. So I think in any system there has to be a standard of entry, who can participate and who can meet the financial requirements of the system, but once having met those I think they should be welcomed into the system."[7.146]

What screening of applicants should be allowed a depository?

As in prior hearings, the question was explored as to whether a depository should be allowed latitude in screening applicants and, if so, on what grounds?

Commissioner Evans of the SEC testified:

"Subsection (d)(2) would require the rules of the clearing agency or securities depository to provide that certain enumerated classes of persons, and others

[7.146] *Ibid,* pp. 1959-1960.

designated by the Commission, are eligible to become participants, subject only to certain exclusionary rules permitted by that subsection.

The Commission believes that the bill should be amended to permit clearing agencies and securities depositories, by rule, to impose criteria for participation in a clearing agency or securities depository, applicable to all participants in addition to those set forth in subsection (d)(2) of proposed section 17A, provided that the Commission determines that such additional criteria are necessary or appropriate in the public interest, for the protection of investors, or to assure the prompt and accurate processing and settlement of securities transactions. The primary purpose of the Commission's suggestion in this regard is not to unnecessarily restrict entry to a clearing agency or securities depository, but rather to insure that all broker-dealers and other financial institutions will have access to such entities on a reasonable and nondiscriminatory basis, and at the same time to protect the financial integrity of these entities and their participants."[7.147]

The Executive Director of BASIC commented as follows:

"We would stress 'access' particularly, since the quality of participants has a close relationship to the safety of securities and funds in a depository. Before one makes just about every registered broker-dealer in the United States eligible to join depositories, for example, it seems to me that he should consider the implications to a depository of the SIPC 1972 annual report. Pages 56-57 contain 40 illustrative examples of reasons for failures of broker-dealer firms. In 13 of the 40, fraud was indicated, and in 11 of the 40 variations of the term 'inept management' appeared. While a depository's screening might well not keep out all of such firms who apply, it should not be precluded from trying on the basis of such criteria as, for example, the honesty and integrity of the applicants or their operational capacity or business experience. Rejection of an application should, of course, always be subject to review by the appropriate regulatory authority."[7.148]

* * *

"**Mr. Curtis.** I am reminded of one other thing, that you did not comment on today but your supplemental memorandum certainly does on the access provisions and especially the need to preserve in the depositories the ability to deny participation on the basis of character of the applicant. To the extent that we tie a national system together, will any one segment of that system need to pass on the character of an applicant to participate in any other segment of it?

Mr. Bevis. I would think, Mr. Curtis, that generally participants would be a participant of only one depository and not necessarily participants in all three.

Our plea for a depository's right to attempt to screen applicants is essentially based on the fact that we don't believe that mass screening done by others can

---

[7.147] *Ibid,* pp. 1781-1782.

[7.148] *Ibid,* p. 1874.

necessarily be as effective as one focused on a particular applicant at a particular time.

Certainly, as I have said before, and to pick some names out of the paper – if I am right, they have not yet been convicted of any crime – if a depository received an application from the Meyer Lansky brokerage firm, or the DiCarlo Bank or the Lansky-DiCarlo Mutual Fund, I don't think that a depository should be precluded from examining them and their background very much and perhaps denying them participation. I would not, of course, leave that to subjective judgment, but subject to review by the regulatory authority. I think that is essential.

Mr. Curtis. I was trying to ask a smaller question. If that entity applied for participation in Pacific Securities Depository, would the DTC refuse an interface unless it also reviewed the character of applicants to any interfaced segments of a national system, that is, would DTC say, 'We won't interface with you, Pacific, unless we have the right to interview all applicants in your system.' If not, are you satisfied you can maintain the integrity of the system without that?

Mr. Bevis. I would doubt that any depository would try to second guess any admission into another depository of a particular participant. I would, however, say that any depository that leaves securities with another depository as its custodian, and some of these amounts can become very large, would want to make an overall appraisal of the effectiveness of operations, controls and financial reliability and it is possible that access could be a part of that overall evaluation.

* * *

Mr. Goldwater. It seemed to me you were getting into perhaps an area of SEC law in regard to the integrity of the operation and procedures, the financial ability of, say, a brokerage concern. Why would you necessarily be concerned about that other than just in a cursory way. Isn't your main concern the integrity of the securities more so than the integrity or the character of the institution that has them on deposit with them?

Mr. Bevis. In addition to the integrity of the securities there are very important financial risks that arise from the depository's dealing with a participant . . .

So, in addition to the integrity of the securities in the vault, there are very important financial and operating considerations that have to do with the participants, broker-dealers or otherwise.

* * *

Mr. Goldwater. What you are talking about then, is replacing the SEC in its enforcement of its regulation . . .

To get down to the point where you are passing on the integrity and the practice of a brokerage concern, it seems to me that you are getting into

enforcement of SEC regulations that perhaps is not your area of authority. I just throw this out for discussion.

Mr. Bevis. I would be glad to talk to that point because it is a very important point. To a proposition that anyone admitted as a broker-dealer, or a bank, should automatically have access to the depository, I would say that the screening that has been done by the agencies who admitted or gave charters is not enough for a depository. I point to the SIPC report, to the weekly or biweekly reports of the NASD on the disciplining of members and why they had to disclipline, the newspaper reports of SEC actions – all as proving that the screening for the purpose of registering a broker-dealer is not sufficient for a depository. I think the record should be quite clear on that.

Now, as regards subjective rejections of applications, improper or unwise, I wouldn't leave that decision with the depository's management for a moment. I would have it reviewed by the regulatory authorities to make sure that there was no arbitrariness or capriciousness involved.

My final point is that participants in a depository get more value out of the depository, the more participants that are in. There will be pressures to expand the number of participants always, because otherwise a participant has to operate two systems, one making deliveries through the depositories and the other making physical deliveries outside and he would like everything to be in the first category. But it will have to be worked out on a practical basis with these important considerations in mind, in my judgment.[7.149]

Representatives of the ABA and the NYCH banks also asked that depositories be allowed some latitude in screening applicants.[7.150]

Will banks use a depository not regulated as a bank? – The position that depositories should be operated and regulated as banks had been asserted by BASIC and others at prior hearings. The Subcommittee at the 1973 hearing dwelled on the significance of this aspect of depositories and received opinions from several organizations, e.g.:

Solomon of the Fed stated:

"The officers of banks holding securities have understandable misgivings about placing those securities in a securities depository unless it is supervised by an agency with a deep knowledge of fiduciary responsibilities and banking standards in general. These officials recognize that the custody and handling of securities is first and foremost a fiduciary function – an operation that banks have long engaged in as a regular part of their business. A joint rule-writing effort between SEC and the bank regulatory agencies for securities depositories would provide the needed assurance to bank managements that the new depositories will be properly regulated, supervised, and examined by a bank regulatory agency.

[7.149] *Ibid*, pp. 1921-1923.

[7.150] *See* Ibid, pp. 1929 and 1964, respectively.

Accordingly, the Board on July 13 sent a letter to Senator Harrison Williams' Securities Subcommittee in which we said:

> "***the public acceptability of bank clearing agencies (depositories) . . . will be enhanced by providing for the concurrence of the appropriate bank supervisory agency prior to the adoption of any rule by the SEC applying to any clearing agency (depository) which is a bank."[7.151]

From Stewart of NCG:

"We feel very strongly that the approach taken by H.R. 5050 could well defeat the purpose of the trust company approach and would thus tend to discourage fiduciaries from placing their securities in a depository. H.R. 5050 would have the depository look a great deal like a securities firm with the SEC being involved in all aspects of the depository — beginning with the rulemaking role, through, and including the supervisorial role. It is clear to us, as we have stated before, that securities held by banks and trust companies, particularly in a fiduciary capacity, will be entrusted only to a depository operating in a regulatory atmosphere similar to that in which banks and trust companies now operate."[7.152]

* * *

"**Mr. Stewart** . . . I think they (banks) would view with some misgiving a turnover of the bank regulatory function to the SEC."[7.153]

Coriaci of Continental Illinois Bank stated:

"We are concerned, as I think Mr. Bevis said quite some time ago, depositories looking and feeling and smelling and everything else like a bank. We have a deep concern for our customers and their participation in a depository, and whether or not they permit us to put their securities in a depository.

Mr. Goldwater. It appears you would need common procedures in law and regulations for it (MSTC) to proceed, and enforcement of these procedures. I understand it is your opinion that this should come from the banking industry?

Mr. Coriaci. Yes. As you undoubtedly know, the banks are in effect depositories today. We serve as safekeeping agencies for a number of our customers, we act as safekeeping agents for a number of smaller banks that do not have facilities in their own shops and we feel we have expertise in this area to begin with.

We also know the bank regulatory agencies have supervised and reviewed us time and again and we are used to that type of supervision and we feel the record pretty well speaks for itself in the bank as far as the result of those

---

[7.151] *Ibid,* p. 1817.
[7.152] *Ibid,* p. 1826.
[7.153] *Ibid,* p. 1916.

examinations, so we are comfortable with that type of regulation and know our customers are comfortable with that type of regulation."[7.154]

A representative of ABA testified:

"**Mr. Young.** Then are you saying, if that situation develops, banks will refuse to deal with the depositories which are nonbanking depositories?

Mr. Milburn. I would go so far as to say they may be inclined that way because again they are looking to the protection of the assets for which they have responsibility and, in looking to the protection of those assets they prefer a bank to be managing those assets, they prefer to have some representative on the Board of that bank so that they can keep an eye on how those assets are being managed.

I think we would have very, very grave doubts about joining a depository which was not, in effect, a bank subject to examination and enforcement by banking authorities."[7.155]

A NYCH representative said:

"**Mr. Curtis.** Mr. Thomas, maybe there is one matter that has not been clearly set out in this record and that is why is it necessary for a depository to be a bank?

Mr. Thomas. Well, I think one of the main reasons on this, and it goes back — Herman Bevis probably said it the other day — our 12 banks alone, as I testified, hold 2.8 billion shares of stock for our customers. That is $108 billion. We have a fiduciary responsibility there. These are not our securities. In the process of each day's trading back and forth we get into figures that are astronomical. One of the functions that is most important in any depository, in addition to the immobilization of the certificate by book entry, is the settlement in dollars at the end of the day. Unless we can be assured that within this function when we have sold securities and directed the book entry from us to somebody else, we are going to get our money, and this is our customers' money, that is why we like the framework of a bank as a depository rather than just some organization."[7.156]

The Conference of State Bank Supervisors submitted a letter for the record which contained this statement:

"It would appear that if the securities depositories are to achieve the objective of immobilizing stock certificates in securities transactions, there must be significant participation by banks in a fiduciary or other capacity. It is believed that banks, particularly those located outside the areas where depositories are

---

[7.154] *Ibid,* p. 1916.
[7.155] *Ibid,* pp. 1937-1938.
[7.156] *Ibid,* pp. 1969-1970.

situated, would more readily participate if the depositories were supervised and regulated by the existing banking agencies at the federal and state levels."[7.157]

The relationship of the House Committee's jurisdiction to regulation of bank depositories – In the Senate, the Committee on Banking, Housing and Urban Affairs has jurisdiction over matters involving both the banking and securities industries. In the House, the Committee on Interstate and Foreign Commerce has jurisdiction over the securities industry, but another House Committee over banking.

A matter of House Committee jurisdiction may in part account for the reluctance of the House Subcommittee to accept a major role for banking authorities in regulating depositories that are banks (even though such was accepted in the Senate and espoused by all major witnesses before the House Subcommittee except the SEC). Two excerpts from the Hearings bear upon this point.

"**Mr. Curtis.** This may be an appropriate point to note, as the chairman asked me to note, that the Commission's concern of the responsibilities between the SEC and the banking regulatory agencies is not conditioned upon a limitation of this committee's jurisdiction to the extent that banks engage in the functions of securities depositories or clearing agencies or transfer agencies and supervised by the bank regulatory agency.

This committee has been assigned the responsibility to assure that bank regulatory agencies properly carry out their functions. This responsibility was assigned to it under the Securities and Exchange Act of 1934.

Mr. Moss. We want you to be very clear on that that this committee has no intention of yielding any of its jurisdiction in this area because of the nature of the entity that migher perform the functions. We still have the responsibility in the securities field and we will exercise it fully.

Mr. Evans. On the other side, the Banking Committee has jurisdiction over both securities and banking institutions, so they can balance the two. It would seem appropriate that this committee have jurisdiction over securities activities of both, so you could balance them.

Mr. Moss. We don't have both, but to the extent we have one, we have it fully and will hold on to it.

* * *

Mr. Moss. I endorse your comments with great enthusiasm and I contrast them with the testimony we have had saying 'Let us use only those traditional agencies, not traditional in the functional sense but traditional as they relate to us, those we know well, leave us with them.'

You know, you appear, I hope, before a committee of friendly and thoughtful members of the House, who traditionally do not deal with banking. We deal with the investment banking industry. We deal with trade practices, with more

[7.157] *Ibid*, p. 1981.

regulated industries than the traditional committee of the other body on the Hill that deals with banking. It has a limited scope.

This is part of the Commerce Committee, which has jurisdiction over all regulated industry in the Nation. And so, in urging that we not be bound by the tradition of the past and that we seek new ways to better perform services, in keeping with that kind of a tradition, a tradition of flexibility of opportunity to accept and challenge and to come up with better answers, it was in that spirit that this committee drafted H.R. 5050."[7.158]

Assessment of the position at year-end 1973

In connection with the passage of H.R. 16946 in 1972, it had been reported that some members of the House Subcommittee and full Committee were not aware of opposition to the bill's regulatory pattern for bank depositories. To make sure that there was no misunderstanding on this point in 1973, BASIC's Chairman and counsel talked to all House Subcommittee members except the Chairman (who was not available) during the month after the 1973 Hearings closed.

