



**REMARKS BEFORE THE
SECURITIES TRANSFER ASSOCIATION**

COMMISSIONER MARY L. SCHAPIRO*

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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
450 Fifth Street, N.W.
Washington, D.C. 20549**

Thank you for inviting me to speak to you today. I would like to review some key legislative, regulatory and industry developments that are likely to be of vital interest to you.

I. Legislative Developments

In the waning days of its legislative session, Congress passed and the President signed, several landmark laws that will have profound consequences for the securities markets. These laws include the Market Reform Act of 1990 and the Securities Enforcement Remedies and Penny Stock Reform Act of 1990. I believe that passage of these laws marks the beginning of a dramatic new era of securities regulation and enforcement. Viewed together, the SEC - in the regulatory and the enforcement context - has assumed awesome new powers.

A. The Market Reform Act of 1990

The Market Reform Act expands the Commission's authority for market oversight significantly. As I will describe in general terms, the Market Reform Act includes provisions concerning emergency authority, large trader reporting, broker-dealer holding company risk assessment, market volatility, and coordinated clearance and settlement. Many of the details in each of these areas will need to be established during the next

few years, and I expect the Commission will engage in several substantial rulemaking projects to fill in those programmatic and operational requirements.

1. Emergency Authority

The Market Reform Act expands the Commission's authority to take emergency action to protect investors. The Act revises Section 12(k) of the Securities Exchange Act of 1934 to clarify the Commission's authority to suspend trading in a single security for as much as 10 business days and to halt all trading on any national securities exchange or otherwise subject to Presidential review. The Act also authorizes the Commission, in an emergency, summarily to alter, supplement, suspend, or impose requirements or restrictions established by the Commission or a self-regulatory organization for up to 10 business days. An "emergency" is defined as one of two conditions:

- (a) a sudden and excessive fluctuation of securities prices generally that threaten fair and orderly markets, or
- (b) a substantial disruption of the safe or efficient operation of the national system for clearance and settlement of securities transactions.

The President may terminate any emergency action taken by the Commission, and aggrieved parties may obtain judicial review of that action.

2. Large Trader Reporting

The Market Reform Act also authorizes the Commission to obtain information to facilitate its monitoring of trading activity in securities markets more effectively. Under newly created Section 13(h) of the Securities Exchange Act, the Commission would be authorized to create a large trader reporting system. The purpose of these provisions is to enable the Commission and self-regulatory organizations to review the trading activity of market professionals and other investors that engage in a substantial level or value of securities trading, as well as to monitor the effects on the securities markets of such activities.

3. Broker-Dealer Holding Company Risk Assessment

Perhaps the single most important measure in the Market Reform Act is the one which authorizes the Commission to collect information from broker-dealers for purposes of holding company risk assessment. The demise of Drexel Burnham Lambert Group, the holding company parent of what was, at one time, the fifth largest broker-dealer in the United States, was a case study in why this authority is necessary. Knowledge of Drexel Group's financial condition and its principal

financial resources might have given regulators earlier warning of their financial difficulties to permit a more orderly wind-down of their operations and positions. This would have reduced the risks of settlement gridlock and financial loss to financial intermediaries and public investors.

The holding company risk assessment provisions of the Market Reform Act are designed to enable us to assess the overall financial exposure of broker-dealers that are part of holding company systems. Toward that end, the statute authorizes the collection of risk assessment information, but does not in itself provide the Commission with any new authority to regulate directly the activities of a broker-dealer's affiliates.

4. Market Volatility

The Market Reform Act also authorizes the Commission to promulgate rules to address manipulative trading practices and market volatility. This provision was not sought by the Commission in its package of legislative reforms sent to Congress in June 1988. It is a fairly controversial grant of authority to the agency that will be exercised only with extreme care.

5. Coordinated Clearance and Settlement

Of potentially greater interest to this group are the clearance and settlement provisions of the Market Reform Act.

Those provisions amend Section 17A of the Exchange Act in two principal areas. First, the Market Reform Act directs the Commission, in connection with its responsibilities over the national clearance and settlement system, to facilitate the establishment of linked or coordinated facilities for clearance and settlement of transactions in securities, options, futures and commodity options, in coordination with the Commodity Futures Trading Commission and consultation with the Board of Governors of the Federal Reserve System. Second, the Market Reform Act gives the Commission specific authority to adopt rules concerning the transfer and pledge of uncertificated securities, and to override state law to the extent necessary to promote safe and efficient operation of the national system for the clearance and settlement of securities transactions. In this regard, we are directed to establish, within the next few months, an Advisory Committee to consider, among other things, the areas in which state and related federal laws concerning the transfer and pledge of securities do not provide the necessary certainty, uniformity, and clarity for interested parties concerning their respective rights and obligations.

The Commission's authority is intended, in some respects, to be a shotgun behind the door to encourage states to act promptly in passing commercial law changes that are often viewed as technical, complex, and of little interest to local constituents. There are several hurdles the Commission must pass if it determines to engage in rulemaking. The Commission must make specific findings in consultation with the Treasury Department and the Federal Reserve Board that, the rules are necessary for the protection of investors or in the public interest and are designed to promote prompt, accurate and safe clearance and settlement. Even if the Commission adopts a rule, the Market Reform Act authorizes states to override that rule prospectively by enacting, within two years laws that explicitly differ with the Commission's rule.

The Division of Market Regulation has been working closely for the last two years with the ABA Section on Business Law, Advisory Committee on Market Transactions, headed by Robert Haydock. This committee is preparing a report which will identify some of the changes in commercial law that should be considered to provide a basis for efficient and safe clearance, settlement, and transfer operations. Those areas include, to name but two items,

- . the ability of two US market participants to settle by book entry at a US clearing agency, a transaction in foreign**

securities held by a non-US custodian for that US clearing agency; and

- clarification of which laws govern transfers, pledges, and the priority of claims to securities in multi-party, multi-state transactions.**

I understand that the ABA committee expects to circulate its report for comment in the next couple of months and I'm sure they'll be looking for transfer agent input.

B. The Securities Enforcement Remedies Act of 1990

In the last month, Congress also enacted the Securities Enforcement Remedies and Penny Stock Reform Act of 1990, which has the unfortunate acronym of "SERPSRA". This Act will add several arrows to the Commission's quiver to enforce the federal securities laws more effectively. These arrows include the ability to seek civil monetary penalties for violations of the federal securities laws and Commission authority to issue cease-and-desist orders against any person who is violating, has violated or is about to violate any section of the Securities Act, Exchange Act, Advisers Act or Investment Company Act.

1. Civil Penalties

SERPSRA amends existing law to authorize federal courts, on application by the Commission, to order civil penalties for violations of the federal securities laws. Until this change, the Commission could not seek civil penalties for violations except in limited circumstances, such as insider trading. The amount of the penalty will be determined by the Court in light of the facts and circumstances. SERPSRA establishes maximum dollar penalties depending on the nature of the violation, using a three-tier system. In any tier, the penalty can be as great as the pecuniary gain to the defendant as a result of the violation.

- . Tier One: \$5,000 for individuals, \$50,000 for others;**
- . Tier Two: (violations involving fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement) \$50,000 for individuals, \$250,000 for others;**
- . Tier Three: (violations that satisfy Tier Two standards requirements and -- directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons) \$100,000 for individuals, \$500,000 for others.**

SERPSRA also authorizes the Commission to impose civil penalties in its own administrative proceedings against registered broker-dealers, municipal securities brokers and dealers, government

securities brokers and dealers and registered clearing agencies and transfer agents. Civil penalties could also be imposed in administrative proceedings against associated persons of registered entities, including associated persons of broker-dealers and transfer agents. The same tiering of penalties is provided for Commission proceedings as for District Court proceedings. The Commission may - at its discretion - take into account the respondent's ability to pay a penalty in determining whether such a penalty is in the public interest. The Commission can also order an accounting and disgorgement of ill-gotten gains.

2. Cease-and-Desist Orders

The new provisions also permit the Commission to issue, after notice and opportunity for hearing, cease-and-desist orders. The Commission must find that the respondent is violating, has violated, or is about to violate any provision of the federal securities laws. A cease-and-desist order may, as the Commission deems appropriate, require future compliance or steps to effect compliance, either permanently or for such period of time as the Commission may specify.

SERPSRA also authorizes the issuance of temporary cease-and-desist orders against registered entities if the Commission determines that it is necessary to prevent the dissipation of assets, significant harm to investors or substantial harm to the public interest.

We are required by the new law to establish, within one year after the date of enactment, regulations providing for the expeditious conduct of hearings and rendering of decisions in connection with cease-and-desist orders. I chair the Commission's task force which has commenced this process. We have established an ambitious goal: to ensure that the Commission is now meeting, and will continue to meet, the highest standards in the fair and efficient administration of justice.

