Report of the Securities Transfer Association

To the Presidential Task Force on Market Mechanisms

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REPORT OF THE SECURITIES TRANSFER ASSOCIATION TO THE PRESIDENTIAL TASK FORCE ON MARKET MECHANISMS

I. Interest of the Securities Transfer Association in Commenting On the Effect of the Market Events and Financial Crisis of October 1987

The Securities Transfer Association, Inc. ("STA") is a national membership organization comprised of approximately 600 securities issuers, banks, non-bank financial institutions, and other entities involved in securityholder recordkeeping, securities certificate issuance, and securities custody activities. The STA membership list includes entities of widely varying sizes and geographic locations.

Securities transfer agents perform various services for issuers of securities and securityholders. For example, transfer agents examine certificate endorsements and assignments and cancel certificates properly presented for transfer, print and issue new certificates to the transferee and record the change of record ownership of securities on the issuer's securityholder records. They also prepare, maintain and certify securityholder records, disburse dividends and interest payments and transmit securityowner communications, such as proxy materials and annual reports. Some transfer agents maintain custody of certificates on behalf of some securities depositories, and in that capacity each day exchange information with the relevant depository about position balances and issue and transmit certificates pursuant to the depository's instructions. In addition, some transfer agents maintain securities as custodian for individual securityholders through dividend reinvestment plans and employee stock purchase programs.

Transfer agents perform their functions, in coordination with securities depositories and clearing corporations, as a critical, integral component of the National Clearance and Settlement System, which has been subject since 1975 to Securities and Exchange Commission oversight. The account records which are maintained in that National System reflect the ownership of interests traded in the nation's securities markets. Those account records and the National System can be impaired whenever transfer agents fail to perform their activities safely, accurately or efficiently or whenever entities in the securities transaction processing chain, such as securities depositories, broker-dealers or other securities custodians, fail to effectively coordinate activities respecting transfer of securities ownership. Moreover, ineffective ownership transfer processing can affect the accuracy of issuers' securityholder records, interrupt the channels of communication between issuers and shareowners (or debtholders), and frustrate investor rights and expectations - all of which can affect investor confidence and capital market integrity.

The risk that recordkeeping or certificate handling practices will become ineffective either at particular institutions or generally is highest - to the extent such a risk exists at all - during periods of high trading volume. Although the market crisis that occurred this past October did not entail sustained high volume, unlike the paperwork crises of the late 1960's, certainly the trade volume on peak days in October, and the settlement volume as well, spiked to levels that taxed exchange and broker-dealer trade-handling capacities. Certainly also, the financial crisis associated with October's market events created a sense of urgency. Accordingly, as the national association representing securities transfer agents, the STA has a significant interest in the impact of the market events of October on securities ownership recordkeeping and certificate handling and on the performance of National Clearance and

Settlement System facilities during that critical, stressful period.

II. Purpose of this Document

The significant market events of this past October have spawned numerous task forces, surveys, and analyses of all segments of the financial markets that either contributed to or were affected by the devastating fall in stock market prices and the equally staggering jump in trading volume and volatility. In November, following consultation with the staff of the Securities and Exchange Commission ("Commission"), the STA undertook to review and report to the Commission and other interested parties concerning the impact of those events on securities transfer processing and securities ownership recordkeeping and on transfer agents' ability to perform their functions. To ensure maximum coverage, the STA retained Market Facts, Inc. to gather from transfer agents and broker-dealers both quantitative and qualitative data on transfer processing and ownership recordkeeping performance in the weeks following October 19. In addition to the Market Facts survey, the findings of which are summarized herein and attached hereto, the STA has attempted to place those events in perspective, by reviewing briefly in this Report the developments that have occurred since 1975 in immobilizing securities certificates, devoting professional management attention to operations functions, and applying sophisticated automation and disciplined accounting controls to the settlement and transfer processes, and by evaluating the degree to which the significant investment in those initiatives proved adequate to the recent challenge of high volume and price volatility.