Several times during the September 1973 hearings, the House Subcommittee Chairman stressed the intention to move H.R. 5050 to mark up quickly.[7.159] BASIC received its copies of the printed hearing record for September 11-14, 1973 in March 1974. Nothing had been heard about a mark-up of Title IV of H.R. 5050 by the end of 1974's first quarter.

At the end of 1973, BASIC had been at work for 46 months. Towards the end of 1971, a major uncertainty had been introduced into its plan to develop a CSDS – the uncertainty as to whether or not the Congress would or would not prescribe regulation that would foster, or impede, the CSDS development. After two years of uncertainty, the question remained unresolved.

[7.158] *Ibid,* pp. 1798 and 1941.

[7.159] See, e.g., *Ibid,* pp. 1824, 1942, 1950, 1961, and 1970. The last citation, closing the Hearings, includes this: "Mr. Moss . . . The committee has a target date of the 9th of October to commence its first markup session on the legislation. Prior to that time we will attempt to have a hearing record published and available."

VIII

SOME OTHER STEPS TOWARD A SYSTEM FOR AUTOMATED PROCESSING OF SECURITIES TRANSACTIONS

Table of Contents

VIII

SOME OTHER STEPS TOWARD A SYSTEM FOR AUTOMATED PROCESSING OF SECURITIES TRANSACTIONS

Making operational the book-entry transfer of ownership of securities immobilized in depositories has been a giant leap forward in solving securities transaction processing problems. Yet, it is not the whole solution. Even for DTC to use book-entry, for example, hard-copy documents by the thousands flow to and from it by hand daily in the form of instructions, authorizations, etc. The labor-intensive, error-prone clerical work involved is multiplied for non-depository securities transactions settled by physical delivery in the old manner.

Many have had visions of the securities transaction processing system of the future—a communications network, mostly computer-to-computer, linking the whole financial community. They see the network ultimately connecting: trading floors or other places where trades are immediately "locked in"; broker/dealers; their bank, mutual fund, and other institutional customers; depositories; transfer agents; and money settlement facilities. "On-line" and "real-time". Settlement the day of the trade; no "T+5". International, not merely national.

Technically feasible? Yes. Just around the corner? Not the whole system, which is some time away, but parts of it are in place, are being put in place, or are being planned, now.

The important obstacles in the way of reaching the ideal system are not technology and hardware. Both of these exist today and, while they undoubtedly will be improved dramatically in the future, are probably adequate to do the minimum job. The real problems have to do with people. Changes in present systems and procedures have to be made by hundreds of thousands of people in thousands of different institutions before the ideal system can be hooked up and made to work. And these people range from A to Z in sophistication, competence, resources, and inertia.

The ideal system will require that everyone using the system adhere to uniform standards in a number of important matters. Codes to identify securities, institutions, individuals, etc. must be identical. The format of communications must be rigidly defined and adhered to. EDP equipment must be capable of being compatibly linked. And so forth.

There is nothing new in the prescribing of, and adherence to, uniform standards in the securities and banking industries, of course. Exchange clearing corporations have for years required clearing members to adhere to prescribed securities codes, member codes, input forms, etc. There are standards for MICR encoding of checks, transit codes to identify banks, message formats to transfer funds electrically, etc.

The ultimate system for processing securities transactions will require the adoption of certain standards across the country (ultimately internationally) by at least depositories, securities clearing houses, at least those broker/dealers that are clearing members, at least those banks, mutual funds and insurance companies, that are depository participants, and transfer agents.

Of all the instruments in the financial community, the CSDS is the only one that touches – or will touch – all these various industries and institutions. BASIC has proceeded on the premise, therefore, that the CSDS, in setting standards for interface with it, may well play an important role in setting standards for the settlement by electrical communication by others of transactions in securities not even eligible for the CSDS. This is not presumptuous; to repeat, it is merely recognition of the fact that the CSDS interconnects with more of the varied elements of the financial community than any other institution. There is no good reason, therefore, why its standards, applicable to an important segment of securities transactions, should not contemplate and be usable in the larger universe.

BASIC has done work in connection with CUSIP, FINS, four uniform forms, COD DKs, electrical communications systems in the banking and securities industries, and transfer instructions by magnetic tape. There are systems implications in all these subjects. A brief description of this work of BASIC follows. As will be seen, its role has varied from furthering implementation of the work of others to early exploratory studies.

C U S I P

CUSIP is the name given to the standard code for identifying securities issues. It is an acronym of its creator, the Committee on Uniform Security Identification Procedures (the "CUSIP committee") of the American Bankers Association. Although sponsored by the ABA, the committee members represented all elements of the financial community across the country. The code consists of 9 characters, the first six of which identify the issuer and the next two the issue. The last is a check digit.

The CUSIP Committee completed its work on the development of CUSIP in 1967. Compiling and publishing the directory was assigned by the ABA's CUSIP Agency under contract to the CUSIP Service Bureau of Standard Statistics Co., Inc. (of Standard & Poor's).

By the time BASIC was formed in early 1970, the CUSIP directory listed about 1 million securities issues and their CUSIP codes, some three-quarters or more of which were state and municipal bonds. Thus, the imaginative pioneering work of ABA's CUSIP Committee had in being in 1970 an absolutely essential ingredient of any future automated securities transaction processing system – code identifiers for almost all securities issues traded in any volume.

The central problem with CUSIP when BASIC came into the picture was that not many financial institutions were converting to CUSIP from their in-house securities issue codes (none standard, except to the extent that exchange symbols were used). Not many were even buying CUSIP directories. CUSIP code identifiers appeared on few of the documents transmitted in connection with completing securities transactions.[8.1]

[8.1] Those involved in the future in implementing financial community-wide changes to a standard should study the CUSIP experience. It is an excellent showcase project. Each financial institution has its own securities code. To change to another – and standard – code requires time, effort, expense, retraining of clerks, temporary disruption. Each institution says to itself: "If I go to the trouble and expense of changing, but the others who send documents to me don't use CUSIP, I have lost – not gained. Even if some authority requires me to put the CUSIP number on securities transaction documents sent to others, I might well find it more economical to continue to use my own securities code internally, with a front-end and back-end conversion from and to CUSIP on the external communications."

CUSIP number on certificates

Before BASIC came into existence, it had been recognized that having the CUSIP number on certificates would, as a matter of clerical routine, make the insertion of the CUSIP number on securities transaction documents easier. If a clerk has to look up the CUSIP number in a one-million-entry directory before putting the number on a document, this is time-consuming work. If the number is on the certificate about which the document is being prepared, the exercise is much quicker. Moreover, to best accommodate the clerical production line, the CUSIP number should be in approximately the same place on each certificate.

In February 1970, a NYSE official had proposed that the CUSIP number be placed in the upper right-hand quadrant of stock certificates. However, for a fair percentage of certificates, which vary in format, this proposal was unsatisfactory. On April 2, 1970, members of BASIC's Task Force met at the American Banknote Company with representatives of that company, the American Society of Corporate Secretaries, the Stock Transfer Association and the Corporate Transfer Agents Association.

After inspecting many varities of certificates, it was concluded that the space in the right of the certificate's "open throat" could accommodate the CUSIP number in all cases. This was communicated to Mr. Philip L. West, NYSE's Director of Stock List, on April 8, and on April 15 he wrote to his listed companies recommending the placement of the CUSIP number on certificates and its positioning. (The letter is attached as Appendix W.)

BASIC followed through on the inclusion of the CUSIP number on the stock certificate. At its committee meeting on April 22, 1970 it adopted a position statement calling for, among other things, the inclusion of CUSIP on all stock certificates and bond instruments (a) ordered after June 1, 1970; (b) delivered by banknote companies after October 1, 1970; and (c) issued by transfer agents and others after January 1, 1971. A press release reporting this action was issued on April 23, 1970. (The documents are attached as Appendix X.)

BASIC sent letters requesting that self-regulatory bodies make the foregoing timetable mandatory by rule, and requested that it be adopted as policy by others. The letters went to all exchanges, NASD, all clearing house associations, the Treasury Department, and interested associations. By mid-1970, the requested action had been taken by AMEX, NASD, NYSE, NYCH, MSE, the Municipal Finance Officers Association, the Los Angeles Clearing House Association, the Corporate Secretaries Society, and perhaps others who did not report back to BASIC. Commencing September 3, 1970, the Treasury Department arranged that CUSIP would appear on all Treasury bills.

In the second quarter of 1970, a decision was found to be needed as to standard placement of CUSIP on bonds, for bond instruments varied in format perhaps even more widely than stock certificates. The Task Force solved this problem with the assistance of Frank P. Smeal, Chairman of the Municipal Securities Committee of the IBA, and of officials of U.S. Banknote Company. From inspection of hundreds of bond instruments, the logical position emerged as on the panel after the name of the issuer. A letter to Mr. Smeal reporting this conclusion is attached as Appendix Y.

There have been no self-regulatory or other organized bodies with widespread authority or influence over the format of state and municipal bond issues. For this reason, it may not be surprising that BASIC's exhortatory efforts in 1970 produced CUSIP numbers on an unsatisfactorily small percentage of such issues. This, notwithstanding the unusual difficulty of back-office clerks in accurately identifying, and distinguishing among, issues of this type of security. It was most encouraging to see the Public Finance Division of SIA step into this void in 1972. Through SIA Committee and staff work, there was first a disposition of the question of whether or not CUSIP should distinguish among purposes of an issue, then a vigorous campaign to expand the use of CUSIP in the state and municipal bond area. A copy of an SIA release dated March 15, 1973, "CUSIP and Municipal Bonds", giving background on CUSIP, is attached as Appendix Z.

Converting in-house systems to CUSIP

Getting CUSIP on stock and bond instruments was no systems advance *per se;* it was to facilitate a systems change to CUSIP. As had been indicated, if ultimately all in the financial community will be using CUSIP to communicate with each other, it is a sure thing that CUSIP will ultimately replace in-house securities identification codes. BASIC, in its April 22, 1970 position paper referred to above, urged members of the financial community to convert their internal identifiers to CUSIP as early as possible. It pointed out that "this is in preparation for the universal use of CUSIP on uniform documents to be adopted for the processing of securities transactions."

BASIC's press release and widespread distribution of its position paper did not produce quick results, based upon the slow rate of increase in subscriptions to the CUSIP directory in 1970. A "crisis meeting" was held between ABA's CUSIP Agency and officials of Standard & Poor's on December 14, 1970, to which representatives of BASIC and other organizations were invited. In a nutshell, S&P stated that it continued to lose money on the CUSIP service because its revenue from directory sales and other services was less than its costs; it could not wait forever – suffering losses meanwhile – to learn whether CUSIP would fly.

This meeting spurred another round of activity to promote the use of CUSIP. Reese H. Harris, Jr., Chairman of ABA's CUSIP Agency, on January 12, 1971 called for exchanges to set a date (April 1, 1972) by which CUSIP on clearing input would be mandatory (an excerpt is part of Appendix AA). On February 16, 1971, the SEC announced a proposal to require the use of CUSIP on specified reports filed with it (Appendix BB). BASIC's actions are outlined below.

Mandatory use of CUSIP on documents

All involved with CUSIP had recognized from the beginning that its big "payoff" would be when it was used in communications – whether these be electrical or hard-copy documents – to process securities transactions. Morever, it seemed certain that in due course those with authority or influence would have to set deadlines for the changeover.

Goodbody
Dupont
(Ross Burt)

BASIC distributed on July 15, 1970 a draft position paper on this subject (Appendix CC). The paper proposed that CUSIP be included on four widely used forms (delivery bills, comparisons, reclamation forms, and transfer instructions) even before these forms were standardized. The suggested deadlines, all between January and June 1971, were for (a) acceptance by exchanges of CUSIP on clearing input, (b) a requirement for this, and (c) inclusion of CUSIP on the four named forms.

Responses to the July 15 paper indicated a general inability to produce and use documents with CUSIP as quickly as the deadlines would require, as well as a questioning of the usefulness of CUSIP in a variety of places on the disparate documents then in use. On October 30, 1970, BASIC issued a general letter withdrawing the idea of requiring CUSIP on existing documents and deferring the matter until uniform forms were promulgated (the letter is Appendix DD).

The "crisis meeting" with Standard & Poor's on December 14, 1970, referred to above, sharply suggested the need for a big push for the use of CUSIP, and the best candidates here were the high-volume clearing input and output of NASD and the exchanges, and the documents handled by NYCH banks.

The Task Force of BASIC drafted a statement in early January 1971 proposing an April 1, 1972 deadline for CUSIP on all the foregoing documents. On January 25, 1971, Howland, Kolton, and the Executive Director met with the Operation's Committee of ASEF to secure its support, which was obtained. The BASIC Committee approved the statement at its meeting on January 27, and it was released under date of February 11 (Appendix AA). Within weeks thereafter, AMEX, NYSE, MSE, and NYCH announced to their members the April 1, 1972 deadline for mandatory use of CUSIP.

BASIC's work on uniform forms is covered later in this chapter. In connection with this discussion of CUSIP, it may be mentioned that one of the uniform forms calling for CUSIP was required to be in use by September 1, 1972 and two others by December 1, 1972. (It was eventually decided that the inclusion of CUSIP on the reclamation form was not useful.)

CUSIP is not in universal use on documents

A large New York bank furnished BASIC with the following statistics on the use of CUSIP on its receive documents in March 1973:

Received via	% with CUSIP
DTC	100%
FRB wire	100%
SCC	50%
NCC	80%
Over the window	40%
Weighted average	70%

An operating official of the bank had these comments:

"With regard to your question on how successful CUSIP Implementation has been, my feeling is that it has been extremely successful to date . . .

Literally all transactions passing through DTC have CUSIP numbers and all transactions passing through the Federal Reserve Book-Entry or wire system have CUSIP numbers. The CUSIP numbering system is an excellent vehicle for effecting accurate security transactions in these two systems.