3. Signature Guarantees

Now, if you can all just stand one more word on signature guarantees. . . SERPSRA amends Section 17A of the Exchange Act to authorize the Commission to regulate transfer agent signature guarantee practices, including the acceptance or rejection of signature guarantees. The standard for such rulemaking is quite broad and permits the Commission to prescribe rules as necessary or appropriate:

- . in the public interest;**
- . for the protection of investors;**
- . to assure the equitable treatment of financial institutions which issue signature guarantees (i.e., banks, broker-dealers, savings and loans, and credit unions); or**
- . in furtherance of the purposes of the Securities Exchange Act of 1934.**

As you know, signature guarantees are essential to the transfer of securities. Because an issuer or its transfer agent cannot know all registered transfer owners, it must rely on the guarantee of the owner's financial intermediary that the signature of the registered owner is genuine and effective. The current signature guarantee process is archaic, manually intensive, and costly for guarantors, transfer agents, and, ultimately, security holders. Moreover, because the universe of potential guarantors has expanded dramatically in recent years, it is difficult for the current signature guarantee system to accommodate the increased number of signature guarantors. As a consequence, many financial institutions are effectively precluded from providing signature guarantee services for their customers or must enlist the services of another financial intermediary to re-guarantee their signature guarantees.

As the securities industry moves closer toward an uncertificated environment, the signature guarantee will continue to play an essential role in the transfer process. Owners will need to submit transfer instructions signed by the owner and a signature guarantee from the owner's financial intermediary warranting that the signature of the owner is genuine and effective.

The Division of Market Regulation is working on proposed signature guarantee rules that are designed to address historic

problems in this area -- practices that limit the acceptance of guarantor institutions for reasons unrelated to the creditworthiness of those guarantors. The Division is also working on proposed rules that would encourage modernization of the entire signature guarantee process, to support private sector programs that provide widespread access by financially responsible guarantor institutions. I expect the Commission will consider whether to publish those rules for comment in the very near future.

II. The Group of Thirty

Many of you are already familiar with the Group of Thirty and its nine recommendations to harmonize clearance and settlement in securities markets throughout the world. These recommendations are not just based on the goal of achieving greater harmony among securities markets. These recommendations are also based on a view that clearance and settlement systems can be made more efficient and safer for investors and their financial intermediaries.

Our securities markets today are perhaps the safest, deepest and most efficient in the world. We have instituted many positive changes in the clearance, settlement, and transfer process. The cost to investors of executing securities transactions has fallen significantly in nominal and real terms since 1975, and our clearance, settlement and transfer

infrastructure is now capable of handling trading volume that was unthinkable 20 years ago.

We cannot, however, rest on our laurels. Clearance and settlement of securities transactions remains a very risky proposition that can quickly turn profitable transactions into substantial losses.

The Securities and Exchange Commission strongly supports the efforts of the Group of Thirty. As the experience of the last three years has demonstrated, weaknesses in the clearance and settlement system can create major risks for the entire global financial system.

During the last year, the Group of Thirty U.S. Working Committee has been exploring ways to implement two recommendations: Shortening the settlement cycle for securities transactions from five to three business days and settlement in same-day funds. This process has been long, and at times difficult and contentious. It is also extremely important to the future viability of our national clearance and settlement system, our securities markets and our economy.

A. T+3 Settlement by 1992

The Group of Thirty Report recommends that all trades be settled by the third day after the trade date, T+3. The Commission agrees with the Group of Thirty that shortening the settlement period could have a substantial positive impact in terms of reducing risk in the clearance

and settlement system. A shorter settlement time period will reduce the number of outstanding trades, thereby reducing the counterparty risk and market exposure associated with unsettled securities transactions.

Settlement practices in US markets vary in two segments of the industry – the institutional market and the retail market.

On the institutional side, a majority of transactions currently settle in automated, book-entry form at the securities depositories. The major obstacle to T+3 settlement for institutional trades, therefore, occurs in the current methods of trade confirmation and affirmation with institutional customers that precedes such book entry settlement. Currently, self-regulatory organization rules require that institutional clients who desire delivery- or receipt-versus-payment privileges must participate in trade confirmation and affirmation systems operated by the securities depositories, such as the National Institutional Delivery System ("NIDS"), managed by the Depository Trust Company ("DTC"). To accommodate an earlier settlement period, NIDS would need to be changed to an intra-day, interactive trade confirmation and affirmation system. Procedures and rules must ensure that an acceptable percentage of transactions are processed through this system and that sufficient resources are available to enforce compliance with the system.

On the retail side, the problems are more difficult. For example, many retail investors hold securities certificates that must be delivered

to their broker-dealer when securities are sold, and many retail investors who buy securities pay for their purchases by mailing a check to their broker-dealer after receiving a trade confirmation with the trade price, including the broker-dealer's commission. Many broker-dealers with this kind of client base worry about the cost of doing business in a T+3 environment, particularly the cost of accepting and delivering physical certificates, and investor reaction to the changes in customer payment and delivery procedures that may be necessary to effectuate earlier settlement time-frames.

Everyone recognizes that shortening the settlement cycle will involve significant expense for market participants. In addition, shortening the settlement cycle will put greater pressure on processing physical certificates. As a result, the U.S. Working Committee has been considering plans to link T+3 settlement with a reduction in certificate flow, such as through the development and use of a direct registration system. There is, however, no necessary connection between a reduction in certificate flow and the achievement of T+3 settlement. Therefore, it remains to be seen whether the Working Committee's final blueprint for implementation of T+3 settlement will include as a prerequisite significant reduction in certificate flows in connection with securities settlements.

I believe that a number of steps would need to be taken if certificates are indeed to be dematerialized or immobilized as part of the industry's efforts to achieve settlement by T+3. First, if investors are to be asked to give up their certificates, the industry must establish a workable system for custody and money transfer that is acceptable to individual investors. Direct registration of ownership interests, in a system that is either centralized (similar to the current Treasury Direct system for government securities) or decentralized among transfer agents but tied to securities depositories, should be considered seriously, and questions as to who will pay for the start-up and maintenance costs of such a system must be answered. As a corollary to this effort, there would be a need for an extensive educational program to persuade investors that they will not be harmed by the loss of the ability to obtain paper certificates. In addition, it is very important that the industry take steps to protect the ability of issuers to have open channels of communication to their shareholders. I am pleased that the transfer agent community, under the leadership of this association, has taken up the challenge and has become an active partner in the US Working Committee's efforts by designing such a system and addressing these difficult questions. I look forward to hearing more about this system as work progresses and at the Commission's Roundtable in Washington on November 27th.

Of course the development of a direct registration system that is operated by transfer agents may necessitate a greater level of regulatory oversight of the transfer agent community. In this connection, I expect that the Commission will reconsider its existing regulations to determine whether they foster efficient and safe transfer agent operations, necessary and sufficient to provide the highest degree of investor confidence. The STA's rulemaking petitions provide a useful starting point for that process.

B. Same-Day Funds Settlement of Securities Transactions

The Group of Thirty Report also recommended the adoption of a same-day funds convention for settlement of securities transactions. Adoption of same day funds settlement would increase the efficiency of the clearance and payments systems, and may reduce risk, especially if all markets are consistent in their use of same-day funds settlement. What same-day funds settlement provides, in many respects, is finality to the transaction. With next-day funds settlement, there is always the potential, however remote, that payment will not be completed.

Same-day funds settlement was considered by the Financial Industry Securities Council almost five years ago and it concluded then that same-day funds settlement should be a long-term goal for the securities markets. As you know, FISC consists of representatives of

the American Bankers Association ("ABA") and the Securities Industry Association ("SIA"). To my knowledge, those organizations have not adopted formal positions on the Group of Thirty recommendations.

In its August 1990 Status Report, the U.S. Working Committee concluded that all payments for settlements among financial intermediaries, and between financial intermediaries and their institutional customers, should be made using same-day funds in 1992. This recommendation would be applied to payments associated with dividends, interest, redemptions, and reorganization. The Committee did not recommend, at that time, the use of same-day funds for settlement payments between financial intermediaries and their retail customers.

The U.S. Working Committee has circulated questionnaires designed to learn more about the implications and consequences of these recommendations and the STA has circulated similar questionnaires. If you have received a questionnaire, please respond. If not and you would like to respond, I'm sure the STA leadership or U.S. Working Committee would welcome your participation.

The Group of Thirty U.S. Working Committee has identified the important issues and created the momentum for change. It is now incumbent upon all segments of the U.S. securities industry and the Commission to devote careful thought and attention to these issues.

The Securities Transfer Association has risen to the occasion and provided important leadership in the development of direct registration alternatives. The STA leadership has devoted considerable time and energy to this effort, and they deserve your support. While the issues may at times seem daunting, you must redouble your efforts.

We have a very full agenda in Washington these days, but I can assure you that the issues associated with clearance and settlement are receiving priority attention from the Commission and its staff.

We look forward to hearing more about these issues at the SEC's Roundtable, which will be held in Washington on November 27, 1990.