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General Accounting Office

SEC's Efforts To Find Lost And Stolen Securities

Each year about $1 billion in securities, such as stocks and bonds, are lost by or stolen from financial institutions and their customers. At Congress' direction the Securities and Exchange Commission (SEC) established a program requiring financial institutions to report lost or stolen securities to the SEC and to check securities received to determine if any have been previously reported as lost or stolen. In 5 years of operation, about 1 percent of the 1.1 million securities reported to be lost or stolen were reportedly found through the program.

GAO believes that the program's success could be improved if SEC's regulations exempted fewer securities from the program, more financial institutions complied with the program, and the program were linked with a similar Department of Justice program used by law enforcement authorities.

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MAY 18, 1984

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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

GENERAL GOVERNMENT DIVISION

B-214637

The Honorable John S.R. Shad
Chairman, Securities and Exchange Commission

The Honorable William French Smith
The Attorney General

This report reviews the effectiveness of the Securities and Exchange Commission's lost and stolen securities program. It recommends specific actions that will enhance the program's ability to aid in locating lost and stolen securities, help law enforcement investigations involving securities, and deter illegal uses of securities.

Copies of this report are being provided to the House and Senate Committees on Appropriations; House and Senate Committees on the Judiciary; House Committee on Banking, Finance and Urban Affairs; House Committee on Energy and Commerce; Senate Committee on Banking, Housing and Urban Affairs; