REMARKS OF

COMMISSIONER MARY L. SCHAPIRO*

BEFORE

THE CASHIERS' ASSOCIATION OF WALL STREET INC.

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*The views expressed herein are those of Commissioner Schapiro and do not represent those of the Commission, other Commissioners or the staff.

U.S. Securities and Exchange Commission
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Good evening. It's a pleasure to be here this evening.

I'd like to speak to you today about two issues, signature guarantees and the Group of Thirty's recommendations for swifter settlement of securities transactions. Together, these two issues play a major role in our efforts to modernize the clearance and settlement system.

The securities business has undergone major changes in the past few years, and the securities industry and its regulators have been forced to adapt to respond to them. The Market Crashes of 1987 and 1989, of course, gave us cause to seek improvements in our automated systems, and to enhance our risk reduction efforts. In the wake of these events and the various attempts to increase cross-border trading, clearance and settlement concerns only have increased. As Western Europe attempts economic consolidation and as Eastern Europe begins to build capital markets and Latin American nations refine and improve newly prosperous markets, our desire to coordinate clearance and settlement in the world's financial markets grows continually as well.

As you may know, the Group of Thirty is a private organization composed of business people and bankers from around the world.

Although it has no official standing, the Group of Thirty has worked to develop changes in the financial system which would result in systemic improvements based primarily on private initiatives.

In 1988, the Group of Thirty proposed nine recommendations to improve and harmonize clearance and settlement systems in markets throughout the world. These recommendations were designed to increase safety and soundness, to enhance global competitiveness, and to achieve efficiencies in the clearance and settlement system by creating certain minimum standards for clearance and settlement systems in both fully developed and emerging markets.

Many of these recommendations are already standard features of the U.S. clearance and settlement system. For example, the U.S. securities markets already have a centralized depository system, and already employ a system for netting securities transactions.

In two respects, however, the U.S. clearance and settlement system does not meet the Group of Thirty's recommendations. Securities transactions in the United States are not yet settled on the third day after the trade date, T+3, and securities transactions are not yet settled using same-day funds. In order to meet these

recommendations, a Steering Committee and Working Committee were formed in the United States.

The Securities and Exchange Commission strongly supports the efforts by The Group of Thirty and the U.S. Steering and Working Committees. We recognize, as does the Group of Thirty, that the importance of efficient and safe clearance and settlement systems cannot be overrated. As the experience of the past few years has demonstrated, weaknesses in the clearance and settlement system can create major risks for the entire financial system. Improved and coordinated global clearance and settlement procedures will make our markets more efficient while reducing the risks that firms undertake, thereby improving the growth and stability of the world's financial markets. To emphasize our interest in these issues, the Commission sponsored a Roundtable last November at which more than 30 industry representatives discussed the benefits of and ways to achieve T+3 settlement and use of same day funds.

The Commission supports The Group of Thirty's efforts in particular because we appreciate that initiatives to upgrade the world's clearance and settlement systems will be most efficient if they are undertaken by industry members and not by government

regulators. I believe that private initiatives, especially in a complex and technical area like clearance and settlement, lead in the first instance to more informed, more practical, and more cost-effective solutions. For this reason, the Commission has supported the work of the Group of Thirty Working and Steering Committees, and has encouraged a broad range of industry participants to contribute their views and their expertise to the process.

Let me now turn to the two specific recommendations of The Group of Thirty that we have identified as relevant to the U.S. markets: shortening the settlement cycle from T+5 to T+3 and payment for securities transactions in same-day-funds. From a purely domestic perspective, the importance of these two initiatives in our efforts to reduce systemic risk is beyond doubt. As you know and as I have stated before, the longer the settlement period, the greater the risk to the financial system, both because there are more unsettled positions open at any one time and because each position is unsettled, and thus subject to the risk of adverse market events, for a greater length of time. Fast and final settlement could reduce that risk substantially. Settlement of transactions in same-day funds also would reduce systemic risk by eliminating the existing element of uncertainty between settlement and actual payment as to whether a

final movement of funds will take place as scheduled. These benefits may be hard to quantify, but they are real and I believe they are substantial.

Achieving these recommendations, however, will not be painless. Market participants will have to change their current practices. Many will need to make substantial investments in their back offices in order to adapt successfully. Customer behavior will also have to be changed. These are all substantial hurdles, and the associated costs should not be underestimated. Indeed, many industry participants have expressed doubts as to the wisdom of the Group of Thirty improvements, especially in the absence of a concrete proposal for changing the clearance and settlement system.

Recently, Chairman Breeden asked The Group of Thirty Steering Committee to set up a Task Force to develop a blueprint for implementation of T+3 settlement. This Task Force, consisting of representatives from major brokerage firms, banks, and other financial institutions, is charged with identifying the mechanisms by which T+3 settlement and use of same day funds can most readily be attained and the proper timetable for implementation. In accepting Chairman Breeden's invitation to chair the Task Force, John

Bachmann, identified the major issues in considering whether and how to implement T+3 settlement. These issues include:

- Clarify what are the safety and soundness issues today and tomorrow, who is worried about them, and why are they concerned.

