

FEDERAL RESERVE BANK
OF NEW YORK

ATCIR No 8408
August 18, 1978

MISSING, LOST, COUNTERFEIT, OR STOLEN SECURITIES
Request for Comments on SEC Program

** To The Chief Executive Officers of All State Member
Banks in The Second Federal Reserve District:*

In our Circular No. 8143, dated July 11, 1977, we indicated that the Securities and Exchange Commission had adopted regulations--Rule 17f-1-- to monitor missing, lost, counterfeit, or stolen securities. These regulations require all State member banks, among others, to make certain reports and inquiries involving these securities.

As indicated in the enclosed Federal Register notice, the Commission is now soliciting public comment on the provisions and operation of the Lost and Stolen Securities Program and on the redesignation of the Securities Information Center, Inc. to maintain and operate the data base of reported missing, lost, counterfeit, or stolen securities for an additional specified period. Such comments must be received by the Commission on or before September 8, 1978.

For further information regarding this matter you may contact the Securities and Exchange Commission, the address of which is included in the enclosed Federal Register notice.

PAUL A. VOLCKER,
President.

PROPOSED RULES

[8010-01]

SECURITIES AND EXCHANGE COMMISSION

[17 CFR Parts 240, 241, and 249]

[Release No. 34-15015; File No. S7-6111]

LOST AND STOLEN SECURITIES

Advance Notice of Intent To Engage in Rulemaking

AGENCY: Securities and Exchange Commission.

ACTION: Advance notice of intent to engage in rulemaking.

SUMMARY: The Commission requests comment on the provisions and operation of the Lost and Stolen Securities Program and on the redesignation of the Securities Information Center, Inc. ("SIC") to maintain and operate the data base of reported missing, lost, counterfeit or stolen securities. In initially implementing the Lost and Stolen Securities Program, the Commission provided that its first year of operation would be conducted on a pilot basis and that the designation of SIC would terminate at the end of the pilot year. Comments are solicited in order that the Commission may assess whether modifications to the Lost and Stolen Securities Program may be appropriate and whether a redesignation of SIC should be made for an additional specified term.

DATE: Comments must be received on or before September 8, 1978.

ADDRESS: Persons wishing to submit written views, data, and comments should file three copies thereof with George A. Fitzsimmons, Secretary, Securities and Exchange Commission, Washington, D.C. 20549. All submissions should refer to File No. S7-611 and will be available for public inspection.

FOR FURTHER INFORMATION CONTACT:

Gregory C. Yadley, Division of Market Regulation, Securities and Exchange Commission, Washington, D.C. 20549, telephone 202-376-8129.

SUPPLEMENTARY INFORMATION: In order to facilitate conversion of the pilot phase of the Lost and Stolen Securities Program (the "Program") to a more permanent basis, the Commission has determined that it is appropriate at this time to solicit comments concerning the provisions and operation of the Program. Subsequent to the review and analysis of these com-

ments by the staff of the Commission, the Commission may propose amendments to rule 17f-1 (17 CFR 240.17f-1) reflecting the views of interested persons submitted in response to this release.

BACKGROUND

Problems relating to missing, lost, counterfeit or stolen securities were outlined by the Commission, in 1970¹ and were subsequently the subject of a series of Congressional hearings.² Implementation of a system to receive reports and inquiries concerning missing, lost, counterfeit and stolen securities was recommended by members of Congress, the industry, and law enforcement agencies. To accomplish this objective, the Securities Acts Amendments of 1975³ introduced new section 17(f)(1) into the Securities Exchange Act of 1934 (the "Act") and provided that certain financial institutions⁴ shall make reports and inquiries with respect to missing, lost, counterfeit or stolen securities in accordance with rules promulgated by the Commission. The section also provides that reports and inquiries shall be made to the "Commission or other person designated by the Commission" and that reasonable fees may be charged for the processing of such data.

On December 6, 1976, the Commission adopted § 240.17f-1 establishing reporting and inquiry requirements with respect to missing, lost, counterfeit or stolen securities.⁵ On August 5, 1977, the final, amended version of the section was published,⁶ and on Janu-

¹Study of Unsafe and Unsound Practices of Brokers and Dealers, Report and Recommendations of the Securities and Exchange Commission (pursuant to section 11(h) of the Securities Investor Protection Act of 1970), December 1970.

²Organized Crime—Stolen Securities, hearings before the Permanent Subcommittee on Investigations, Senate Committee on Government Operations, 92d Cong., 1st Sess. (1971); 93d Cong., 1st Sess. (1973); 93d Cong. 2d Sess. (1974).

³Pub. L. 94-29 (June 4, 1975).

⁴The institutions subject to section 17(f)(1) are enumerated in the statute as follows: Every national securities exchange, member thereof, registered securities association, broker, dealer, municipal securities dealer, registered transfer agent, registered clearing agency, participant therein, member of the Federal Reserve System, and bank whose deposits are insured by the Federal Deposit Insurance Corporation.

⁵Securities Exchange Act Release No. 13053, 41 FR 54923 (December 6, 1976). Certain technical amendments to the section were made by the Commission in Securities Exchange Act Release No. 13280, 42 FR 11829 (March 1, 1977). Further amendments regarding the role of transfer agents in the program were proposed in Securities Exchange Act Release No. 13281, 42 FR 11844 (March 1, 1977) and incorporated into the rule in Securities Exchange Act Release No. 13832, 42 FR 41022 (August 12, 1977).

⁶Securities Exchange Act Release No. 13832, 42 FR 41022 (August 12, 1977).

ary 2, 1978, the computerized system for the processing of reports and inquiries became fully operational.

In order to monitor the effectiveness of § 240.17f-1 and the system designed to carry out its provisions, the Commission determined that the lost and stolen securities program should be instituted initially on a pilot basis, through December 31, 1978. Furthermore, the Commission determined that it would be appropriate to designate another person, as provided for in the statute, to receive and process the reports and inquiries for which the Commission is the appropriate instrumentality, as defined by the section⁷ at least for purposes of the pilot program. Accordingly, the Commission solicited plans from persons interested in acting as the Commission's designee, and, after analysis of the submissions, designated the Securities Information Center, Inc. ("SIC") to act on its behalf⁸ through the pilot year ending December 31, 1978.

SOLICITATION OF PUBLIC COMMENTS

Inasmuch as the pilot year and SIC's term of designation will expire on December 31, 1978, the Commission solicits public comment at this time on the provisions of § 240.17f-1, the operation of the program to date, and on the question whether it would be appropriate for the Commission to redesignate SIC to receive and process reports and inquiries made pursuant to the section.

To focus the attention of public commentators, those aspects of the program which are of particular concern to the Commission are outlined below. Public comment relative to these issues will assist in the formulation of appropriate amendments to the section.

1. *Institutions subject to § 240.17f-1.* The financial institutions required to make reports and inquiries with respect to missing, lost, counterfeit, or stolen securities pursuant to § 240.17f-1 include nearly 20,000 institutions and a broad variety of securities and banking entities.⁹ Preliminary research suggests that it may be appropriate to exempt from the operation of the section certain classes or subclasses of these institutions or to limit the appli-

cation of the section with respect to such institutions. Similarly, it may be appropriate to broaden the scope of the section to include additional classes of financial institutions or to impose greater requirements on certain classes or subclasses of institutions. The Commission invites comments on these issues and seeks assistance in identifying appropriate criteria for making such determinations.

2. *Securities encompassed by § 240.17f-1.* Although section 17(f)(1) of the act applies to all securities, under § 240.17f-1, securities issues for which CUSIP numbers have not been assigned are exempted from the reporting and inquiry provisions of the program. Comments are requested concerning the appropriateness of this exemption, its permanent incorporation into the section, and whether other types of securities should be exempted.

3. *Appropriate Instrumentalities.* Section 240.17f-1 specifies that reports and inquiries shall be made to the "appropriate instrumentality." For securities issued by the U.S. Government, an agency or instrumentality of the U.S. Government, the International Bank for Reconstruction and Development, the Inter-American Bank, or the Asian Development Bank, the appropriate instrumentality is any Federal Reserve Bank or Branch.¹⁰ For reports and inquiries regarding all other securities, the appropriate instrumentality is the Commission or its designee. This bifurcation of the responsibility for the processing of reports and inquiries resulted, in part, from the desire to take advantage of the information contained on the Federal Reserve Banks' "Checklist of Lost or Stolen Securities." At the time of the enactment of section 17(f) of the act, this manually accessed checklist had been used by member banks of the Federal Reserve System for nearly 6 years.¹¹

Information is requested from interested members of the public as to whether the framework of dual appropriate instrumentalities provided by the section is appropriate or whether a unified central data base would be preferable. In addition, comments as to any difficulties experienced due to the concept or operation of the two appropriate instrumentalities are invited.

With respect to corporate and municipal securities, the Commission de-

termined to exercise its authority to designate another entity to process reports and inquiries. As stated earlier, SIC's term as the Commission's designee expires on December 31, 1978. The Commission must, therefore, either designate SIC for another specified period of time or designate another entity to receive and process the reports and inquiries made pursuant to the section. While the staff's experience with SIC has been positive and unofficial comments from industry sources have been favorable, the Commission, in conformity with concepts of fairness, solicits submissions from other persons interested in serving as the Commission's designee.¹²

In formulating submissions to the Commission; prospective designees should consider carefully the "Criteria for a Lost and Stolen Securities Reporting and Inquiry System" set forth in the Appendix, and should detail the manner in which their proposed system would operate, and include an estimate of the costs for establishment and operation of such a system and a plan for allocation of such costs.

Additionally, in order to assist the Commission in its evaluation of SIC and its processing system, and to aid in the formulation of system improvements, comments are invited from interested persons concerning their experience in working with SIC, their suggestions for modifications of the design and operation of its system, and the appropriate number of years for which a designation should be made.

4. *Reporting requirement.* Section 240.17f-1 provides that all institutions subject to its provisions shall report the discovery of the loss of any security to the appropriate instrumentality and to a registered transfer agent for the issue. A report to the appropriate law enforcement agency is also required in cases of suspected criminality. The section sets forth differing time requirements within which such reports shall be made, depending on the type of loss involved and the circumstances involved in the loss.¹³ The attention of commentators is directed towards the appropriateness of these time requirements and the possibility that other circumstances exist that might make desirable the inclusion in the section of new time frames applicable to such circumstances.

All reports of loss are required to be made on Commission Form X-17F-1A. The Commission solicits suggestions regarding appropriate modifications in

⁷Under § 240.17f-1, reports and inquiries are directed to the "appropriate instrumentality." In the case of U.S. Government securities, the appropriate instrumentality is any Federal Reserve Bank or branch thereof. The Commission is the appropriate instrumentality for all other securities, including State and municipal issues.

⁸Securities Exchange Act Release No. 13538, 42 FR 26495 (May 24, 1977). AutEx, Inc. was originally named as the designee. Subsequently, as a result of the acquisition of AutEx by ITEL Corp., SIC was created as a wholly owned subsidiary of ITEL Corp.

⁹See note 4, *supra*.

¹⁰Section 240.17f-1(a)(2)(i).

¹¹During the drafting stages of rule 17f-1, the Federal Reserve Banks offered to serve as an appropriate instrumentality on a "temporary" basis in order to facilitate implementation of section 17(f). At that time, it was understood that the Federal Reserve Bank would not be held to a permanent commitment but would consider at a later date whether it was desirable to continue to play such an active role in the Commission's program.

¹²Section 17(f)(1)(A) of the act does not require that a designation be made but provides that reports and inquiries shall be made to the Commission or other person designated by the Commission.

¹³For example, if there is a substantial belief that criminality is involved in the loss, the report must be made one day after discovery. Section 240.17f-1(b)(1)(i).

the format and graphics of the form, as well as the information required to be submitted on the form, in order to facilitate its use, make it more informative, and encourage its use by the transfer agent community as a "uniform stop transfer order form." Comments are also requested as to whether copies of the reporting form, Form X-17F-1A, should be sent to other entities.¹⁴

5. *Inquiry requirements.* Section 240.17f-1 requires reporting institutions to make inquiry whenever securities come into their possession or keeping unless an exemption applies. The section does not specify the time at which such inquiries must be made. It is expected, however, that a reporting institution will make inquiry prior to giving value, particularly if the securities or circumstances appear to be suspicious, in order to verify that the securities have not been reported as missing, lost, counterfeit or stolen. Comments are welcome as to whether amendment of the section to require inquiry within certain specified time periods would be desirable and, if so, the appropriate lengths of such time periods.

Presently, the section provides that a reporting institution need not inquire if the security is received: (1) Directly from the issuer or issuing agent at issuance; (2) from another reporting institution or a Federal Reserve Bank in its capacity as fiscal agent; or (3) from a customer of the reporting institution and is registered in the name of such customer or its nominee.¹⁵ In addition, for the purposes of the pilot program only, certain additional exemptions from inquiry are available: Corporate and municipal security issues not assigned CUSIP numbers¹⁶ and receipts involving securities of \$10,000 or less are exempt, as are inquiries by registered transfer agents.¹⁷

Specific comments are solicited as to the desirability of continuing or incorporating permanently into § 240.17f-1 these special exemptions. With respect to the \$10,000 *de minimus* exemption from inquiry, comments are sought concerning whether the exemption amount should be lowered to bring a greater number of transactions into the scope of the inquiry provisions, or whether it should be raised, to focus on those transactions with the great-

est potential losses. Comments are also invited as to whether the exemption amount should vary, depending on the nature of the security involved. Finally, comments regarding the appropriateness of additional exemptions from required inquiry, on either a provisional or a permanent basis, are solicited.¹⁸

F. *System design and fee structure.* The SIC processing system provides for two levels of user access with respect to inquiries. A reporting institution must choose to be either a "direct inquirer" or an "indirect inquirer" at the time of its registration in the Program. Direct inquiries have the ability to access the data base directly while indirect inquirers must process their inquiries through a direct inquirer.

This scheme of classification for participation was created with a view towards minimizing the monetary and administrative costs of the program. This interest also guided the Commission in its formulation of the pricing schedule for reporting institutions.¹⁹ Usage fees are based on the aggregate volume of items processed by SIC and are apportioned among the direct inquirers according to classifications based on size.²⁰ This billing structure was deemed to be preferable to a "per item" or a "flat fee" system because it would avoid any disincentive to making permissive inquiries of the system and would allocate the costs of the program in a reasonable manner. Under this scheme, the smallest institutional classifications of direct inquirers have been charged \$26.75 over the first two quarters of the pilot year without any limitation on the number of reports and inquiries submitted.

In formulating the pricing schedule, the Commission attempted to minimize the fees applicable to smaller institutions in the expectation that they would choose direct inquirer status. Such has not been the case; only one half of the originally estimated number of direct inquirers actually elected this status. Comments from in-

terested persons are solicited as to whether the direct/indirect inquirer status option has achieved its purpose of making the benefits of the program available to all institutions subject to section 17(f)(1) of the act, while minimizing their costs and, in addition, whether this billing system, which is based on the size of the institution, has proven just and workable and, if not, what alternatives should be considered.

REQUEST FOR COMMENTS REGARDING STAFF INTERPRETATIONS OF § 240.17f-1

Since the implementation of the program, the staff of the Commission has issued several interpretations and no action letters concerning various provisions of § 240.17f-1. In this regard, the Commission solicits comment as to whether they should be provisionally or permanently incorporated into the section. Several of the specific areas addressed are summarized as follows:

REPORTING PROVISIONS

1. *Warrants.* The staff declined a request that warrant cards, representing rights, be exempted from the reporting provisions of § 240.17f-1. The rationale for this position is that although individual rights are generally of minimal value, the number of rights represented by a warrant card is correlated to the number of shares a stockholder owns and, thus aggregated, can have a considerable value.²¹

2. *Losses during completion of delivery, deposit or withdrawal.* With regard to subsections (b)(2)(ii)(B) and (b)(2)(iii)(C) of the section, regarding the time and party to report a loss when securities are delivered "over the window," the staff published an interpretation stating that copies of delivery bills, stamped by receiving institutions "Received Subject to Count and Examination" and returned to delivering institutions, are "receipts" under the section and thereby create an obligation on the part of the receiving institution to report any losses to the appropriate instrumentality.²²

3. *Timely submission of report.* Due to the difficulties certain institutions have faced in researching the data required to be submitted in the report of loss, the staff has published interpretations of the reporting requirements of the section stating that in instances where no criminal activity is suspected a report must be made under subparagraph (b)(2) of the section as soon as the reporting institution has available to it the CUSIP and certificate

¹⁴For example, it has been informally suggested to the staff that inquiry should not be required in the case of bearer securities where the institution taking such securities into its possession sold such securities to the person delivering them and proof of purchase is offered.

¹⁵Direct inquirers shoulder the costs of the system. Indirect inquirers are charged no fees by SIC but, rather, are subject to whatever fees they agree to pay their direct inquirer. One benefit of this approach is that it significantly alleviates problems relating to the frequent collection of small bills from large numbers of persons, a problem which the Securities Investors Protection Corp. has experienced to a great extent in its collection of assessment fees.

²⁰Billing classifications are based on the amount of deposits for banks, annual revenue for securities organizations, and number of shares issued in the case of non-bank transfer agents.

²¹Letter to Morgan Guaranty Trust Co., dated Mar. 13, 1978 (public availability date Apr. 13, 1978).

²²Letter to Northwestern Trust Co., dated Feb. 28, 1978 (public availability date Mar. 29, 1978).

¹⁴It has been informally suggested to the staff that the designated examining authority of a broker-dealer should receive a copy of the form in order to better assist them in their monitoring of the activities of their members.

¹⁵Section 240.17f-1(c)(1)(i)-(iii).

¹⁶Consequently, short term securities such as commercial paper are not subject to the requirements of § 240.17f-1 during the pilot program.

¹⁷See Securities Exchange Act Release No. 13832, 42 FR 41024 (Aug. 12, 1977).

number of the security, provided, however, that the institution acts in good faith in promptly researching this data. This extension of time is not available, however, where the circumstances surrounding the loss suggest possible criminal activity.²³

4. *Report to Law Enforcement.* Subparagraph (b)(ii) of §240.17f-1 provides that all reporting institutions shall promptly report to the appropriate law enforcement agency upon the discovery of the theft or loss of any security where there is a substantial basis for believing that criminal activity was involved. To clarify those instances where such reports should be submitted to law enforcement, the staff issued an interpretation stating that an institution does not necessarily have a "substantial basis" for such a belief in those instances where the institution's knowledge of the loss or theft is based on unsubstantiated information given to it by another party.²⁴

INQUIRY PROVISIONS

1. *Exemption upon receipt from another reporting institution.* In an interpretative letter, the staff expressed the opinion that the exemption from inquiry available upon receipt of securities from another reporting institution is also available in those instances where the delivering institution is affiliated with and under the common control of a reporting institution and acts solely as a "certificate drop."²⁵

2. *Exemption upon receipt from a Federal Reserve Bank.* Under §240.17f-1(c)(i), inquiry is not required in instances where a reporting institution receives securities from a Federal Reserve Bank in its capacity as fiscal agent. This exemption is not available under the section, therefore, when securities are delivered by the Federal Reserve Bank from a safekeeping account. The staff has issued an interpretation providing that when securities are delivered to a reporting institution by the Federal Reserve Bank out of the safekeeping account of another reporting institution and such securities had been delivered to the Federal Reserve Bank by a reporting institution, inquiry is not required.²⁶

3. *The \$10,000 de minimus exemption.* In order to ease implementation of §240.17f-1 during the pilot pro-

gram, inquiry is not required in the case of transactions involving securities of less than \$10,000 (face value in the case of bonds and market value in the case of stocks). The staff of the Commission, however, has interpreted this exemption to include securities up to and including \$10,000 exactly, in recognition of the fact that most debt securities are issued in \$5,000 face value denominations, and in the interest of reducing the burden imposed by the section on municipal securities brokers and dealers.²⁷ In addition, the staff has interpreted this exemption to apply not to the individual certificates involved in a transaction, but rather to the transactions as a whole.²⁸

4. *Transfer agent exemption.* For the purposes of the pilot program, registered transfer agents are exempted from §240.17f-1's requirements that reporting institutions inquire with respect to securities coming into their possession or keeping. The staff of the Commission has interpreted this exemption to be applicable to a transfer agent engaged as an exchange, conversion, or redemption agent or depository or tender agent (whether such transfer agent is acting as the issuer's transfer agent or as a depository or tender agent in connection with a so-called "unfriendly tender offer"), as long as such transfer agent maintains or is provided with current and accurate records of stop transfer instructions and inquiry of such records is made for each item received prior to issuing a new certificate, transferring record ownership, disbursing funds, or otherwise completing the transaction.²⁹

REQUEST FOR COMMENTS REGARDING PROVISIONS AND OPERATION OF §240.17F-1

Inasmuch as the pilot year and SIC's term of designation expire on December 31, 1978, the Commission solicits public comment at this time on the provisions and operation to date of §240.17f-1, on the appropriateness of the continued applicability of the special pilot program exemptions, and the redesignation of SIC to receive and process reports and inquiries made pursuant to the section. In particular, the Commission solicits comments per-

²³Letter to Federal Reserve Bank of St. Louis, dated Jan. 12, 1978 (public availability date Feb. 12, 1978). Although the rationale was based on the situation presented by debt security transactions, in order to avoid confusion the interpretation was designed to apply to equity securities as well.

²⁴For example, where four \$5,000 bonds are used as collateral for a single loan, the total transaction exceeds \$10,000, and the \$10,000 de minimus exemption from inquiry may not be claimed. See letter to LaSalle National Bank, dated Dec. 7, 1977 (public availability date Jan. 7, 1978).

²⁵Letter to the Stock Transfer Association, dated Mar. 8, 1978 (public availability date Apr. 8, 1978).

taining to the items enumerated below. In responding, all commentators should attempt to furnish the Commission with data supporting their views to the greatest extent possible.

1. Whether any classes or subclasses of institutions defined as "reporting institutions" under §240.17f-1 should be exempted from the provisions of the section and whether any class or subclass of institution within the jurisdiction of the Commission not now subject to the section should be included in the program;

2. Whether the present exemption from the program of securities of an issue not assigned a CUSIP Number should continue and whether other types of securities should also be exempted;

3. Whether the present framework of dual appropriate instrumentalities is appropriate or whether a unified central data base would be preferable, and, particularly, whether the concept or operation of the two appropriate instrumentalities has resulted in any difficulties in complying with the section;

4. Whether the Commission should redesignate SIC or designate another entity for the purposes of receiving and processing reports and inquiries made pursuant to the section.³⁰

5. Whether the time requirements within which reports must now be made are appropriate and whether other circumstances exist for which specific time requirements should be provided;

6. Whether the report form, Form X-17F-1A, should be modified in terms of its format and graphics and in terms of the information required, and whether the form has proven useful to identify and trace missing, lost, counterfeit and stolen securities;

7. Whether inquiries should be made within certain time periods and, if so, within what time periods;

8. Whether the exemptions from inquiry provided for the purposes of the pilot program should be continued, continued in a modified form, or allowed to lapse, and, particularly, whether the present de minimus exemption for transactions involving securities of \$10,000 or less (face value in the case of bonds and market value in the case of stocks) should be increased, decreased, made a permanent part of the rule, or allowed to lapse;

9. Whether additional exemptions from inquiry should be permitted on either a provisional or permanent basis;

Whether the present program allowing for an election of participation status as either a direct or an indirect

³⁰Persons interested in acting as the Commission's designee should submit a plan for their program in accordance with the instructions outlined in Appendix A.

²³Letter to First Trust Co. of St. Paul, dated Mar. 20, 1978 (public availability date Apr. 20, 1978).

²⁴Letter to Continental Stock Transfer & Trust Co., dated Jan. 12, 1978 (public availability date Feb. 12, 1978).

²⁵Letter to First National Bank of Boston, dated Jan. 12, 1978 (public availability date Feb. 12, 1978).

²⁶Letter to Bankers Trust Co., dated Mar. 21, 1978 (public availability date Apr. 21, 1978).