Other security transactions that utilize SCC, NCC, or deliveries over the window are averaging approximately 50% use of CUSIP numbers. In these instances, where the physical securities accompany the delivery bill and the deliverer's internal system may not utilize CUSIP there is little incentive, or need, to place CUSIP on the delivery bill . . .

I feel CUSIP is gaining acceptance and is being used effectively in the areas where it can be most helpful. I don't feel legislation would speed the implementation for municipals and OTC issues. As the OTC issues become eligible for depositories, and perhaps as the actively traded municipals become a part of some depository system, there will be a need for CUSIP and it will be actively and effectively used."

The foregoing statistics and discussion demonstrate that the systems needs of central processors of securities transactions will see that a standard (in the case of CUSIP, to identify securities issues) will be adopted, used, and found useful. The question is raised, however, as to whether it is really useful for certain other types of transactions until they are volume-processed through some centralized facility.

Such a systems question about standards is not easy to answer for large numbers of financial institutions with wide ranges of volume, sophistication, and record-keeping methods. It was with this in mind that the Executive Director, in writing on August 4, 1972 to the Chairman of the SEC about the "million dollar systems study" (discussed in Chapter VII), suggested:

"It is entirely within the realm of possibility that universal adoption of some standards will be accomplished only through use of governmental authority. Simkin has rightly emphasized the essentiality of universal standards in the future widespread application of advanced technologies to reach the ultimate system. If the SEC wishes to 'guinea pig' whatever problems there are for it in seeing that standards are implemented, there is a ready-made pilot project for it today: CUSIP.

CUSIP is sure to be on anybody's list of future required standards. It has been engineered, tested, largely debugged, and approved or endorsed by everyone in sight. CUSIP ought to be used internally and externally by all members of the financial community that process securities transactions. It would help a lot if all broker/dealers adopted CUSIP for internal and external use. Improvements in the transaction consummation process are not going to come all at once, but in steps. Why should not the SEC recognize this sure-to-be-required step, and

order the implementation of CUSIP by a stated date? Much might be learned from this as to how the SEC can best play an activist's role in reaching the transaction consummation process of the future."[8.2]

So far as is known, no action along the foregoing suggested line was taken.

FINS

The far-seeing ABA Committee also correctly pointed the finger at another standard that would ultimately be needed to apply modern communications technology to the completion of securities transactions. This was the need for a financial industry numbering system ("FINS"), a uniform code to identify each member of the financial community across the country (ultimately in the world?) that is importantly involved in the processing of securities transactions – brokers/dealers, exchange facilities, banks, transfer agents, nominees, mutual funds, insurance companies, and others. The CUSIP Technical Sub-Committee developed a FINS based upon guidelines established by a Special Broker Number Task Force of the NASD, created in 1968. It reported initial proposed specifications for FINS on June 15, 1969 and a revision dated February 3, 1970.

FINS' specifications

FINS, therefore, had been developed into a proposed standard with detailed specifications by the time BASIC entered the picture in March 1970. However, there had been nothing like the securing of endorsements, the building of a directory, etc., as with CUSIP. The ABA turned the FINS project over to BASIC in 1970.

BASIC's first move regarding FINS was to circulate the ABA Subcommittee's proposal to some 100 organizations and firms, soliciting comments. The letter dated July 2, 1970 is attached as Appendix EE. Some 17 replies were received. Of these, 8 indicated satisfaction with the specifications; other offered suggested changes in the numbering plan. Perhaps more importantly, some, while not challenging the specifications for a FINS, raised questions as to FINS' general usefulness at that time, pointing to existing broker/dealer clearing numbers and other existing code identifiers as sufficient for the present systems. For example, the minutes of the September 23, 1970 meeting of the Delivery Problems Committee of the Joint Industry Control Group contained this:

> "There was agreement that FINS seems to be a positive step towards standardization. However, the Committee had difficulty in seeing specific advantages to the use of FINS in the current operating environment."

These comments gave the BASIC Task Force pause, considering the then known difficulties in persuading the financial community to adopt and use CUSIP – which seemed of more demonstrable current usefulness.

[8.2] Memorandum in Appendix U, "Toward Improving the Transaction Consummation Process", pp. 15-16.

Assessing the need for FINS

BASIC, however, received scattered queries as to why FINS was not being implemented. As a result of these, the Task Force made a revision of FINS based on suggestions received on the numbering plan of the ABA Subcommittee, and incorporated this revision and background information and explanations in a position paper dated February 16, 1971 (Appendix FF). This was sent under date of February 18 to two government agencies and six associations that had nationwide jurisdiction or membership related to the processing of securities transactions. These were selected because it was believed that local and regional numbering plans might already be sufficient, so that the real question of usefulness probably centered on a national plan. Each was asked whether, to them or their members, FINS would benefit them at present and, if not, whether they foresaw a need for FINS in the future.

Responses that there are no present or foreseen needs were received from the Fed, Stock Transfer Association, Corporate Transfer Agents Association, and American Society of Corporate Secretaries. The Investment Company Institute indicated that a FINS would help its members. An acknowledgment was received from the SEC promising to comment later on the questions, but there was no further word.

In view of the foregoing reaction, BASIC put FINS on the back burner. It was almost a certainty that FINS would ultimately be essential in an automated securities transaction processing system and, indeed, most of the research for a practical numbering plan had been done by the ABA Subcommittee. FINS would probably not become useful — and, therefore, used — until two or more CSDs interconnected into a fledgling national CSDS.

With this in mind, when the Working Committee of NCG was formed, BASIC put FINS before it as a potential project. As this committee probed potential depository interfaces, it again brought FINS to the fore. After study of the subject and consultation with a large number of interested organizations in 1972 and 1973, a FINS was developed, approved by NCG, and published under date of February 13, 1974 (attached as Appendix GG). As this was written, alternative plans for publishing the directory were being reviewed. As was expected, depositories were urging the NCG Working Committee along. They were close to having a need for a nationwide financial industry numbering system.

FOUR UNIFORM FORMS

Forms used to process securities transactions have been "personalized" by the issuers since the days of the buttonwood tree. About the only exceptions have been input forms prescribed by clearing corporations and depositories. While the forms of necessity must contain the minimum information that a receiver has to have to recognize and process the transaction, many houses included material extraneous for this purpose and related only to their internal systems.

Thus, clerks in a firm or bank receiving documents from many sources had to search for a given bit of information around the compass — it would appear in the northwest quadrant in one, the center in another, the southwest in a third, etc. As one broker put it

in 1970: "the plumbing industry was 40 years ahead of the securities industry in standarding minimum specifications in the output of a variety of producers." Clerks made errors, of course, solely because of the variety of places where they had to look for information.

Aside from reducing clerical errors, uniformity of forms used to conclude securities transactions has an important relationship to an ultimate automated system. Such a system would require a rigid sequence and format, not the helter skelter of variegated forms. BASIC approached uniform forms with this in mind.

ABA's SIP Task Force did extensive work on certain uniform forms. It released a proposed comparison form in June 1969 and a proposed standard transfer instruction form and batch control ticket in February 1970. This original and essential research work gave uniformity in the documents involved an important head start.

Research during 1970

BASIC's Task Force talked with a number of broker/dealer, exchange, and bank personnel about the SIP Task Force's product and the principal forms that cried for standardization. As to the latter, a consensus emerged that BASIC should concentrate on delivery bills, comparisons, transfer instructions, and reclamation forms.

By July 1970, BASIC's Task Force, after soliciting suggestions from the banking and securities industries, made a first draft of a uniform delivery bill, and reclamation form. In July and August 1970, it presented these, along with SIP's comparison and transfer instruction forms, to the relevant JICG Committees and others for comment.[8.3] Within the next two months, comments were received from about a dozen representatives of exchanges, banks, and associations. A number of questions were raised as to format and the machine-readable feature.

The Executive Director called a meeting of representatives of about 25 large brokerage firms for December 18, 1970. The purpose was to inform the group of BASIC's decision not to try to make the certificate machine-readable and, in the light of this, to solicit suggestions as to the best approach to the uniform forms under consideration. Representatives of 11 firms attended. There were wide differences in the group as to making documents machine-readable, or not, and even as to making the use of uniform documents mandatory.

Proposed uniform forms

Members of BASIC's Task Force spent the first six or eight months of 1971 trying to get a feel of the internal systems problems of a large number of broker/dealers, banks, and exchange clearing corporations if the four uniform forms were mandated. Time and cost to convert, as well as prospective benefits, were assessed. While most of those consulted endorsed the theory of uniformity, understandably most took a dim view of having to change their internal systems to put the theory into practice. This was

[8.3] At this point, consideration was being given to making all but the reclamation form machine-readable by OCR equipment. This idea was later discarded by BASIC, for reasons developed in the discussion of the machine-readable certificate in the next chapter.

particularly true of those who were highly automated. These discussions, however, resulted in format changes to modify the impact of uniform forms on many systems.

Under date of September 1, 1971, a printed paper containing the four proposed uniform forms was circulated for comment.[8.4] About 2,500 copies were distributed. The covering letter contained these comments:

> "It has long been widely agreed in principle that the standardization of the Transfer Instruction, Delivery Ticket, Comparison, and Reclamation forms would be of great benefit. Each of these forms must be individually examined by the receiver — often, by several people at various points — and each will trigger a series of actions: acceptance or rejection of the form and its associated documents; comparison with internal forms; and preparation of new documents. Presently, the same elements of information must be extracted from a wide variety of forms, many of them encumbered by information pertinent only to the sender.
>
> Thus, the advantages of standardization include these: visual scanning time and visual fatigue will be reduced; erroneous acceptances, erroneous rejections, processing errors, and consequent re-handling will be reduced; forms of uniform size, shape and format lend themselves better to 'mass production' processing techniques, and to the development of simpler and more effective training manuals and procedures. Savings of processing and training time, and the reduction of errors, should be considerable.
>
> In addition to the near-term benefits that standardization will bring, another important objective of the uniform forms effort is to anticipate systems of the future. Conversion to uniform forms by users in the banking and securities industries will provide standard message formats, which better lend themselves to processing now, but which will be essential if machine-to-machine transmission and processing is to take place in the future. The proposed standard forms make use of existing identifying codes, such as the CUSIP number, anticipate a future FINS (Financial Industry Numbering System) number to identify senders and receivers, and provide for several other control and identifying codes that would be required for ultimate machine processing."[8.5]

Comments on the draft forms were received from members of the financial community across the country, including:

Brokers	33
Banks	14
Transfer agents	8
Service bureaus	3
Exchanges	3
Industry committees	2
Other	2
	65

[8.4] Reproduced in *Senate 1971 Hearings,* pp. 417-429 and *House 1971 Hearings,* pp. 1895-1907.
[8.5] *Senate 1971 Hearings,* p. 418.

Most of the responses applauded the concept of standardization of the four forms as a beneficial step towards faster and more accurate handling of industry paperwork. Many respondents suggested modifications in the draft forms, which were considered carefully and adopted where practical.

Final disposition by BASIC

Revised forms and a proposed final report on the subject were considered by the BASIC Committee at its meeting on December 22, 1971. The Executive Director, in recommending promulgation of the four uniform forms, told the Committee that, if they were submitted to brokers and banks for a popular vote, they would probably be rejected by a majority of 90% or more: each voter would point to one or more details in the package as the basis for rejecting the whole lot. At the same time, he said, every possible effort had been made to adopt as many suggestions as possible while still retaining uniformity.

The draft final report went on to say:

> "Based on the responses received, it is believed that the attached forms can replace those presently in use. Special requirements that are unique to a user's system can be met by adding to the user's own set, while preserving the receiver's copy as-is.
>
> It is recognized that for some firms, systems conversion will be extensive, or, in some cases, difficult to schedule because of current projects. However, it appears from the large number of favorable responses that most firms will convert speedily.
>
> The question of costs and benefits is a difficult one. While the costs of conversion are relatively easy to assess, the benefits are hard to quantify in terms of dollars. Although estimates both of conversion costs and of benefits to be derived from conversion vary from firm to firm, it is agreed that the long-term advantages to the banking and securities industry as as whole should be the overriding consideration. On balance, these long-term advantages should outweigh the sum of the short-term costs and inconveniences to individual firms.
>
> Obviously, until most of the forms that circulate conform to the standard, the large benefits will not be realized. This suggests strongly that conversion commence as soon as possible in advance of the mandatory dates and that each firm and association in the industry use its best efforts to achieve nationwide uniformity."[8.6]

The Committee decided to recommend adoption of the four forms with mandatory dates for use as follows: Transfer Instruction and Reclamation Form, September 1, 1972; Delivery Ticket and Comparison, December 1, 1972.

[8.6] The final report is reproduced in *Senate 1971 Hearings,* pp. 430-454 and *Senate 1972 Hearings,* pp. 777-799. The quotation above may be found in the 1971 Hearings on pp. 431-432.

On December 31, 1971, BASIC sent letters to AMEX, NASD, NYCH, and NYSE requesting that each take appropriate action to implement BASIC's recommendations. On January 6, 1972, a similar letter was sent to other exchanges and clearing houses in the country, and to associations within the banking and securities industries. Members of AMEX and NYSE were informed that the uniform forms were to be used, by the mandatory dates recommended by BASIC, in a joint letter of AMEX and NYSE dated January 27, 1972; NYCH took the same action on January 13, and NASD on February 1.

Many organizations took quick action to convert to the uniform forms. Others, based upon inquiries received from brokers, banks, and others did not face up to the conversion problem until near the respective mandatory use dates. One large transfer agent ran a check on September 14, 1972, fourteen days after the deadline for use of the uniform transfer instruction, and found that 70% of the banks and brokers were doing so and 30% were not. This is as good an illustration as any of the difficulty of obtaining mandated change by a given deadline among the diverse units of the banking and securities industries.

Nonetheless, the uniform form show was on the road.

COD DKs

COD DKs are rejections of securities delivered against payment ("COD") to a settling agent—most often a bank. The rejections are because the agent does not have instructions from his customer or correspondent to make the necessary payment.

A discussion of solutions to the COD DK problem belongs in a chapter on steps toward an automated system for several reasons. First, much of the existing problem is traceable to slow communications. Second, system revisions to reduce DKs involve changes in, and coordination of, procedures of an unusual variety of scattered members of the financial community. A complex settlement of a COD transaction can involve the executing broker, his correspondent settling broker in another city, the COD customer (say, a pension or mutual fund), the customer's local bank, and the local bank's correspondent bank in the settling city (the latter is called the "agent bank" in the ensuing discussion for brevity, even though the local bank is no doubt acting in an agent capacity also).

Finally, for those who optimistically look to a federal agency to mandate the steps to achieve a modern securities processing system, the COD DK problem should hold interest. As will be explained later, BASIC concluded that solution to the COD DK problem needed certain federal regulations, and requested these of the appropriate federal agencies. These have not been forthcoming after more than two years. The problem is admittedly complex. But few steps to reach a modern transaction consummation process are simple.

Background

The Fed's Regulation T permits a broker to grant to his customer the privilege of not paying for purchased securities until they are presented to the customer (usually, his designated agent). The practical reason for Regulation T is to prevent an institutional

buyer, otherwise paying on T+5 like the general investing public, from running a credit risk between the time of payment and the receipt of securities. As institutional trading increased, with many orders involving large amounts of money, institutional customers could not be asked to, in effect, extend brokers such large credit.

The path of the simplest COD transaction is as follows: (1) the customer places a buy order with his broker, telling him then or subsequently where to present the securities against payment; (2) the broker executes the order; (3) the broker sends a confirmation of the trade(s) to the customer; (4) the customer informs the agent bank of the transaction and instructs it to make payment against delivery; and (5) the broker delivers the securities to the agent bank and receives payment. The customer's local bank may be part of the communication chain between customer and the agent bank. The broker may use a correspondent broker in another city to settle.

If, in the transaction chain described above, the broker presents securities to the agent bank before the latter receives instructions from the customer, the agent bank rejects the securities as a DK ("I Don't Know the transaction").[8.7] The broker then has to re-present the securities later, often after broker or bank has communicated with the customer to pinpoint the problem.

COD DKs had been a matter of concern to the brokerage industry from at least the mid-60s. The paperwork problems of the latter 60s, and higher interest rates on loans to finance the DK'd securities, heightened the concern. Some of the 1969 research studies, referred to in Chapter I, dealt with DKs.[8.8]

NYSE in 1968 had attempted by rule to cure one source of DKs. Large institutional buy orders were often executed in two or more trades. The COD customer's instructions to agent banks frequently were for the total order. Securities delivered for only one of the trades was a "partial", and DK'd by the agent bank. (Since each settlement by the bank created a transaction charge to the customer, one order, if executed in five trades, would cost the customer five times the transaction charges if he authorized settlement of five "partials" as opposed to authorizing acceptance of delivery of only the total order.) The NYSE rule (430) directed brokers to require COD customers to authorize agent banks to accept "partials".

NYSE's rule could not be enforced. Brokers, competing for institutional orders, could not maintain a united front in requiring customers to carry out the NYSE rule.

[8.7] Securities are also rejected for many other reasons, usually traceable to errors by broker or bank clerks, such as: wrong security, wrong quantity of shares or principal of bonds, wrong dollar amount, no due bill attached, securities not negotiable, delivered to wrong bank, duplicate delivery, account to be charged omitted, incomplete, or inaccurate, etc. Banks may reject erroneously because of delays in routing customer instructions to the proper place, misfiled manifolds, etc. Rejections of deliveries for all these reasons are sometimes loosely called DKs in "the Street", but should not be, for clerical errors are to be sharply distinguished from a system that begets communications delays.

[8.8] See, e.g., the NAR AMEX study, *House 1971 Hearings,* p. 2088 (in which "standing instructions", discussed later, are recommended). The NYCH Special Committee study, *House 1971 Hearings,* pp. 2001-2005, concludes on securities settlement: "Nevertheless, under appropriate controls and with full knowledge of the disadvantages enumerated above, this Committee believes this (standing instruction) procedure may offer a viable alternative to principal's instructions for securities settlement."

Where one, or a few, would not enforce the rule, none would—perhaps, more properly, "could"—under highly competitive conditions. This experience of the effective authority of COD customers over the system for settling COD transactions carried great weight with BASIC in its subsequent recommendations as to solutions for the COD DK problem. Particularly, it pointed to the need to search for an authority higher than the strong influence of COD customers.

M. F. Educational Circular No. 262 of NYSE, May 28, 1969, dealt with ways of reducing COD DKs. On February 26, 1970, NYSE sent a letter to officers in charge of operations of member firms reporting on a study of DKs for a six-week period. The statistics as to the causes of rejections of COD deliveries were later summarized in the NYSE publication "Perspectives on Operations", May 1970. "Standing instructions" were suggested as the solution to the "no instruction" problem.

BASIC's Task Force started to look into the COD DK problem in the second quarter of 1970. While DKs had receded somewhat from the rate in the late 60s, they remained a serious problem. Moreover, they were the source of recriminations among the banking and securities industries and COD customers—charges and counter charges as to who was to blame, allegations of deliberate DKs by banks to create collateral loans, or deliberately late instructions by customers to create a money float, etc. It was an atmosphere that could be dissipated, if at all, only with some objective fact finding.

BASIC's 1970 research

The Task Force set out in June 1970 to collect data on the magnitude of DKs and their relationship to total COD deliveries, the timeliness of instructions from customers to settling agents, and any other information pointing to faults in the total system that produced DKs.

Through the cooperation of three large agent banks and four large brokers in New York, some 11,000 COD deliveries taken in by the three banks, and 1,700 such deliveries by the four brokers, during the week of June 22, 1970, were analyzed. The timing of receipt by agent banks of instructions from customers to settle was also tabulated, as was the communication method.

The study indicated that between 16% and 25% of the COD deliveries to banks were rejected. About 9% were turned down because of lack of customer instructions. Over half the customers' instructions to pay against delivery were received by the banks too late to settle on settlement date. (A high percentage of deliveries were being presented after the settlement date; if *all* had been presented on T+5, obviously the DK rate would have been huge.) Mail was the dominant method to communicate instructions to pay cash against delivery, but wire and telephone dominated when the customer was to receive cash on deliveries out. A limited study showed that brokers' confirmations were often reaching customers too late for the latter to issue timely instructions.[8.9]

[8.9] The foregoing and other date are presented in a BASIC discussion paper entitled "Reducing the Rejections of Deliveries Against Payment Because of Lack of Instructions (DKs on COD Deliveries)", December 1, 1970. Reproduced in *Senate 1971 Hearings,* pp. 393-402.

In August 1970, the Task Force drafted its first position paper on the COD DK problem and potential solutions. The paper briefly summarized the pros and cons for the most important partial or total solutions that were being advanced, namely: abolish the COD privilege; extend settlement date; speed up communications; and require standing instructions. The draft proposed that the solution to DKs consist of a progression of steps:

1. Brokers give each confirmation a unique transaction number and have confirmations in COD customers' hands not later than the day after trade;
2. Customers have instructions in agent banks' hands by specified times before settlement date;
3. Customers give agent banks standing instructions to settle on the basis of a copy of the broker's confirmation if specific instructions to the agent bank are not timely;
4. Agent banks equip themselves to settle COD transactions in accordance with the foregoing; and
5. That rules and regulations requiring the foregoing be adopted, as appropriate, by the exchanges, NASD, the Fed, and the SEC.

The August draft was revised monthly based upon discussions with brokers, exchanges, banks, the Fed, and customers. Each proposed step had both critics and sponsors. At the request of some, DKs by brokers were researched in September 1970 and a discussion of them added to the paper. Where critics were violent, like some who opposed standing instructions, the Task Force invariably asked them to come forward with better alternative solutions. None could.

In October discussions with bankers, the latter pointed out that the proposed solution could result in presentation of confirmation and securities as to which a bank had no prior notice, with payment expected on the same day. The banks stated that they could not process such same-day settlements in any volume. A footnote was added to the position paper having the effect of giving banks, if they needed the time, 24 hours to settle these transactions.

The BASIC Committee approved dissemination of the discussion paper at its November 24 meeting. It was published under date of December 1, 1970 (see footnote 8.9) and about 1,200 copies disseminated. A press release of December 7 announced the publication (Appendix HH).

By the end of January 1971, the Task Force had received written and oral comments (some 16 in writing) about the various steps in the proposed solution. A consensus of reactions appeared to be about as follows:

Solution in discussion paper

	Brokers	Bankers	Customers
1. Brokers give each confirmation a unique transaction number	Object	Agree	Neutral
2. Brokers' confirmations or trade data in customers' hands on T+1, using faster communications than mail	Object	Agree	Agree
3. Customers give specific instructions to agent banks to settle	Neutral	Agree	Agree
Such instructions to meet deadlines before settlement date, using faster communications than mails	Agree	Agree	Object
4. Customers give standing instructions to settle on the basis of brokers' confirmations	Agree	Object	Object
5. Even with standing instructions, banks may DK (for 24 hours) transactions coming to them without prior notice	Object	Agree	Agree
A. Brokers give banks advance confirmation so that latter may be prepared to settle under standing instructions	Agree	Object	Object

Many individual and group conferences with the Task Force took place in the first two months of 1971 about the DK problem and its solution. On February 3 there was a meeting with ASEF's Operations Committee. On February 23, 1971, the Task Force held a meeting attended by representatives of all three of the groups involved—brokers, banks, and COD customers.

The conclusions of the Task Force from reactions to the December paper were summarized in a memorandum dated March 5, 1971 (attached as Appendix II.) The principal ones were these:

> "There is fairly widespread agreement that communication delays are the major contributor to the current COD DK problem. It would seem to follow that, even if standing instructions were universal, the broker-customer-bank communication would have to be fast enough for the customer to correct errors and misunderstandings in the trade. Otherwise, these would carry through the settlement, and give rise to cost and disruption in their correction.

The starting point in eliminating COD DKs, therefore, should be the speeding up of trade data from brokers to customers, and of instructions to settle from customers to agent banks.

Many believe that these steps alone can be made to solve the problem, and that brokers, customers, and agent banks should be given an opportunity to show that this is so. This school of thought is sufficiently strong and widespread that it deserves a trial over a period of several months.

Many others — particularly in the brokerage community — believe that the COD DK problem cannot and will not be solved until standing instructions are a universal requirement for COD transactions. The trial of faster communications as a complete solution should be undertaken by the parties involved in the light of this important body of opinion. What this means, in short, is that if a communications speed-up does not solve the COD DK problem, then there would appear to be no alternative to making standing instructions a requirement for COD transactions. And, to be effective, this would probably have to be by government regulation."[8.10]

The memorandum recommended that (a) the exchanges and NASD adopt rules requiring fast transmission of broker confirmations to customers and customer instructions to agent banks, and (b) that BASIC's Task Force measure the impact of these rules on transmission speeds and DKs for several months.

The Committee adopted the foregoing recommendations at its March 24, 1971 meeting, and AMEX and NYSE promulgated the required rule within the next two months.

BASIC's 1971 research on communications and DKs

A memorandum was prepared under date of April 5, 1971 outlining a research program to fix responsibility for COD DKs in the forthcoming months (attached as Appendix JJ.) The program would answer three questions: When do customers receive brokers' confirmations? When do agent banks receive customers' instructions? And, what is the DK trend? This information should, in addition to fixing responsibilities, show the impact of the new rules being adopted by the exchanges.

The Investment Company Institute cooperated by arranging to obtain from more than a score of its non-New York members the times when they received brokers' confirmations. The statistics were tabulated by ICI—by broker name—and furnished to BASIC for one week in each of June, July, and August 1971. Under arrangements by the American Bankers Association, a number of non-New York banks provided similar information for October, as did one New York bank for August.

Ten large New York brokers provided the Task Force with DK information for one week each of May, June, August, September, and October 1971, including copies of

[8.10] Appendix II pp. 5-6.

delivery bills and reclamation forms. The latter two forms enabled the Task Force to identify the type of bank customer involved in DKs.

Ten NYCH banks cooperated by providing statistics on time of receipt of customers' instructions, identified by type of customer, for one day each of the months of June-October, inclusive.

The size of the foregoing sample is indicated by these statistics of coverage: Deliveries totalling $2.1 billion; DKs totalling $125 million; timing of receipt of 7.8 thousand brokers' confirmations, and of 19.4 thousand receive and 14.7 thousand deliver instructions.

Statistics derived from the foregoing research were summarized monthly and presented to the Committee. An overall summary was contained in Appendices A, B, and C accompanying the final report on the COD DK subject, which is attached as Appendix KK. In general, there was not much improvement during the period covered in timing of communication via brokers' confirmations or customers' instructions, nor in the incidence of DKs.

Toward the end of the Task Force's 1971 research, it seemed that mere statistics did not particularize enough who did what to cause DKs. A new tack was developed. About 50 apparent DKs were selected at random and, with the complete cooperation of all parties involved, an attempt was made to trace the transactions through their course. Sufficient information was obtained to reconstruct the story on 27 of these items. As the final report on COD DK's stated:

> "In this admittedly very small sample, quite a variety of things happened to bring about the DKs, as Appendix D shows. The principal contributors to these DKs, however, would appear to have been.

	No	%
Brokers	12	45%
Customers	9	33
Agent (settling) banks	6	22
	27	100%"[8.11]

The final position paper on COD DKs, dated December 15, 1971, contained the same recommendations as in the discussion paper of a year earlier, except for the 24-hour delay permitted banks on an item presented to them of which they had no prior notice. The Committee's recommendation stated:

> "We repeat and confirm the essence of the recommendations contained above. However, the DK problem having been placed before the financial community through the discussion paper for more than one year and the New York and American Stock Exchanges having adopted rules regarding the timing of communications from brokers to COD customers and from COD customers to clearing agents, we believe that the timetable for the steps recommended in the discussion paper can be accelerated, and urge the appropriate regulatory bodies to do so."[8.12]

[8.11] Appendix KK p. 8.

[8.12] Appendix KK p. 2.

In adopting its final recommendations, BASIC had in effect concluded that COD customers were the kingpins in solving the COD DK problem. It was they who were in a position to demand the appropriate performance from both brokers and agent banks. They would do this, the Task Force believed, if they were required to issue standing instructions to agent banks to pay on the basis of a copy of the confirmation of named brokers accompanying the securities. However, it appeared that none other than a federal authority could impose such a requirement.

Placing the COD DK solution before the FRB and the SEC

The December 15 report with recommendations of BASIC was transmitted on December 23, 1971 to appropriate staff of the FRB and the SEC. There ensued correspondence about BASIC's DK solution over the next six months between the Executive Director and Miss Janet Hart, Assistant Director, Division of Supervision and Regulation of the Fed, and Irving M. Pollack, Director, Division of Trading and Markets of the SEC. (The principal letters are attached as Appendix LL.) The major points dealt with in these letters are summarized below.

Hart letter of March 3 and Executive Director's reply of March 17, 1972 – Hart expressed concern about not giving the customer an opportunity to disavow erroneous deliveries that otherwise would settle under standing instructions. The Executive Director pointed out how the customer could protect himself by insisting on faster communications.

Hart letter of May 11 and Executive Director's reply of July 6, 1972 – By May, the Fed staff had canvassed a number of member banks across the country about BASIC's solution. Opposition to standing instructions was expressed (as it had been to BASIC's Task Force). It was pointed out that the mails were too slow, and alternative wire transmission systems not adequate, for customers to receive confirmations in time to furnish agent banks with specific instructions by the established deadlines.

The Executive Director agreed that mails must be forgotten in a solution of the DK problem. As to availability of faster communication methods, he pointed out that both buy orders and reports of executed trades are usually communicated by telephone or wire. He added: "It has seemed to us reasonable to question whether fast communications technology adequate for, and used by, the 'front office' cannot be the same for the 'back office' ".

Pollack letter (undated, probably latter June) and Executive Director's reply of July 11, 1972 – Pollack transmitted copies of 11 letters from non-New York City banks (identities removed) that had been received by the Fed staff. Comments on these letters were requested. Again, reservations were expressed about mandatory standing instructions.

The Executive Director's reply commented on the questions which regulators had to face and answer. An accompanying memorandum picked out the principal points made in the eleven letters and responded to them. The letter concluded:

"I have talked about one or more potential procedures or actions that might be prescribed by regulation as an attack on the DK problem. In each case, enforcement is a problem. This is why we came to the conclusion that, regardless of other details included in regulations, a universal requirement for standing instructions would ultimately be required. Then, the COD customers' 'enforcement' of fast communications, if for no other reason merely to protect themselves from faulty settlements, would be more effective than all possible policing by governmental agencies."

There being no further correspondence on solving the COD DK problem, the Executive Director wrote to direct to the Federal Reserve Board and the Securities and Exchange Commission under date of November 3, 1972. After itemizing the past correspondence, the letter stated:

"I have heard of no further action on the COD DK subject since Mr. Pollack's letter — some four months ago.

One of the recommendations in BASIC's solution was —

> 'That rules and regulations requiring compliance with procedures to solve the COD DK problem be promulgated by the . . . Federal Reserve Board, and Securities and Exchange Commission, as appropriate.'

Here is a case in which, contrary to positions taken in other areas, an important part of the private sector has agreed that direct government action is needed as a part of a solution to an important securities industry problem. BASIC, a group of responsible people, has worked on the problem, unanimously agreed upon a solution, and referred the solution to the government for implementation steps which are beyond the powers of the private sector.

I suspect that the delay is because government agency people have found that BASIC's solution is controversial and that no noncontroversial solution to the COD DK problem has surfaced. If so, I can understand it; some members of BASIC voted for its proposed solution with considerable reluctance, and only because diligent search had uncovered no better solution.

It seems to me that ten months is a long time for a regulatory agency to have before it a problem within its jurisdiction which is important to the securities industry without any definitive steps to resolve it. I hope that you can secure prompt action."

No response was received from the SEC. Under date of November 17, 1972, Mr. Frederic Solomon, Director of the Division of Supervision and Regulation of the Fed wrote requesting comments on seven potential proposals of rules on the COD DK problem. The Executive Director responded under date of November 30, 1972 with a letter and accompanying memorandum. (These are also included in Appendix LL.)

No further word was heard from the two federal agencies on implementing solutions to the COD DK problem.

This is a minute of the Committee's December 1972 meeting:

"The Chairman and Executive Director reported that BASIC had done everything possible to get the regulatory bodies, particularly the Federal Reserve Board and the SEC, to implement an effective COD DK solution as recommended by BASIC. The bankers on the Committee recalled that they endorsed the solution in spite of opposition from many on their own staffs because they felt there was no alternative solution."

Applying modern communications technology to the DK problem via depositories

BASIC saw two separate studies of a sample of COD deliveries around mid-1973 indicating that DKs ran about 2-2-1/2% of the dollar amount of deliveries. This was half or less of the DK rate shown by BASIC's studies in 1971. It is not known whether the improvement is attributable to lower transaction volumes, or improved procedures from spotlighting the DK problem, or both.

In any event, DTC in 1973 developed and commenced pilot operations on an "Institutional Delivery System" that uses advanced communications technology for COD transactions. The system uses DTC to connect broker, COD customer, and agent bank to perform these functions (by wire, if the customer is out of New York City): capture the transactions from the broker and confirm it to the customer; lock in confirmed transactions with a notification to the agent bank; and effect delivery to or from the agent bank by book-entry on settlement date or as directed otherwise by the deliverer. This system would perform the function for broker-customer transactions that exchange clearing corporations perform in part for broker-broker trades.

DKs would be eliminated. Of course, use of the system would have to become very widespread before all or most DKs were eliminated. However, the experiment is another illustration of the potential of depositories for knitting together various members of the financial community in the use of advanced technology to solve securities transaction problems.

STUDY OF ELECTRICAL COMMUNICATIONS IN RELATION TO A CSDS

A concept of a wire network connecting all important members of the financial community, to be used to complete securities transactions by electrical communication, antedated BASIC. This possibility was also very much in the mind of the Task Force during its work on uniform forms and other matters. However, it was obvious that change toward such a radically new system would have to take place step-by-step, with careful planning and execution of each step.

CCS was already breaking the ground in the use of modern communications technology. Commencing in 1968 it piloted, then debugged and, by 1971, had success-

fully implemented the exchange of data on magnetic tape between CCS and its odd-lot-broker participant to effect delivery and settlement for odd-lot transactions, which ran to a very large volume. Commencing in 1970, CCS developed an extremely important expansion of communications via magnetic tape – its "PDQ" system. Under PDQ, tapes produced by SCC (later SIAC) are reviewed by brokers to eliminate deliveries that they will *not* make on settlement date (the "exception technique"). CCS (later DTC) then used the revised SCC tapes to make computer book-entry deliveries between brokers by 8 A.M. on settlement day. PDQ had been debugged by, and was implemented about, March 1972. By latter 1973, it was obviating the preparation of about 1.75 million documents per month.

To the Task Force, a depository could become a hub with spokes running to broker/dealers, clearing corporations, other depositories, transfer agents, and bank, insurance company, and mutual fund participants. Thus, a depository would be in an ideal position to work out the greatest practible use of modern communications technology in the settlement of securities transactions by the entire financial community.

The Task Force in early 1971 commenced asking itself questions like these: Are there electrical communications systems in the banking or securities industries, or elsewhere, that could be used by a CSDS to speed or automate the securities transaction consummation process? Are any such systems being planned or developed? Is there anything that BASIC can do now—and the CSDS later—to coordinate the development of any of such systems so that they could be useful and used in a financial-community-wide securities transaction system?

Commencing in May 1971, members of the Task Force visited and familiarized themselves with a number of communications systems, including: NYCH's CHIPS, NASD/Bunker Ramo's NASDAC, FRB's Fed Wire (and national switching center at Culpeper), bank-Western Union's Bank Wire, SIAC's SECTOR, NYSE's BAS, some wire systems of large brokerage firms, IBM's Programmed Airline Reservation System "PARS", and one or two others. At the instance of John Lastavica of the First National Bank of Boston, the Executive Director and Task Force held an all-day meeting on May 20, 1971 with a group of communications experts put together by Lastavica. Many technological solutions to communications problems were discussed.

The Task Force concluded from its exploratory work that there was indeed a possibility that a CSDS could be a focal point in expanding the use of electrical communications in the processing of securities transactions. However, it felt that, in carrying the study further, communications experts were needed.

At its meeting on September 22, 1971, the Committee approved the formation of an "Ad Hoc Communications Committee", to be comprised of experts from organizations sponsoring BASIC. This committee was formed within the next few weeks, consisting of:

Name	Affiliation
Richard G. Mills, Chairman	First National City Bank
Armand Keim	AMEX
V. Reed Manning	NASD
L. Roger Smith	NYSE
Louis Zimmerman	Chase Manhattan Bank

Members of BASIC's Task Force assisted the committee in fact finding and other research, coordination, and drafting.

The Committee worked at its task over a period of some four months and issued its report of some 50 pages under date of March 17, 1972.[8.13] Some indication of the scope of the study may be gained from its table of contents:

[8.13] "Applicability of Electrical Communications Within a Depository System", reproduced in *Senate 1972 Hearings,* pp. 535-585.

Table 1 – Network Requirements for 50 Largest NYSE/ASE Brokers
Table 2a – Network Requirements for 47 of the 56 Largest Banks
Table 2b – Network Requirements for the Nine Largest N.Y. Banks
Table 2c – Monthly Network Cost for 56 Largest Banks (Using customized bank network)
Exhibit IV – Customized Bank Network Map
Table 2d – Monthly Network Cost for 56 Largest Banks (Using 1006 line type replacing the 1005 line type in Table 2c)
Table 3 – Line Requirements for 12 Largest Non-New York Transfer Agents
Table 4 – Transfer Volumes for 15 Largest New York Transfer Agents
Table 5 – Line Requirements for Inter-Depository Deliveries
Table 6 –Monthly Cost of Transfer Agents and Depositories Tandem Dial Private Line Network
Exhibit V – Transfer Agents and Depositories Tandem Dial Private Line Network

Appendices

A. Communications Objectives
B. A Description of the Depository System
C. Feasibility of Using Existing Systems
D. Teleprocessing "Front End" Costs

The Ad Hoc Communications Committee concluded that there was a distinct potential for benefits, including sizeable cost savings, from expanded use of electrical communications between a CSDS and the members of the financial community with which it communicated. Part of the report reads:

> "This document is the report of a working group . . . set up by BASIC to study the possible applicability of electrical communications as an adjunct to the central certificate depository system in aid of the settlement process. The Committee considered possible use of a number of existing communication systems and produced a recommendation, evolutionary in approach, for realization of appropriate communication facilities. It also developed an implementation concept for an initial two phases of such an approach, identified some of the areas of potential savings, and assessed their approximate magnitudes.
>
> The system as proposed is extremely conservative in terms of innovation and exploitation of high technology; it is one that the Committee believes is amenable to practical implementation in the immediare future and extension to a more elaborate and 'automatic' form at an appropriate later time. It is expected that the system evolution will not stop at that point; the Committee recognizes that however accurate may be the data upon which are based the recommendations described in later sections, the actual traffic patterns and information flows once a network is in place are likely to be other than anticipated and to change with shifting and growing use of the depository

system. We have deliberately been relatively modest in the magnitude of the innovative steps recommended in the initial phases with an eye to future development of more sophisticated systems, measurements on and experience with the simple facilities that we propose.

It has been a key objective in producing the work reported here to assure that no design decisions are permanently preempted and that a minimum of possible paths are closed off by the actual implementation of the communication facilities proposed here.

Even if accepted and implemented to the letter, the specific recommendations that follow permit and in fact encourage the Depository and its users to:

1. Experiment; for example, in 'piggy-backing' Depository needs on other communications systems that are already in existence or that may appear from time to time.
2. Develop further the requirements for an overall communications system customized for the Depository's needs.
3. Develop and implement additional standards that would facilitate the automation of the Depository making it less dependent on clerical operations."[8.14]

The Ad Hoc Committee's report was circulated widely, with comments solicited. Reactions were uniformly favorable, with several organizations expressing the desire to participate in any implementation phase.

The evolutionary approach in expanding the use of electrical communications appears wise. It is real-world. Regardless of when the optimum securities transaction processing system is reached, it will have been reached step-by-step. And some steps, as described earlier, are already taking place. In addition to those mentioned, at year-end 1973 DTC was known to be exploring the technical aspects of input-output terminals on participants' premises for effecting transactions by direct connection with DTC's computers, as well as for interrogating the computers as to a participant's security position, cash settlement position, etc.

STUDY OF COMMUNICATING TRANSFER INSTRUCTIONS VIA MAGNETIC TAPE

While a CSDS was expected to reduce the volume of transfers materially—and has—it is also expected that the transfer of certificates into private names will continue in some volume for years to come. Transfer instructions are in hard copy, some produced by computer but others manually. While BASIC's uniform transfer instruction form standardized information and format, this did no more in advancing the use of electrical communications in the transfer system than pave the way.

The Task Force began considering the possibility of using modern communications technology to convey transfer instructions around the middle of 1971. Discussions with

[8.14] *Op. cit., Senate 1972 Hearings,* p. 543.

several transfer agents, brokers, and others developed support for a study of this subject. As a result of these encouraging explorations, in November 1971 the Ad Hoc Transfer Standards Committee was formed, consisting of:

Name	Affiliation
Bertram W. Roberts, Chairman	Morgan Guaranty Trust Company
Nicholas Arrigan	NYSE
John J. Britt, Jr.	Merrill Lynch, Pierce, Fenner & Smith, Inc.
Glenn A. Deppler	First National City Bank
Charles J. Horstmann	NYSE
Leonard J. Mastrogiacomo	Manufacturers Hanover Trust Company
Robert J. McCausland	Shields & Company
James E. Osborn	General Motors Corporation
H. Frank Pearson	Donaldson, Lufkin & Jenrette, Inc.
George R. Reis	Bache & Company
Frank W. Shelton	American Telephone & Telegraph Co.
George C. White, Jr.	Chase Manhattan Bank

Members of BASIC's Task Force provided liaison, drafting, and other assistance to the committee.

The transfer standards committee worked about five months with CCS, brokers, and transfer agents. The research was as to feasibility and potential benefits of magnetic tape transfer standards and, having reached affirmative conclusions regarding these, the standards that would have to be agreed upon and used to make the system work. The scope of the committee's work is best indicated by the table of contents of its final report:[8.15]

I. Summary

II. Introduction

1. Background
2. Formation of Committee and Objectives

III. Benefits

1. Brokers
2. Transfer Agents
3. Depositories

IV. Standard Magnetic Tape

Physical and Magnetic Characteristics

V. Tape Labels

1. Reason
2. External Labels
3. Internal Labels

[8.15] "A Proposed Standard for Transfer Instructions on Magnetic Tape", June 30, 1972, attached as Appendix MM.

VI. The Standard Format

1. Introduction
2. Standard Segments – Illustrated
3. Samples of Formats
   A. Broker – Depository
   B. Depository – Transfer Agent
   C. Transfer Agent – Depository

VII. Name and Address Standards

Introduction to Clearing House Procedures
SECTION A – Uniform Stockholder Description
SECTION B – Uniform Stockholder Addressing

VIII. Storage of Transfer Instructions

IX. Appendices

1. Coding Information
2. Denomination Table
3. Transfer Taxes

The approach of the committee is best indicated in these words from the report's summary:

"This transfer standard could be the first of many standards concerning other phases of communication between members of the banking and securities industry.

Since the publication of the American Bankers Association's Securities Imprinting and Processing (SIP) Task Force report in 1970 there has been general agreement on the need for standards within the banking and securities industry to expedite securities processing. To meet this need the Banking and Securities Industry Committee (BASIC) in December 1971 recommended the adoption of four uniform forms as a logical first step. These forms were then made mandatory by regulatory bodies within the industries. A logical second step would be the adoption of standards to permit direct delivery of the information on the forms but in machine language between the sender's and receiver's computers.

To this end, BASIC formed the Ad Hoc Transfer Standards Committee which studied the matter and produced this Report. The Report recommends the adoption of a standard for delivery of magnetic tape transfer instructions between brokers, banks, and other members of the financial community, and depositories and transfer agents. The Report takes a permissive, evolutionary approach, suggesting that firms be encouraged to use magnetic tape for transfers on a strictly voluntary basis. It is worth noting that universal acceptance of the standard is not necessary for its success since a relatively small number of brokers and agents accounts for the major portion of private name transfers discussed in this paper. The Committee believes that the benefits to users far

outweigh any conversion effort required to conform to the standard and that most firms will embrace its use. The Committee also believes that the investing public will be the ultimate beneficiary by virtue of improved transfers and more efficient service.

The Committee envisions that standard magnetic tape transfer instructions would be submitted by a depository member to a depository. The depository would, by issue, debit the member's account, sort and merge other members' instructions into a new tape and forward the new tape to the transfer agent along with a depository jumbo certificate. The agent would then use the tape to credit the shareholder, issue certificates and return both the certificates and a magnetic tape with details of the issuance to the depository for redelivery to the member."[8.16]

The report was given the same wide dissemination as other reports. Members of the Ad Hoc Committee and of the Task Force held a number of group meetings with brokers, bankers, and transfer agents as to potential costs and benefits from the report's recommendations. Positive steps toward implementation have not taken place.

Among the standards covered in the committee's report is that for names and addresses. Conversion of these to a strict universal standard in computer files would be expensive for large financial houses. Standard message formats are also outlined. These specify the use of standard codes, such as CUSIP, FINS, and Taxpayer ID numbers. Whether or not a system involving the communication of transfer instructions via magnetic tape is ultimately found to be economically feasible, the standards that it would use are going to be needed in the ultimate transaction consummation system.

* * * * *

This chapter had dealt with some steps toward a system for the automated processing of securities transactions – in additional to the computer book-entry securities deliveries of depositories themselves. It has dealt with only "some steps", for there will also be others as the securities transaction consummation process is improved. While some of BASIC's work has covered the detail required for implementation, other work is no more than exploratory.

What BASIC has not done is develop the grand securities processing systems design for the nation's entire financial community, neatly tied up under one cover. Many decry this – particularly some consultants. They believe that the national plan must be rather specific. Otherwise, how does one know that a given step will or will not mesh with others in the ultimate system?

Developing the written national plan as the first step would be interesting, but not very rewarding. There is considerable agreement as to what the ideal securities transaction processing system should be like. The 1969 systems research (see Chapter I) covered the waterfront. What is needed now is the painfully slow, evolutionary, step-by-step, process of doing – not studying.

[8.16] *Ibid*, p. 1.

Once BASIC decided that the CSDS showed the greatest promise from among alternative systems in alleviating the paperwork problem, the way was cleared to use the CSDS as a focal point for many other moves toward the ideal system. The enormous head start that the NYSE had given a potential CSDS, by developing CCS into a successful operation, meant that BASIC could immediately start *building.*

True, the CSDS would not touch all the elements of the ultimate securities handling and transaction processing system, but it would deal with such a large portion of the global problem that its leadership influence would undoubtedly be pervasive.

IX

EXPLORING A SYSTEM BASED UPON THE MACHINE-READABLE CERTIFICATE

Contents

IX

EXPLORING A SYSTEM BASED UPON THE MACHINE-READABLE CERTIFICATE

The SIP Committee's work

By the time BASIC was formed, work on a machine-readable stock certificate had been going on almost four years. The ABA's Security Imprinting and Processing ("SIP") Task Force was established in June 1966 as an adjunct to the CUSIP Committee. Its original specified objective was to "develop specifications for a format for imprinting the identification number and description on the certificate in a man-machine readable type font". As SIP explored its subject, it added other information to be included in machine-readable font.

SIP issued a "Status Report" in July 1968.[9·1] The report outlined extensive exploration of optical character recognition ("OCR") type font on 8" x 12" certificates (the most common size) and its readability by existing OCR equipment. This exercise disclosed a number of problems and raised a number of questions. As a result, the report stated that the SIP Task Force "unanimously agreed that the most logical approach would be the development of a reduced size standard format for a certificate . . ." The size would be that of a punched card, and 22 columns of punching would be provided for. The preparation of standard transfer instruction, trading and delivery confirmation forms — with provision for OCR — was reported to be in process.

After the July 1968 Status Report, SIP spent much time and effort in exploring an engraved certificate of punched card size. Specimens were produced and tested. Brokers were canvassed for potential cost/benefit realizations. Problems that surfaced were explored. SIP issued its "Report and Recommendations" under date of June 1969.[9·2] Its principal recommendation was stated at the outset of the report:

> "The Security Imprinting and Processing Task Force recommends that the securities industry support the adoption of a man-machine readable document, a standardized punched card certificate with provision for optical character recognition. General specifications for the proposed new certificate are outlined in this report. The urgent need for this implementation cannot be overemphasized.
>
> The SIP Task Force also recommends that the Stock Exchanges, who are responsible for setting the rules governing the design of a certificate, establish a joint task force charged with the responsibility for finalizing the certificate specifications. The final specifications should then be reviewed and tested, particularly with respect to document security and processability, prior to adoption."[9·3]

[9·1] Reproduced in *House 1971 Hearings,* pp. 1987-1995.

[9·2] Reproduced in *House 1971 Hearings,* pp. 1960-1970.

[9·3] *Ibid,* p. 1961.

SIP was considering in its work a financial-industry-wide system for processing securities transactions. It appeared to conclude to recommend a new system based upon OCR and punched card processing as an alternative only to the certificateless society. Its report contained this statement:

> "The work of the Task Force soon evolved into a three phase standards program involving the certificate, the broker confirm/comparison form, and the transfer instruction form. The membership of the Task Force concluded that standardization of these forms, with encoding of the pertinent information in a man-machine readable font to permit automated processing of the documents, would be a significant factor in resolving the operating problems of the securities industry. This standards program should form a firm foundation from which new security processing systems can be built.
>
> At the outset, it was recognized that one solution to the problems in the security processing cycle was the complete elimination of the certificate. However, the Task Force agreed that the legal questions, the problem of public acceptance and the major changes in the present concept of security handling which would be required, made the attainment of a 'certificateless' society far in the future. It was felt that the industry needed more realistic and attainable tools to cope with their present and future problems in the face of continuing high volumes of activity. In addition, even in a 'certificateless' environment, instruction and advice forms would still be required. Therefore, it was generally agreed that the paper flow benefits from the elimination of certificates could be achieved almost as closely through the development of a standard format instruction form and certificate which could be machine processed."[9-4]

The potential alternative system based upon immobilization and book-entry via depositories may have been considered but, if so, was not discussed.

The NYSE, following through on the SIP recommendation, wrote to banknote companies in September 1969. The letter requested opinions as to the relative security against counterfeiting of the card- and page-size certificates, whether there were any effective substitutes for engraving of certificates, and estimates as to length of time for banknote companies to convert all present cettificates of customers from the larger to the smaller. Responses to the NYSE varied rather widely on each of the points inquired about.

At least one corporate issuer was pressing NYSE in the latter part of 1969 to allow it to commence issuing punched card certificates in actual circulation as a pilot project. Its transfer agent, a large New York bank, endorsed the experiment from the standpoint of assessing the impact on its own operations.

The NAR AMEX study of September 1969 endorsed the concept of machine-readable certificates and supporting documents, but recommended certain further work before the particular form of certificate or document was specified.[9-5]

[9-4] *Ibid,* p. 1965.

[9-5] See *House 1971 Hearings,* p. 2131.

The NYCH Special Committee study made much the same recommendation.[9.6] The Lybrand study considered the page- and card-size machine-readable certificate and advised against both.[9.7]

In January 1970, the NYSE sent a letter to manufacturers of OCR equipment regarding the ability of their equipment to read OCR characters on the SIP certificate, with some related questions. (A more comprehensive questionnaire on this and other subjects had been sent to manufacturers by ABA on behalf of SIP in 1968.)

A few manufacturers responded that their equipment could read the OCR characters on the SIP certificate as is, but more companies pointed to changes that would have to be made in the certificate or their equipment.

BASIC's initial explorations

It is evident from the foregoing recital that an enormous amount of work — mostly by SIP, but some by others — had been done on the machine-readable certificate by the time BASIC was formed in March 1970. By then, there was a wide consensus that the certificate and accompanying documents should be machine-readable. This was so persuasive on BASIC that, in the position statement adopted at its March 25, 1970 meeting, this statement was included:

> "We have already stated our position on immobilizing the certificate. For documents necessary to effect securities transactions, as well as for such certificates as must continue to move, we give high priority to arriving at, and recommending for universal adoption, a system for the man-machine-readable stock certificates and supporting documents which move between the securities and banking industries."

The principal questions being asked about a system based upon machine-reading when BASIC entered the picture were: Is OCR technology ready for the stock certificate problem? Should a machine-readable certificate be page-size or card-size? Would benefits outweigh costs if the banking and securities industries converted securities handling and transaction processing to a system based upon machine-reading equipment?

At its April 22, 1970 meeting, the Committee authorized the retention of NAR to update the state of development of OCR equipment. NAR was asked to concentrate on equipment that could read OCR on page-size certificates (it being believed that any equipment that could do this could also read OCR on the card size). NAR submitted its 30-page report in July 1970.[9.8] A key conclusion in the report was that:

> "This survey has established that equipment exists which can read OCR from typical stock certificates."[9.9]

[9.6] See *Ibid,* p. 2001.

[9.7] See *Ibid,* pp. 2249-2253.

[9.8] "OCR Equipment for Reading Stock Certificates — Report to the Banking and Securities Industry Committee", reproduced in *House 1971 Hearings,* pp. 1971-1987.

[9.9] *Ibid,* p. 1981.

Besides the NAR work, during some four months commencing in May 1970 the Task Force researched a number of aspects of machine-readable certificates and related systems. Some of the work was covering ground already treaded by others, such as consulting experts about counterfeiting as SIP and the NYSE had done. Like others before, the Task Force consulted banknote companies as to the time and cost to convert to three new certificates: a punched card size; an 8 x 12 with an OCR strip on the back; and an 8-1/2 x 12 with an OCR strip on the front. The Task Force also explored the feasibility of placing an OCR scan line or lines in the open throat of 8 x 12 certificates.

The Task Force spent considerable time on the system that would be built around the machine-readable feature of the certificate. For this purpose, it spent much time in the operations areas of six brokerage firms, one bank, four bank transfer agents, two corporate transfer agents, and two bank registrars. Consultations with the three largest banknote companies were almost continuous. Potential procedures, costs, benefits, problems, etc. were gone into in detail. All of those consulted were most cooperative.

The possibility was explored that the stamps, endorsements, guarantees, etc. could be reduced in size so at to be reasonably contained on the reverse of a card-size certificate. Included were informal discussions with transfer tax authorities. They were sympathetic to working out a change. An independent expert was retained to pass judgment on banknote companies' estimates of time and cost to convert to new types of or variations of certificates.