- Identify all parties interested in and affected by these changes. What would be the main impact on each, both positive and negative.

- Point out other benefits beyond safety and soundness.

- Recognize the principal obstacles and challenges change would entail.

- Show areas where agreement exists.

- Identify what unresolved issues remain and what would seem to be the best solution, or what choices exist in resolving each.

We hope that the Task Force will complete its work within the next six months.

The U.S. Working Committee repeatedly has stressed the close relationship between the movement to T+3 settlement and the process of effecting settlement by book-entry only. For this reason, the Working Committee has proposed that, by 1992, all new corporate or municipal securities issued must be depository eligible and, for transactions among financial intermediaries and between financial intermediaries and their institutional clients, all settlements and other movements of corporate or municipal securities must be effected only by book-entry movement within a depository. The Working Committee has also spent many long hours debating the merits of requiring book-entry settlement for retail customers.

A requirement that institutional customers settle their securities transactions by book-entry is not as dramatic as it may sound. As you know, many institutions currently use the automated confirmation, affirmation, and settlement service offered by the depositories' National Institutional Delivery System.

Book-entry settlement for individual investors cannot be achieved as easily, however. Currently, retail customers who leave their securities in street name with their brokers are the only group of individual investors in a position to settle their securities transactions by book-entry. Many individual investors either keep their own securities certificates, or maintain their securities registered in their own names with a broker or other custodian. If book-entry settlement were required for retail transactions, such an investor would need to get his or her securities to a broker before selling them. That could significantly impede retail customers' access to the securities markets.

To solve the problem of settling individual investors' transactions by book-entry, a Direct Registration Subcommittee of the Working Committee was formed to develop direct registration alternatives for retail investors that could be implemented before or simultaneously with the 1993 T+3 settlement goal. The Committee identified two prototypical systems that might serve the needs of public investors -- one based on an expansion of existing securities depository relationships and another based on expansion of existing transfer agent/issuer services. The Committee asked for comment, and I urge you to do so.

Remember that the effort is not to build one system exclusively, but to build systems that meet all types of investor and marketplace needs. Your firm may have a philosophy of accumulating customer assets. But, not every investor is your customer or will be your customer, so the systems need to permit easy transfer among broker-dealers and lenders. The systems also need to provide for customer safety in the event of custodian insolvencies and be designed to build and maintain investor confidence in the safety of their assets and systemic integrity under all circumstances.

The move to book-entry only settlement will require the strictest standards for safety, scrupulous auditing by internal and external auditors, and vigilant monitoring and oversight by government regulators. Book-entry only settlement for all trades poses the potential threat of new, unforeseen difficulties in recordkeeping and funds and securities safekeeping. I believe the Commission should require strict adherence to the highest industry safeguarding standards and the highest levels of integrity on the part of all entities involved in book-entry settlement. Before any direct registration system is implemented, there must be appropriate rules and procedural safeguards to ensure that book-entry settlement not only

fully benefits all participants in our markets, but also operates safely so as to instill confidence in retail investors.

With respect to same-day funds settlement, implementation efforts have been undertaken by major clearing agencies in consultation with the staffs of the Commission and the Federal Reserve Bank of New York. Although more work needs to be done, I understand that a proposal may be available for comment by early next year.

An important factor in the implementation of same-day funds is the ability of clearing participants and clearing agencies to anticipate daily settlement requirements. The better the ability of these institutions to anticipate daily settlement, the easier it is to address daily operational needs prior to settlement. Thus, comparison of all transactions on a next-day basis and close-out of uncompared transactions that day would be a significant step forward. The effort to improve comparison of corporate equity trades has borne impressive results, although we still see members closing out on T+3, T+4, and T+5 instead of T+1. More needs to be done, however, to accelerate comparison of trades in corporate and municipal debt securities.

Signature Guarantees and STAMP

Now I want to turn to the subject of signature guarantees. This is another securities processing area that we at the Commission have been working with the industry to improve. There are a couple of developments on this front that I believe will greatly streamline the signature guarantee process and at the same time offer proper safeguards for all market participants. One of these is proposed Commission Rule 17Ad-15, developed under authority given to the Commission by the Securities Enforcement Remedies and Penny Stock Reform Act of 1990 to ensure equitable treatment among signature guarantors. The other development is the STAMP program, which is the industry's plan to facilitate acceptance by transfer agents of guarantees by participating guarantors.

As you know, signature guarantees are essential to the transfer of registered-form securities. Before a transfer of ownership can take place, a security must be endorsed by the registered owner. Neither an issuer nor its transfer agent, however, can be certain that a signature is genuine. Therefore, the issuer or its transfer agent rely on the guarantee of a financial intermediary that the endorsement on the certificate is genuine and effective. A signature guarantee

transfers from the issuer or transfer agent to the guarantor liability for forged endorsements or unauthorized transfers. The signature guarantee process is thus essential to the smooth functioning of the securities transfer system.