Even without the particulars provided by the Market Facts survey, it is apparent to the STA that, on the whole, post-settlement processing of equity security interests functioned admirably in extraordinary circumstances. While many were comparing and contrasting the market events of October 16, 19 and 20, 1987 with the market crash of 1929, those principally concerned with securities operations also had in mind the paperwork crisis of the late 1960's. In recalling the events of the late 1960's and the resulting market retraction, it must be remembered that what was then aberrant market activity - an average of 20 million shares a day on the New York Stock Exchange - would constitute less than an hour's volume on a quiet day in 1987. It must also be noted that, painful as the paperwork crisis was, it served to mobilize the financial community, whose initiatives in the 1970's laid a foundation for effective, predominantly automated recordkeeping, transaction settlement and ownership transfer processing in the 1980's.

Accordingly, the STA herewith furnishes its observations concerning the impact of heavy trading activity and price volatility in multiple, interrelated markets on equity ownership record maintenance and stock certificate processing within the transfer agent community, and on the longer-term regulatory and operational initiatives, relevant to the STA, that may be necessary to accommodate the evolving and increasingly volatile securities markets.

III. Background

The 1960's Paperwork Crisis

In the late 1960's, paperwork logjammed when trading volume on the New York Stock Exchange increased faster than the industry's capacity to process information and settlements. "Between 1964 and 1967, average daily volume on the New York Stock Exchange increased by over 100 per cent, from 4.9 million shares to 10.1 million shares." R. Ferrara and K. Alt, Immobilization of the Security Certificate: The U.S. Experience, 15 Sec. Reg. L.J. 228, 236 (1987). According to the Commission's 1971 report to Congress on the paperwork crisis:

> The industry was unprepared for this veritable explosion in trading volume. With some exceptions, the financial community found itself

> without appropriate systems, procedures, equipment, or qualified personnel to do its business. Further, little could be done to implement the necessary solutions on a timely basis. The problems demanded broad solutions and no one firm could tackle them in isolation. The aftermath was virtual chaos....

SEC, STUDY OF UNSAFE PRACTICES OF BROKERS AND DEALERS, H. Doc. No. 92-231, 92d Cong., 1st sess. (1971), at 13 (hereinafter, SEC Study). The steadily increasing volume, coupled with weak accounting controls, made it impossible for many broker-dealers to keep track of their records respecting securities held for customers or due in settlement of trades. Moreover, less efficient broker-dealers affected other firms. As the SEC Study noted, "inter-dealer clearing systems, as well as the transfer facilities of banks, were similarly taxed beyond their capacities. The entire machinery for the delivery and transfer of securities and the concomitant remittance of funds became clogged." Id. Although trading volume, along with stock prices, began to decline in late 1969, the backlog, coupled with reduced revenues, forced over 100 brokerage firms into liquidation - producing losses for many customers and propelling the formation of the Securities Investor Protection Corporation.

The SEC Study cited the following weaknesses as factors contributing to the losses in 1969 and 1970 and the concomitant "threat of loss of public confidence in the securities markets":

- inadequacy and misuse of capital;
- historical emphasis on sales and trading activities and a traditional lack of attention to professional operations performance;
- lack of systems, procedures, equipment and qualified personnel to maintain accurate, current records;
- lack of industry-wide approaches to the settlement process;

-absence of an effective early warning system as the crisis emerged;

-excessive ease-of-entry into the securities business.

Id. at 11-12. Although the SEC Study focused on poor recordkeeping at broker-dealers, self-regulatory organizations and transfer agents (principally bank transfer agents) were also cited for lack of preparedness and inability to respond to changing business requirements. Significantly, as the SEC Study confirmed, ineffective certificate handling was a key part of the industry's processing crisis.

Regulatory and Systems Response to the Paperwork Crisis

The ultimate products of the paperwork crisis, in addition to the formation of SIPC, were significant increases in broker-dealer and transfer agent regulation and an industry-wide commitment to efficient, disciplined securities processing. Among other statutory and regulatory initiatives, Congress charged the Commission in the Securities Acts Amendments of 1975 with the responsibility to facilitate the development of a "national system for the prompt and accurate clearance and settlement of transactions in securities" (Section 17A(a)(2) of the Securities Exchange Act of 1934 ("the 1934 Act")), the creation and maintenance of regulatory programs for the registration and regulation of clearing corporations, securities depositories and transfer agents (Sections 17A(b) and (c) of the 1934 Act), and the introduction of initiatives "to end the physical movement of securities certificates in connection with the settlement among brokers and dealers of transaction in securities" (Section 17A(e) of the 1934 Act). In response to those directives, the Commission adopted extensive rules governing most aspects of transfer agent services, including certificate turnaround, ownership recordkeeping, handling of shareholder inquiries, safeguarding of funds and securities, and coordination with securities depositories, broker-dealers, and custodian banks in disseminating communications from issuers to shareholders and in handling securities during tender and exchange offers. In addition, the clearing corporations, securities depositories and transfer agents have introduced coordinated, increasingly refined recordkeeping, transaction processing, securities custody, and risk management systems and have devoted disciplined professional management skills to post-trade securities processing operations. Just a few of the major innovations include continuous net settlement systems, clearing agency interfaces, transfer agent certificate custody programs, automated institutional trade affirmation and settlement, the use of large-denomination "jumbo" certificates, and book-entry transfer processing.

At the same time that those securities processing enhancements were being pursued, the securities markets were becoming more diverse and settlement and transfer operations more sophisticated. As new types of securities and derivative products were introduced, including standardized options, financial futures, and various kinds of securitized receivables, institutional investors and arbitrageurs exerted increasing influence on issuers and on the markets. By the 1980's, major corporate reorganizations and associated financing initiatives often dominated market action, and trading volume grew inexorably until 150 million share days on the NYSE became commonplace.

In the midst of that growth and diversification, expanding application of automation has been omnipresent. New information and trade execution systems, new communications techniques, new analytic tools, and new and refined settlement and transfer facilities have enabled the various markets and market participants to handle increasing trade volume in diverse markets with increasing dexterity. Indeed, the intelligent application of automation, combined with professional managerial and operational discipline, has been, and in our view should continue to be, critical to responsible growth and diversification in the securities industry. For that reason, the National Clearance and Settlement System today exhibits a significant degree of automated coordination among its component segments - clearing corporations, securities depositories and transfer agents. For example, transfer agent custodian programs, such as The Depository Trust Company's Fast Automated Securities Transfer ("FAST") program reduces certificate turnaround time by interconnecting depository and transfer agent custody and recordkeeping activities. In FAST, the transfer agent maintains custody of the depository's position, which enables the agent to accept and act on automated transfer instructions without requiring certificate movements between the depository and the transfer agent. Transfer agents also employ Direct Mail programs, which enable broker-dealers to route computerized "transfer and ship" instructions to the transfer agents through the depositories, thereby eliminating the need to return the issued certificates to the broker before delivering certificates to the new registered owner. Thus, as the Commission staff noted in its 1985 Report, <u>Progress and Prospects: Depository Immobilization of Securities and Use of Book-Entry Systems</u>, June 14, 1985:

> The National System has become highly automated, operating through a sophisticated set of interconnections among the various processing entities. Financial institutions that are active in corporate and municipal securities markets depend on the safety and efficiency of the National System facilities to avoid paperwork bottlenecks and expensive processing delays. Indeed, without the efficient National System support savings services, financial institutions could not handle today's heavy trading volume.

<u>Id</u>. at 1.

<u>The National System and Individual Investors</u>

The emphasis in the foregoing excerpt on the institutional sector should not be understood to minimize the significance to the individual investor of the many recordkeeping and custodial enhancements. Since 1980 there has been a steady influx of securities owned by individuals into the securities immobilization system, via customer use of bank and broker-dealer custodians and registration of the securities ownership interests in the "nominee name" of the securities depositories. These securityholders have benefitted, not only from generally enhanced recordkeeping discipline at broker-dealers and at the registered clearing agencies, but also from the coordinated operational network that links their brokers, through the depositories, to transfer agents and enables securityholders to receive accurate ownership recordkeeping services, efficient certificate withdrawals as necessary, and timely distribution of dividends and issuer communications.

In addition, for the many securityholders who choose to safekeep their own certificates and maintain ownership registration in their own name directly on the issuer's records, efforts to automate many transfer agent functions have resulted in prompt and accurate recordkeeping and certificate processing industry-wide. Computerization thus enables high-volume transfer agents routinely to meet, if not exceed, SEC and self-regulatory organization standards for turn-around of certificate transfers and response to shareholder inquiries. Moreover, many transfer agents offer Dividend Reinvestment and Employee Stock Ownership Plans that immobilize individual securityholders' security interests in automated databases maintained at the agents' premises, outside National System depositories. Such automated plans provide individual investors with efficient and important ownership and custody alternatives to broker-dealers. Through those plans, investors may safekeep securities and may accumulate, and liquidate, shareholdings through issuers' agents with confidence that financial or operational difficulties facing broker-dealers will not directly affect the investors' ownership positions.

IV. The Events of October 1987 and Post-Settlement Processing

Notwithstanding the many benefits of market automation, the events of mid-October make it clear that automation, coupled with very substantial, very mobile portfolio assets and interrelated equities and derivative product markets, can facilitate massive sudden capital transfers. On October 16th, the Dow Jones Industrial Average fell 108.35 points with trading volume on the NYSE of 338.5 million shares. On Monday the 19th, as market participants around the world focused on Friday's drop in the Dow, adverse trade figures for the United States, a weakening dollar, and financial risks created by traders' intermarket positions, the market fell an additional 508 points, and NYSE volume soared to an unbelievable 604.8 million shares. On Tuesday, October 20th, high volume continued, with wide spreads in quotations and significant price moves throughout the day. The balance of the week was characterized by high volume and high volatility, as the NYSE contracted trading hours on Friday, October 23rd and the following Monday and Tuesday.

Without attempting to correlate the many interactive causes and effects underlying the trading volume and financial crisis during October and early November, the apparent problems, in the STA's view, cannot be associated with certificate handling or ownership transfer processing - unlike the paperwork crisis of 1969. Indeed, the industry's settlement and transfer facilities reduced paperwork stress, and to that extent performed as designed. Thus, the market crises - however sudden and surprising they may have been and however stressful they became financially - did not entail or produce a certificate processing or ownership recordkeeping crisis.

High trading volume, of course, produced high settlement volume, high book-entry movement volume, and a high volume of requests for securities certificates. Although netting programs at clearing corporations and securities depositories reduced the number, and dollar value, of settlements that would otherwise be necessary to accommodate trading commitments, daily average book-entry deliveries at The Depository Trust Company ("DTC") and requests for certificates registered in customer name nonetheless increased in early November by 50 per cent, and 100 per cent, respectively, above the September daily averages. As DTC reported in its November Newsletter, shares delivered by book-entry for the week of October 26 averaged 1.7 billion a day, and settlements for October 26 and October 27, respectively, involved 480,500 book-entry deliveries ($91.7 billion) and 484,300 book-entry deliveries ($82.1 billion). Those deliveries produced a daily average of approximately 1.1 million changes in DTC participants' securities accounts, and during the weeks of October 19, 26, and November 2, the number of average daily requests for certificates registered in customer name doubled, to 58,000 per day.

Those increases naturally translated into higher processing demands at transfer agents during the same time periods. Two large bank transfer agents, for example, reported a 200 to 400 percent increase above normal levels in requests for customer name securities on peak days in late October and early November. The industry's experience since 1970, of course, has demonstrated that volume leaps of that magnitude can best be assimilated by automation and planning, and many agents employ computer-to-computer links to DTC or periodic exchanges of magnetic tapes with DTC. Thus, despite increases in workloads, no significant problems in certificate processing were reported at major transfer agents during November. Moreover, no increase appears to exist in customer complaints pertaining to delays in receiving certificates, processing transfer requests, handling shareholder inquiries, or effecting purchase or liquidation orders for dividend reinvestment or other custodial securities maintained by investors directly with transfer agents.

To be sure, brokers' customers and no-load mutual fund investors complained about difficulty in reaching their account managers, either to place an order or to get market information. As is revealed in an Adams and Rinehart Post-Crash Investor Attitudes Survey, a survey of individual customer experience during October 19th and 20th, 2 percent of those investors who did not sell gave as their reason for not selling that they were unable to reach their broker-dealer.[1] Significantly, however, as the Adams and Rinehart survey also suggested, the vast majority of individual investors did not enter the market as sellers and did not feel pressured by market events to attempt to sell. In the STA's view, that fact reflects a high level of investor confidence, notwithstanding the October market crisis. We believe such high confidence is based in part on investors' favorable experience in recent years with those major financial institutions, including transfer agents, that participate in the National Clearance and Settlement System and the evident effectiveness of transfer agents in handling their recordkeeping and certificate processing responsibilities.

Accordingly, from the perspective of post-settlement securities processing, the most interesting story in the "crash of 1987" is the one that did not develop. Despite skeptical projections of back-office logjams, anticipated for the week of October 26 - when trades executed the previous week were scheduled to settle - post-settlement processing generally was uneventful. Thus, whatever problems attributable to market stress and liquidity crises may have existed, they did not translate into problems in certificate processing and ownership recordkeeping.

V. <u>The Market Facts Survey</u>

Those general assessments concerning investor confidence levels and post-settlement processing during late October and November obviously are based on statements and

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[1] The actual percentage of investors that had difficulty accessing the market was likely higher than 2 percent. Some prospective purchasers and some investors simply interested in obtaining market information, for example, probably also had difficulty reaching their brokers on October 19th and 20th.

conclusions of informed but disparate sources. Transfer agents, of course, have direct experience of investor behavior and accounting control performance through dividend reinvestment account operations and securities transfer activities. Given that experience, and the interest of the STA in the work of the Presidential Task Force, the STA requested Market Facts to help identify in a more comprehensive, focused way the nature and extent of any otherwise unreported recordkeeping, certificate processing, or market access problems that surfaced during November.

The Market Facts survey collected data pertaining to three basic issue areas: the nature, degree and duration of any increase in transfer volume or securityholder inquiry volume; the nature and degree of any problems encountered in transfer processing, including defective presentments and weaknesses or delays in dividend reinvestment plan ("DRP") order executions; and the change, if any, in the number of individual recordholders or DRP participants. In collecting data, Market Facts contacted 96 transfer agents and 13 reasonably representative broker-dealers. The very tight time frames imposed by the Commission's and the Task Force's reporting schedule precluded a broader or more extensive survey. Survey methodology is summarized in the attached Market Facts report to the STA.

Investor Activity

The data suggest that broker-dealers and transfer agents experienced an increase in individual investor activity following October 19th. Eighty-five percent of the surveyed broker-dealers saw an increase in individual investor activity during the week of October 19, and 39 percent continued to see increases in activity during and following the week of October 26. (Market Facts Broker-Dealer Tables 1 and 2.) Similarly, 47 percent of the transfer agents surveyed cited an increase in stock transfer activity since October 19th. (Market Facts Transfer Agent Table 1.) As discussed below, much of that activity appears to have related to individual investors.

Of those transfer agents experiencing an increase, the average increase in stock certificate issuance was 33 percent, while the increase of stock certificates debited was 16 percent. (Market Facts Transfer Agent Tables 1, 4 and 5.) These data do not reflect actual aggregate certificate issuance volume, but merely rates of change. Because debits historically have exceeded credits, however, these data do reflect an increased demand for certificates. Interestingly also, 42 percent of transfer agents cited an increase in new registered shareholders, compared with 20 percent of agents that cited an increase in closed shareholder accounts. (Market Facts Transfer Agent Tables 16 and 20.) These data, again, do not necessarily reflect an aggregate increase in individual shareholder accounts (though at some agents such increases surely occurred), but the data do reflect a movement toward increased direct shareholder registration. Among those transfer agents that experienced an increase in new account activity, 43 percent experienced an increase exceeding 10 percent, while 25 percent claimed that their increase exceeded 40 percent. (Market Facts Transfer Agent Table 17.) Once again, those increases do not necessarily correlate with net increases, but do confirm that significant numbers of new accounts were established in November.

Survey data concerning individual investors displayed a similar pattern with respect to purchases and sales in dividend reinvestment plans. Eighteen percent of the transfer agents polled cited an increase in the volume of purchases in dividend reinvestment plans, compared to 10 percent that cited an increase in the volume of plan sales. (Market Facts Transfer Agent Tables 31 and 37.) Although these data do not reflect aggregate plan participation levels, they do reflect increases in plan activity and plan purchases.

<u>Transfer Agent Experience</u>

The data reported above reflect increases in stock transfer, certificate processing, and recordkeeping activity. The survey also collected data concerning transfer agent handling, and to a lesser degree broker-dealer handling, of transfer instructions during late October and November.

Approximately 92 percent of transfer agents reported that their turnaround time was not adversely affected by the volume increases. (Market Facts Transfer Agent Table 48.) Responses to the broker-dealer survey supported that conclusion. All broker-dealers surveyed stated that transfer agents' post-October 19th turnaround performance improved or stayed the same, as compared with pre-October 19th performance (Market Facts Broker-Dealer Table 38), and only one broker-dealer evaluated transfer agents' pre-October 19th performance as negative. (Market Facts Broker-Dealer Table 18.) Thus, surveyed broker-dealers' generally positive view of intermediaries' and systems' processing performance pertains both to performance prior to October 19th and thereafter. (Compare Market Facts Broker-Dealer Tables 16-25.)

Processing performance was not without incident, however. For example, although about 85 percent of the transfer agents surveyed reported meeting the Commission's 72-hour turnaround requirements on all days between October 19th and December 1st, 7 agents reported experiencing delays in turnaround. Of those seven, six experienced delays on only 1 - 3 days and 1 experienced delays on 10 days. (Market Facts Transfer Agent Table 49.) Transfer agents surveyed also reported some difficulty in processing broker-dealer submissions, with 12 percent indicating an increase in the number of transfers rejected due to missing necessary data or documents. (Market Facts Transfer Agent Table 23.)

Five broker-dealers reported delays involving transfer agents. Of those 5, more broker-dealers expressed problems with direct submissions to transfer agents than with submissions through depositories. (Market Facts Broker-Dealer Table 31.) Four broker-dealers also experienced processing problems of unidentified dimensions relating to OTC issues, though those problems reportedly were not very serious. (Market Facts Broker-Dealer Tables 26 and 29.)

Approximately 25 percent of the transfer agents surveyed indicated a need to work overtime in order to meet the burst in volume, and 10 percent reported having added extra resources. (Market Facts Transfer Agent Table 19.) Given the demands of high volume, about 33 percent of the transfer agents polled indicated that they were considering various changes, including increased systems hardware capacity (10 percent), changed securities processing procedures (8 percent), enhanced interfaces with depositories (9 percent), increased staff levels (6 percent), and increased telephone capacity (2 percent). (Market Facts Transfer Agent Table 50.)

VI. Conclusions and Recommendations

Based on the results of the Market Facts survey and public information, it appears to the STA that transfer agents readily absorbed the sudden burst of settlement processing produced by the market activity of late October. Neither broker-dealers, transfer agents, nor public investors, expressed any generalized concern about the timeliness and efficiency of transfer handling, despite substantial increases in the number of certificates issued. It is probably too soon, however, to state definitively whether updates to security-holder records during the high-volume period contained any noticeable increase in error rates, either at any particular agent or generally. Despite that qualification, increased DRP purchasing and liquidation activity and significant dividend and interest disbursement activity has occurred since November 1st through transfer agent facilities, and no accounting errors of any significance (which would be apparent by this time) have been identified. Moreover, given the degree to which high transfer volume and high DRP activity volume were concentrated in agents employing automated facilities that are subjected to automated accounting controls, it seems reasonable to conclude that the increased demands in high-volume issues were readily accommodated without likelihood of material error. In any event, as dividend and interest payments are made and proxies are issued over the next few months, any errors that may currently be unidentified will become apparent and should be susceptible to prompt reconciliation.

With respect to certificate processing, the data confirm that 45 of the 96 agents polled experienced an increase in stock transfer activity following the October 19th market crisis. (Market Facts Table 1.) Despite these increases, the data suggest that, to the extent problems surfaced, they were minor in number, degree and duration, and they underscored the importance of effective, high-capacity automated processing capability. About 85 percent of the transfer agents polled, for example, reported meeting the Commission's monthly average 72-hour turnaround requirements on all days between October 19th and December 1st. Of the 7 agents reporting delays, 6 experienced delays on only 1 - 3 days, and 1 experienced delays on 10 days. (Market Facts Table 49.) Similarly, 11 percent of the respondent transfer agents reported receiving from broker-dealers an increased number of faulty (and therefore rejected) certificate presentments, and 9 percent reported seeing an increase in the number of new accounts missing a taxpayer identification number. (Market Facts Tables 23 and 26.)

In the STA's view, transfer agent flexibility in allocating and managing professional personnel, and the availability and use of transfer agent custody facilities and automated links with depositories, including arrangements such as FAST and Direct-Mail, kept certificate processing problems to a minimum. As the data suggest, however, resource flexibility and automated processing capability can be enhanced. Although it may well not be necessary to require all agents to be fully automated, the lack of effective automated links to depositories is significant for any agent that transfers a material number of issues or actively-traded or actively-transferred issues. Similarly, although not all broker-dealer certificate handling can be confined to automated depository systems, broker-dealer processing of transfer instructions outside the depository (and thus outside automated, standardized programs) creates a risk of delay, confusion and error. To the extent any broker-dealer processes a significant volume of instructions in that fashion, those risks increase.

Accordingly, the STA believes that the Commission and the self-regulatory organizations should consider requiring broker-dealers with any material certificate transfer volume to process their transfers of depository-eligible securities issues through depositories. Such a requirement would centralize and unify transfer processing, which in the long run should reduce aggregate transfer processing delays, costs and errors. Similarly, the STA believes that the Commission should give increased attention to requiring transfer agents with any material level of depository-generated transfers to use automated links made available by depositories, including efficient TAC and Direct Mail arrangements. Finally, the STA believes that the Commission should ensure that registered securities depositories develop standardized automated transfer processing programs, including efficient TAC and Direct Mail arrangements.

We believe that those three initiatives, if undertaken and completed, would enhance the securities immobilization effort and streamline appreciably the operation of the National Clearance and Settlement System. We further believe that it would be particularly unfortunate to defer those initiatives pending evidence that October volume levels will recur. Automated readiness and disciplined management skills made a clear difference in transfer agents' ability to absorb the volume escalation professionally.

With respect to recordkeeping experience during November, the Survey data suggest, generally, that high transfer volume in November did not produce noticeable recordkeeping errors at transfer agents, either in postings to master securityholder files or in DRP account entries. Effective transfer agent recordkeeping discipline depends on two primary factors: an environment, both at the agent's premises and in the agent's interaction with presentors, that emphasizes orderly, efficient handling of transfer instructions; and professional management of daily operations. Automation at depositories and at agents certainly enhances the first factor, but only a sense of professionalism, effective staff training, and adherence to well-designed internal control procedures can ensure maintenance of the second factor.

The STA believes that the development since 1975 of automated processing capabilities, dedicated professional management teams, elaborate Commission regulations covering nearly all aspects of transfer operations, and strict internal audit and system controls, in general, have created a disciplined environment at transfer agents. In such an environment, recordkeeping, like certificate handling, routinely occurs in orderly and efficient steps that are well-understood by staff and well-supervised by management. It is not surprising therefore that recordkeeping appears to have remained unaffected, at least at transfer agents, during the high volume spurts in early November.

Disciplined processes can be taxed by sustained high volume, of course. Also, to the extent any single institution becomes casual or indifferent toward the required discipline, recordkeeping precision at that institution can suffer even if certificate turnaround capability does not. Given both of those risks, and given the importance of recordkeeping integrity to issuers, investors and the capital markets, it is critical that transfer agents maintain, and be encouraged by regulatory authorities to maintain, professional recordkeeping skills and experienced management capability. Assurance that such skills and capability are maintained, of course, depends upon agent compliance with recognized standards. The STA is not a self-regulatory organization, however, and it lacks authority to examine members or oversee their compliance with the Commission's recordkeeping, reporting, processing and safeguarding rules. The industry and the public thus depend in large measure upon internal audits and oversight examinations by the Commission and bank regulators to ensure effective compliance.