In July 1970, the Task Force prepared the first draft of a position paper on the machine-readable certificate and circulated it to members of the Committee. The draft went through revisions to accommodate suggestions received as well as additional information obtained. The Committee approved publication of a discussion paper, with changes, at its meeting on August 26, 1970.

Reaction to the discussion paper

The printed discussion paper, entitled "Making the Certificate Machine-Readable", was published under date of September 9, 1970.[9.10] About 1,500 copies were distributed.

The scope of the paper is indicated to some extent by these headings:

The problem

Recommendation

Discussion

Recent studies of the certificate

The approach taken to evaluate the options as to certificates

Current availability, cost, and performance of OCR equipment

[9.10] Reproduced in *House 1971 Hearings,* pp. 1869-1887.

Security against counterfeiting, loss and theft of the certificate

Machine processing of certificates and other documents by brokers and banks – procedural considerations; benefits
- Machine-reading considerations
- Brokers
- Bank cages and vaults
- Transfer agent
- Registrars
- Summary

The operational problem of brokers and banks in converting to a different certificate –
- Handling and filing
- Affixing accompanying documents
- Interference with machine-readibility through mishandling
- Space on certificates for stamps, etc.
- OCR on the back of the 8 x 12
- Summary

Cost and time of banknote companies to convert to a different certificate

The prospect of immobilizing certificates in a central depository impinges on the decision as to the machine-readable stock certificate.

Conclusions

The certificate should be made machine-readable

The 8-1/2 x 12 certificate should be chosen over the other two options

Pilot tests of the 8-1/2 x 12 certificate should be commenced at the earliest possible date

The recommendation contained in the discussion paper was this:

"It is believed that, considering all surrounding circumstances, the best solution is to modify the existing 8 x 12 stock certificate to 8-1/2 x 12 so that it can include a line of OCR information containing the required fields of OCR data. This line of information would be imprinted on the enlarged top white border of the face of the certificate. The OCR information would be imprinted by the banknote companies and transfer agents as appropriate. (See Figure 3)

It is recommended that a pilot operation be commenced for a limited number of corporate issues using the new certificate. The machine-readability of these certificates after normal circulation should be carefully tested over a period of about 4 months. If the test is positive, then the new certificate should be adopted for universal use."[9.11]

[9.11] *Ibid*, p. 1875.

In the covering letter transmitting the discussion paper throughout the banking and securities industries, the above recommendation was clearly designated by the Executive Director as tentative, in these terms: "It contains a recommendation which I have under consideration for submitting to the Banking and Securities Industry Committee". Comments were solicited.

By October 30, 1970, 59 letters had been received commenting on the discussion paper. The comments were all over the lot, as is indicated by the following evaluation:

	Bankers	Brokers	Associations	Other	Totals
Supporting the SIP Card	1	7	3	2	13
Supporting 8 x 12 OCR on Back	1	2	1	1	5
Supporting 8-1/2 x 12 OCR on Front	4	7	1	2	14
Supporting "Do Nothing"	2	2	3	1	8
Supporting Other Positions	2			2	4
Comments Without Definite Position	3	2	2	3	10
Miscellaneous	2	1	—	2	5
	15	21	10	13	59

Evaluating readiness of machine-reading equipment for the certificate problem

One of the quickest and sharpest reactions to the September 9 discussion paper was a challenge as to the readiness of OCR equipment to read characters from stock certificates. This prompted the Task Force to make its own on-site tests of the performance of OCR readers during the fourth quarter of 1970.

Through the cooperation of banknote companies, transfer agents, and others, all three types of new certificates under study were imprinted with OCR characters — some printed by banknote companies, some by transfer agent computer printout, and some by typewriter. These certificates were run through OCR readers of all manufacturers who were offering such equipment.

All equipment tested initially had difficulties reading OCR characters on certificates (although the characters seemed clear to the human eye). After making some mechanical and other adjustments, an acceptable reading performance was obtained with two expensive readers, but not with those of low or medium cost. A "Research Report" dated February 2, 1971 (redated from December 14, 1970 after minor editorial changes) was issued on the foregoing investigations and other work described hereinafter.[9.12]

The conclusion in the report as to OCR equipment was as follows:

"Low and medium cost, say $10,000 to $100,000 (purchase), OCR equipment that would read certificates within acceptable performance limits of speed and

[9.12] Reproduced in *House 1971 Hearings*, pp. 1888-1892.

accuracy is not generally available yet. Such equipment is still in the prototype stage. It would seem to be in the range of two years before such units could be available in quantity, debugged and integrated into bankers' and brokers' certificate processing systems. Even then, there is a question as to whether some of the more promising units would be developed and marketed due to the aforementioned lack of incentive to vendors. Higher cost OCR equipment e.g. $150,000 purchase, is available today to read certificates. Because of its cost, however, it probably cannot be cost-justified until a fairly large percent of all certificates being processed are of the new type.

Considering the time it will take to conduct pilot tests, considering the quality control requirement of OCR and its probable effect on transfer agent time to start issuing new certificates, considering the time it will then take for the new certificates to permeate the industry in quantities sufficient to cost-justify the expensive systems available, taking these things into account, it would appear that 2 to 3 years would elapse before the OCR systems could be considered 'here' and working."[9.13]

The ability of punched card equipment to process engraved certificates of card size seems to have been accepted by most persons, including the Task Force, up to about October 1970. However, in response to questions raised by some, some 2,000 of such certificates were put through, over and over, conventional readers, punches, and sorters of three major card equipment vendors.

Unexpected problems developed. There were repeated misfeeds, and failures to feed at all, due to the friction from the engraved surfaces. A batch of card certificates that had been stored a year without temperature and humidity controls had warped too much. On some cards, a heavy buildup of ink from the engraving process smudged the cards. Mixing of regular and engraved cards caused feeding problems. The Research Report on this phase concluded:

"None of the problems encountered in the limited tests is considered insurmountable by any means. Undoubtedly all could be solved. What the tests do show, as one equipment manufacturer put it, is that engraved cards must be considered a 'new product'. Extensive tests of tens of thousands of card certificates produced in varying card stock thicknesses, and in varying ink thicknesses would be called for before final specifications are drawn. Production and testing would take some months. Based on the testing experience, both the card thickness and the amount of ink build up might have to be strictly controlled in the card manufacturing and engraving process.

As was brought out in the September 9 Discussion Paper, considerable time would be required for banknote companies to convert to production of card sized certificates (an estimated 2.6 years before certificates would be circulating in volume). The additional tests of an engraved card certificate as a 'new product' would extend this time."[9.14]

[9.13] *Ibid*, p. 1890.

[9.14] *Ibid*, p. 1891.

The potential use of magnetic ink character recognition ("MICR") on certificates to make them machine-readable had been considered – and discarded – by SIP. However, this question persisted in some of the comments on the September 9 discussion paper. Accordingly, so as to leave no stone unturned, the Task Force took this question directly to MICR equipment manufacturers. The Research Report summarized briefly the findings, which resulted in this conclusion:

> "MICR equipment could of course be developed to meet the certificate problem. However, again this would require time and money, probably more so than in adapting OCR equipment or punched card certificates. In the light of the promise of immobilization of certificates in depositories, MICR does not seem to be a promising path to pursue."[9.15]

The Research Report reached these general conclusions:

> "A. The stock certificate can be made machine-readable via OCR with an acceptable level of reading accuracy. However, this can only be done by taking great care in imprinting characters on the certificate and by incurring substantial costs.
>
> B. The punched card certificate, which at one time was believed to be a sure thing from the standpoint of processibility, has some bugs. These bugs would have to be eliminated through further experimentation and testing before a usable card certificate could be issued.
>
> C. Magnetic Ink Character Recognition for the stock certificate is not a promising approach for a number of timing, technical, and systems reasons."[9.16]

The decision to discontinue the machine-readable certificate project

All of the information obtained about machine-reading equipment and techniques was evaluated in early December 1970. The prospects of a favorable benefit/cost ratio from a system based upon machine-reading of documents was considered in relation to the prospects of immobilizing certificates in depositories. (Between September and December 1970, the probability that the financial community would get behind a CSDS had been increasing fast.)

Under date of December 14, 1970, the Executive Director sent the Committee a memorandum recommending that the machine-readable project be dropped. The memorandum stated in part:

> "I do not believe that it would be good judgment to pursue the machine-readable project further.

[9.15] *Ibid,* p. 1892.

[9.16] *Ibid,* p. 1892.

The reasons for this conclusion, set out briefly below, above all turn on timing. True, the job remaining to be done to make machine-readable certificate systems operative and effective on a wide scale is impressive: research and testing to develop precise specifications — which do not now exist — for engraved punched cards; further development, then production, of low-cost OCR reading equipment; conversion to a new certificate by banknote companies; investment in OCR imprinting and reading equipment by the banking and securities industries, and adapting their systems and personnel to it; and maintaining dual systems for new and old certificates until the old ones dwindle to a trickle.

However, all this could be judged to be well worth while if the period of benefit from machine-reading the certificate promised to be long. It does not. Immobilization in central depositories of the certificates that move can — and, I believe, will — cut the benefit period so short as not to amortize the cost and effort of developing a machine-readable system . . .

An ultimately successful machine-readable certificate system, as the foregoing discussion suggests, would require participation by: issuers, exchanges, banknote companies, equipment manufacturers, transfer agents, broker-dealers and banks. There is no question but that all of these parties could and would be joined together to make the system operative and effective if the machine-readable certificate were the best solution in prospect for the securities handling problem.

However, that is not the question. The question, rather, is *how quickly* a successful machine-readable certificate system could be brought into being. One essential for success of certificates to be read by OCR equipment would be that such equipment be available at a low enough cost to be economical for a large number of broker-dealers. I find it hard to believe that this could be under three years. A system relying on punched holes in card certificates would probably take longer. A large proportion of the certificates that move can be immobilized in central depositories within a year or two of the effectiveness of either system. The result is the prospect of an extremely short period to amortize a very large investment of time, energy, and money in making the certificate machine-readable and utilizing the resulting product.

In the light of the foregoing, I cannot justify recommending that the machine-readable project be carried further."[9.17]

BASIC's Task Force continued to be on the look out for innovations in man-machine-reading technology or equipment. Nothing came to its attention after December 1970 to cause BASIC to reactivate the machine-readable project.

[9.17] Memorandum entitled "The Machine-Readable Certificate Project", reproduced in *House 1971 Hearings,* pp. 1893-1894.

X

THE TRANSFER PROCESS

Contents

X

THE TRANSFER PROCESS

BASIC did not spend a great deal of time and effort on the roles that transfer agents and registrars play in the processing of securities transactions. The principal reason for this was that achieving its major objective of immobilizing certificates in a CSDS would *eliminate* the transfers. Accordingly, BASIC concentrated on the major cure which, if effected, would take care of lesser ailments in the transfer agent-registrar area.

BASIC, did, however, go into some matters involving transfer agents and registrars, essentially to see whether improvements could be made in the transfer cycle and process to provide better processing of securities transactions in the interim before a CSDS took over.

THE EFFECT OF INDEPENDENT REGISTRARS ON THE TRANSFER PROCESSING CYCLE

One of the questions explored was whether the use of independent registrars significantly slowed transfer turn-around times. The question of whether there should be – or should be *required* to be – a registrar independent of the transfer agent has been debated for many years. It was very much alive when BASIC was formed in early 1970.

Some were saying that there was no such need, others that the additional expense was duplicative and unnecessary, still others that the use of independent registrars slowed up things too much. It was this latter point that BASIC investigated.

The Task Force, with the cooperation of six bank transfer agents in New York, listed the major steps in the transfer-registrar cycle and the elapsed time for each. This was done for automated and manual systems, both of which were being used. The "standard" or "target" elapsed times called for by agents' schedules was compared with that actually achieved. This and related studies were written up in a discussion paper dated November 27, 1970, which is attached as Appendix NN.

The conclusions in the discussion paper were these:

> "It is believed that the function carried out by the registrar should not be eliminated. Even if one institution acts as transfer agent and registrar, it is believed that an audit of the transfer work, such as that carried out by an independent registrar, will be performed – and should be.
>
> In the light of the foregoing conclusion, it is believed that an appreciable saving in time does not, and would not, result from performing the registrar's double checks and the affixing of manual signatures in the house of the transfer agent rather than independently. In particular, the small time savings that would result do not warrant the drastic action of making it *mandatory* that one institution perform both functions, nor of expending the time and energy – and creating the confusion – that would be involved in removing the legal and other obstacles to the change.

In summary, from the standpoint of expediting the processing of securities transactions, an attempt to eliminate the independent registrar is not justified."[10.1]

The paper's recommendation was:

"It has been found that, as compared with alternatives, no appreciable delay in processing securities transactions is occasioned by the use of an independent registrar. Accordingly, it is recommended that no steps be taken to force the transfer and registrar functions for a given security into the same institution."[10.2]

BASIC distributed about 100 copies of its discussion paper, but received few comments. All but one agreed with the paper's conclusions and recommendations. (However, it should be repeated that the paper addressed only the question of delay attributable to the use of an independent registrar, and not objections on other grounds.)

BASIC did no further work on the independent registrar question. However, it should be noted that H.R. 5050, introduced in the House on March 1, 1973, contained this excerpt:

"Every issuer whose securities are registered on a national securities exchange shall consolidate in a single person the functions of transfer agent and registrar . . ."

STUDIES OF TIME REQUIRED TO TRANSFER

Study of the independent registrar question involved the Task Force's dealing only with bank transfer agents. That work, as indicated in Appendix NN, involved measuring the time-to-transfer of a small sample of actual items. This work brought to the Task Force's attention the large discrepancy as to the time required to transfer as heard in comments on the "Street" by brokers, on the one hand, and transfer agents, on the other. Transfer agent people talked in terms of hours; brokers in terms of weeks.