The current signature process is manually intensive and costly for both signature guarantors and transfer agents. Financial institutions guarantee signatures through use of rubber stamps and manually authorized signatures. They must provide each of an estimated 2,000 transfer agents with signature cards containing a specimen signature for each individual authorized to effect the institution's signature guarantee. Guarantors must update the signature cards on file with transfer agents whenever there is a change in the personnel authorized to effect signature guarantees. Guarantors also must maintain strict internal controls to assure that only authorized personnel effect guarantees, and that those individuals understand the extent of the institution's liability for a signature guarantee.

Transfer agents must maintain files of tens of thousands of specimen signature cards, which must be readily accessible so that their employees can compare the specimen signature on the card

with the signature guarantee on the securities certificate. Whenever new signature cards are received by the transfer agent, they must be sorted and filed appropriately to ensure that transfers of securities are based only on the signature of currently authorized personnel of the guarantor.

Transfer agents generally accept the signature guarantees of commercial banks and broker-dealers, because these institutions traditionally have offered signature guarantee services to their customers. The universe of financial institutions authorized to provide signature guarantees for customers, however, has expanded dramatically in recent years. As a result of legislative reforms in the financial services industry over the past decade, approximately 2,500 savings and loan associations and 14,000 credit unions are now authorized to guarantee signatures for securities transfers. As a result, approximately 35,000 financial institutions are currently authorized to provide signature guarantee services. The current, cumbersome system is not able to accommodate the increased numbers of signature guarantors and, as a consequence, many financial institutions are precluded from providing signature guarantee services for their customers or must enlist the services of

another financial intermediary to reguarantee their signature guarantee.

Transfer agents attribute their reluctance to accept these signature guarantees to the burden of assessing financial responsibility of, and monitoring authorized signatures from, this expanded universe of potential signature guarantors and the increased risk posed by increasing the group of acceptable guarantors. Transfer agents also believe that the risks incurred in accepting signature guarantees from unknown financial institutions far outweigh any inconvenience S&Ls and credit unions experience by obtaining signature guarantees from acceptable guarantors.

I will not review the long history of attempted improvements to the signature guarantee process. It is sufficient to say that efforts to address inequitable treatment of guarantors during the last ten years through private-sector business solutions and less formal Commission action were not successful.

Last October, Congress enacted the Securities Enforcement Remedies and Penny Stock Reform Act of 1990, and gave the Commission authority to ensure equal treatment among signature

guarantors. On September 9, 1991, the Commission published for comment proposed Rule 17Ad-15. The comment period expires on October 31, 1991. Please get your comments in now. We need your views. Let me describe a few salient points from the proposed rule.

- Proposed Rule 17Ad-15, if adopted, would prohibit inequitable treatment of eligible guarantor institutions. Eligible guarantor institutions would include all the financial institutions that have guarantor authority -- banks, brokers, dealers, municipal securities brokers and dealers, government securities brokers and dealers, insured credit unions, national securities exchanges, registered securities associations, clearing agencies, and savings associations.

- The proposed Rule would require transfer agents to adopt written standards for determining which guarantors it will accept, establish procedures to assure that its personnel use those standards, and make the standards available to the public on request.

Under the proposed Rule, a transfer agent's standards and procedures may provide for the acceptance of guarantees from

eligible guarantor institutions who are participants in a "signature guarantee program," recognized by the transfer agent. The transfer agent must determine that the program meets certain standards specified in the rule. For example, the program must facilitate the equitable treatment of eligible guarantors, and promote the prompt, accurate and safe transfer of securities by providing protection to the transfer agent against financial loss in the event persons have no recourse against the guarantor and in instances of an unauthorized guarantee purportedly made in the name of the eligible guarantor institution. After making an independent determination that the program satisfies the conditions stated in the proposed rule, the transfer agent then must incorporate in its signature guarantee standards its determination to accept signature guarantees from an eligible guarantor institution that participates in that program.

The Securities Transfer Association ("STA") has developed a signature guarantee program that I understand will be implemented by the end of this year. That program is called the Securities Transfer Agent Medallion Program, or "STAMP." The principal qualification for participation in STAMP is the requirement that participating guarantors obtain insurance to protect transfer agents from loss when they have no recourse against a guarantor. The

insurance may be obtained from any insurance company, and it is expected that participating guarantors will obtain this coverage from their current insurance carriers. To satisfy STAMP's minimum requirements, the coverage must include losses on any one signature guarantee of $50,000. Coverage under the Surety Bond must include losses in connection with guarantees usual and incidental to securities transfers. The Surety Bond would provide protection in addition to that provided by transfer agent blanket bond coverage and would cover losses without imposing a deductible requirement.

Each STAMP participant would receive from the STAMP administrator a unique "Signature Medallion" that would evidence the guarantor's signature guarantee and would replace the manual signature now customary for signature guarantees. To ensure the integrity of the program, the STAMP administrator would keep strict controls over the use of the technology through tracking of all Program participants, location of all stamps and imprint plates, inventory controls and expedited response to participant problems. In addition, before the administrator issues a guarantor any Medallion technology, plates or stamps, the administrator would require the insurance company to provide notification that the particular financial institution has Surety Bond coverage.

Well, there you have it -- two issues of concern to you: signature guarantees and the Group of Thirty. Both issues need your attention if we are to keep our markets safe and efficient in the years to come.