Given the generally favorable reports about recordkeeping during November, the STA does not believe that specific changes are necessary or appropriate at this time in the existing compliance/enforcement mechanism. Nor do we believe that a different enforcement mechanism would make any particular difference in recordkeeping and processing capability and capacity during high volume cycles. Instead, we believe that the primary recommendations made above with respect to enhancing certificate processing efficiency apply as well to ensuring promptness and accuracy in recordkeeping. Transfer agents and securities depositories, therefore, should be encouraged to extend certificate immobilization techniques, including TAC arrangements, and should be obliged to design and apply automation to their operation with a view toward ensuring orderly, efficient processing and providing a certain cushion of excess capacity. Also, self-regulatory organizations should require broker-dealers to use automated, centralized depository channels for any certificate processing steps their customers initiate, to the maximum extent feasible. Such a requirement would be particularly important in any setting in which the traditional 5-day settlement time frame is truncated. In addition, we recommend that the regulatory authorities deemed appropriate under Section 17A of the 1934 Act, as well as individual agents, be encouraged to redouble their efforts to promote the highest standards in transfer agent recordkeeping and management.

In addition to those general recommendations, the STA recommends that two industry initiatives currently under development be supported by the Commission. These two initiatives - the introduction of secure, machine-readable stock certificates through use of Signa III technology developed by Light Signatures, Inc. and the expansion and refinement of transfer agent book-entry registration/custodial services, such as Dividend Reinvestment and Employee Stock Ownership Plans - will streamline processing and enhance securities immobilization.

The Signa III System, for example, employs laser technology and bar-coding techniques to identify uniquely each certificate and to store detailed information about the certificate in a form that ultimately is readable by transfer agents, securities depositories, and financial intermediaries. That System, which has been tested in a pilot mode by two major bank transfer agents, should enhance the integrity of, and simplify the handling requirements associated with, negotiable stock certificates. That enhancement and simplification, in turn, will benefit those issuers, financial institutions and investors - particularly individual investors like those requesting certificates this past November - that favor the availability of certificated evidence of securities ownership, as well as those financial institutions, such as broker-dealers and transfer agents, that must process certificates in connection with such investors' purchases and sales. Similarly, book-entry registration and custodial services, such as dividend reinvestment services, provided by transfer agents enable investors that do not require a certificate to maintain an account directly with the issuer's agent and to effect additional purchases and liquidations directly through the agent and the agent's brokers. Significantly, investors that use such services are not dependent on broker-dealer recordkeeping, though they are dependent on the recordkeeping capability of the agent. Also, such investors, through their relationship with the agent, retain a close relationship to the issuing company, without incurring the risks associated with safekeeping a negotiable certificate. To that extent, such services help reduce the proliferation and circulation of negotiable certificates, which the STA supports.

In summary, those two initiatives - Signa III processing and transfer agent direct registration services - provide a significant opportunity for expanded use of sophisticated automation in an immobilized securities environment. The STA believes that such initiatives, together with the other recommendations made in this Report, will improve processing efficiency, capacity and flexibility and will promote effective handling of high-volume cycles and surges. Accordingly, the STA will continue to support both initiatives and intends to play an active role in promoting industry development of direct registration alternatives, consistent with the guidelines and parameters identified in the SEC Staff Report, Progress and Prospects: Depository Immobilization of Securities and Use of Book-Entry Systems, June 14, 1985. The STA recognizes that an expanded book-entry registration role for transfer agents carries with it increased public responsibility, and we note that the Commission has previously considered, but not adopted, minimum capital or net worth and insurance requirements for transfer agents. See SEC, Securities Exchange Act Release No. 19860, June 10, 1983. As direct registration initiatives gain momentum, and as the Commission gives increased regulatory attention to direct registration alternatives, the STA will be pleased to work with the Commission in evaluating capital and insurance requirements.