Even though a CSDS promised ultimately to eliminate problems associated with transfers, the Task Force decided that it was in the best interests of both industries to get some solid, objective statistics on the time that *is* consumed by the transfer cycle. Accordingly, the Task Force decided to tabulate the time-out-for-transfer, as seen by the sender to transfer.

The cooperation of two New York banks who send large quantities of securities to transfer was enlisted for the study. The first was to tally transfer times of all NYCH banks except itself. The second was to tally the times of the first bank's transfer department. Precautions were taken to keep word of the study from leaking.

The first study was of items sent to transfer during the week of December 7, 1970. The results were summarized by bank, giving each a number (except for three banks

[10.1] Appendix NN, p. 12.
[10.2] *Ibid*, p. 3.

whose transfer volume was considered to be too small to have statistical validity). The variation in performance among the banks was significant. (The study is attached as Appendix OO.) Overall, the transfer times were more than most transfer agents claimed, and less than those claimed by brokers.

With the concurrence of the chairman of the NYCH Clearing Committee, the study was sent under date of February 1, 1971 to each chairman of the NYCH banks. His bank was identified to him in a covering letter, but the others only by number. The study was also sent to members of BASIC, industry associations, and others.

Reaction to the study was quick and emphatic. Transfer agents with good performance said "I told you so", and those with poor performance said "There must be something wrong with the study". Many brokers more or less echoed the latter.

Based upon the foregoing reactions, plus a specific request from the Ad Hoc Committee on Office Operations of the brokerage industry, the Task Force decided to make a second study of transfer times. The week of February 16, 1971 was deliberately selected as a difficult one for transfer agents for two reasons: (1) trading volume on the NYSE for the preceding week had been at a record high, which could increase somewhat the volume of transfers in the week selected; and (2) Friday, February 12 had been a bank but not a brokerage holiday, so that brokers would have used a non-clearing holiday to clear up transfer backlogs.

Sure enough, Study No. 2 (attached as Appendix PP) showed a deterioration in the transfer time as compared with the December 1970 test. The study was sent to the CEOs of the NYCH banks as before. Time required to transfer was greater than transfer agents had claimed, but still less than brokers generally cited.

Dissatisfaction with BASIC's first two transfer-time studies was expressed by some brokers on three counts: (1) the senders-to-transfer were banks, who might receive priority over brokers in transfer departments; (2) while New York bank transfer agents might not be so bad, the others were horrible; and (3) registered bonds took much more time to transfer than stocks.

BASIC set up a third study to ascertain facts on these points. One part of the study, covering the week of August 2, 1971 was identical with the first two studies. The second part, covering items sent to transfer on July 7 and 8, 1971 by a large New York brokerage firm and two *different* New York banks, tabulated the time of all non-legal items (bonds as well as stocks) sent to transfer anywhere. (The results of Study No. 3 are attached as Appendix QQ.)

A table in Appendix QQ gives the following summary of all three studies:

Comparison of Transfer Times

	Weighted average days-all items	Percentage of items returned in 3 days	5 days	7 days
Stocks				
Transfers by 10 Clearing House Banks:				
12/7-11/70	4.1	37.1%	89.0%	98.4%
2/16-19/71	*	17.7	62.0	81.3
7/7-8/71	4.1	39.7	87.8	96.8
8/2-6/71	3.5	58.0	98.7	99.6
Transfers presented to N.Y. Clearing House banks 7/7-8/71 by:				
A broker	4.1	39.8	88.0	95.7
Two banks	4.0	39.4	87.2	99.7
Transfers as of 7/7-8/71 items by:				
Corporate agents	3.9	42.6	87.9	96.7
N.Y. Clearing House banks	4.1	39.7	87.8	96.8
N.Y. area Non-Clearing House banks	5.3	8.6	76.6	88.6
Independent agents — N.Y. area	5.3	19.2	56.0	80.7
Non-N.Y.-area agents	13.7	0.0	.7	2.7
Bonds				
7/7-8/71 items				
N.Y. area agents	5.8	18.2	61.8	79.2
Non-N.Y. area agents	9.1	0.0	0.0	9.0
8/2-6/71 items transferred by N.Y. Clearing House banks	6.1	17.2	48.7	73.5

*Data to make calculation not obtained.

Certain conslusions were drawn in Study No. 3, as follows:

"Subject solely to the size and nature of the samples (and there is no reason to believe that they are not representative), the studies of transfer times suggest certain conclusions:

(1) There is no difference in the transfer time of brokers' and banks' transfer items.

(2) Bonds require appreciably more time to transfer than do stocks.

(3) Transfer time varies considerably among individual agents and types of agents, and is affected considerably by abnormal conditions such as existed in the February test period."[10.3]

Errors in items sent to transfer

The discrepancy between transfer agents' and brokers' statements as to time required to transfer prompted another brief study by the Task Force. Transfer agents reject items sent to them for transfer for a number of valid reasons. Discussions with some broker cage personnel indicated that, under their procedures, time out for transfer included time to send the first time as well as the second.

Whether or not such procedures were typical, errors in items sent to transfer create a delay in the processing of securities transactions. Accordingly, the Task Force made a brief study of the items rejected by a New York bank transfer agent during the period June 1-7, 1971. During this period, out of 22,550 non-legal items presented for transfer, 871 (3.9%) were rejected for these reasons:

	No.	%
Sent to wrong transfer agent	471	54.1%
Quantity differs among transfer instruction, window ticket, and certificates presented	89	10.2
Tax waiver or tax required	72	8.3
Assignment missing, incomplete or illegible	63	7.2
Correction or ADR fee required	54	6.2
More than one issue of stock attached to BOWT	32	3.7
Signature or other guarantees missing	30	3.4
Other reasons (under 1.5% each)	60	6.9
	871	100.0%

* * * * *

Studies of transfer times subsequent to those of BASIC have been made by others. In particular, AMEX instituted a program of compiling such statistics monthly (although probably not counting elapsed time the same way as BASIC).

[10.3] Appendix RR, p. 4.

So far as is known, the transfer-time performance of NYCH banks has been consistently better than that shown in BASIC's first study. Some of this improvement can without doubt be attributed to the actions of CEOs of these banks after BASIC showed each the performance of his bank in comparison with others.

There is one other footnote on the transfer process that should be recorded. Since 1970, the volume of transfers has diminished radically, whether measured in terms of new certificates issued, old certificates received, or average shares per certificate outstanding. Some place the reduction in the 30-50% area. How much of this reduction is due to a drive, going on in the same period, to issue certificates in larger denominations (so-called "jumbos"), is not known. However, some part of the decrease is attributable to the increased immobilization of certificates in depositories.

Uniform documentary requirements for certain legal transfers

BASIC furthered the uniformity efforts of one other securities transaction processing item — legal transfers. Documentation requirements of specific types of legal transfers had been substantially the same for any of such types among many transfer agents, but different for others. Presentors to transfer often were confused as to which agents required which documentation. Holdups of legal transfers, pending submission of additional or different documentation, often was the result.

The Joint Industry Control Group, the Stock Transfer Association, and the Steering Committee of the NYCH banks, studied this problem. Among them, they agreed upon uniform requirements for 18 of the most prevalent legal transfer documentation areas. The cooperating organizations planned to distribute the requirements among their members. Under date of September 15, 1970, JICG requested that, in addition to this distribution, BASIC urge other interested persons in the banking and securities industries to adopt the uniform requirements.

Upon approval of the Committee at its October 1970 meeting, a letter to this effect was sent to all exchanges and bank clearing house associations under date of October 14, 1970 (Appendix RR). Subsequent reports were to the effect that the uniform requirements had resulted in reducing materially the rejections of legal transfers.

XI

BASIC IN 1974

Changes in BASIC's structure actually commenced in latter 1972 when, as noted in Chapter I, the last of the Task Force returned to their employers, Bevis relinquished the title of Executive Director, and the quarters at 84 William Street were closed.

At the end of 1973, Meyer relinquished the title of Chairman of BASIC, but remained a member. Bevis retired from the Committee, but was designated Consultant. Gordon T. Wallis, Chairman of NYCH and of Irving Trust, became Chairman of BASIC. The former Joint Industry Control Group was by then operating as the "BASIC Steering Committee", the investigating and problem solving arm of BASIC, so to speak.

BASIC had before it at the beginning 1974 potential missions in these areas: (a) Federal legislation to regulate depositories, an incomplete subject at year-end 1973 as discussed in Chapter VII; (b) completion of the job of securing UCC amendments in the remaining states, covered in Chapter VI; (c) participation in NCG to promote inter-regional depository development; and (d) such new interindustry problems as might surface.

Until the latter 1960s, the banking and securities industries had fairly well isolated themselves from one another in tackling interrelated operational problems. BASIC changed that. As a vehicle for interindustry teamwork, BASIC remained on standby alert in 1974.

LIST OF APPENDICES

* * * * *

Location of Appendix Volumes

A limited number of volumes of the appendices have been reproduced. They may be inspected at libraries of any of the following:

American Stock Exchange, 86 Trinity Place, New York City.

Depository Trust Company, 55 Water Street, New York City.

National Association of Securities Dealers, 1735 K Street, N.W., Washington, D.C.

New York Clearing House Association, 100 Broad Street, New York City.

The New York Stock Exchange, 11 Wall Street, New York City.

* * * * *

Appendix	Subject
A	Remarks by Ralph S. Saul before the Securities Industry Operations Conference, September 18, 1969.
B	Press release on formation of BASIC, March 13, 1970.
C	"How Do You Get from Here to There in this Securities Industry", portion of remarks of Herman W. Bevis, March 17, 1971.
D	BASIC Task Force memorandum "A Consideration of the Mechanics of Operation of Two Alternative Depository Systems", October 19, 1970.
E	BASIC Task Force Research Report "Information Bearing on CSDS Derived from a Study of Transfer Journals", July 20, 1971.
F	BASIC Task Force Research Report "Estimated Securities Holdings of Potential Participants", April 15, 1971.

Appendix	Subject
G	BASIC Task Force memorandum, "Delivering 'Depository Receipts', Instead of Actual Securities, in Initial Satisfaction of Delivery-Against-Payment Transactions", July 27, 1971.
H	BASIC Task Force memorandum, "The Depository as Co-Transfer Agent", May 12, 1972.
I	BASIC Task Force Research Report "Withdrawal of CEDE Certificates from CCS", January 8, 1973.
J	Report "Questions by the New York State Banking Department; Answers by CCS, Inc.", February 26, 1973.
K	Exchange of correspondence between H.W.B. and Montross of Midwest Stock Exchange Clearing Corporation, August 1971.
L	BASIC Task Force memorandum, "A National Comprehensive Securities Depository System: Some Questions", October 12, 1971.
M	BASIC Task Force memorandum, "Cash Settlement Considerations", April 10, 1972.
N	H.W.B. memorandum, "Interface of CCS, Inc./ DTC with the Banking System for Cash Settlements", March 13, 1973.
O	Exchange of correspondence between H.W.B. and Senator Roth, June-August 1971.
P	Three quarterly progress reports by BASIC to Senate Subcommittee covering last quarter of 1971 and first two quarters of 1972.
Q	H.W.B. letter to Senator Williams on his Subcommittee's report, March 3, 1972.
R	H.W.B. letter to Congressman Moss on legislation involving depositories, December 30, 1971.
S	Memorandum of H.W.B. on SEC bill, March 20, 1972.
T	Correspondence between J.M.M., Jr. and SEC Chairman on Fed membership for depositories, May-July 1972.

Appendix	Subject
U	H.W.B. memorandum, "Toward Improving the Transaction Consummation Process", August 4, 1972, and correspondence with SEC Chairman.
V	H.W.B. letter to Representative Moss on certain points in recent hearing, September 27, 1972.
W	Letter NYSE to listed companies on CUSIP, April 15, 1970.
X	BASIC white paper and press release on CUSIP, April 23, 1970.
Y	H.W.B. letter to Municipal Securities Committee of IBA on placement of CUSIP on bonds, June 12, 1970.
Z	"Municipal Operations Digest" of SIA on CUSIP and municipal bonds, March 15, 1973.
AA	BASIC memorandum, "The Changeover to the CUSIP Numbering System Should Commence Now" and press release, February 11, 1971.
BB	SEC Release on its proposed use of CUSIP, February 16, 1971.
CC	BASIC memorandum, "Mandatory Use of CUSIP Numbers on Documents Used in Processing Securities Transactions", July 15, 1970.
DD	H.W.B. letter withdrawing proposed deadlines for mandatory use of CUSIP on documents, October 30, 1970.
EE	H.W.B. letter soliciting comments on ABA FINS proposal, July 2, 1970.
FF	BASIC Task Force white paper on FINS, February 16, 1971.
GG	NCG findings and conclusions on FINS, February 13, 1974.
HH	BASIC press release on COD DK discussion paper, December 7, 1970.
II	BASIC Task Force "Recommendations of Steps to Resolve the (COD DK) Problem," March 5, 1971.

Appendix	Subject
JJ	BASIC Task Force memorandum, "Program for Fixing Responsibility for DKs of COD Deliveries", April 8, 1971.
KK	BASIC Final Report "A Solution to the COD DK Problem", December 15, 1971.
LL	H.W.B. correspondence with Fed and SEC on COD DK solution, March-November 1972.
MM	Ad Hoc Committee Report "A Proposed Standard for Transfer Instructions on Magnetic Tape", June 30, 1972.
NN	BASIC Task Force discussion paper "The Effect of Independent Registrars on the Transfer Processing Cycle", November 27, 1970.
OO	BASIC Task Force report on transfer times dated January 15, 1971.
PP	BASIC Task Force report on transfer times dated March 5, 1971.
QQ	BASIC Task Force report on transfer times dated September 7, 1971.
RR	H.W.B. letter on uniform requirements for the transfer of securities, October 14, 1970.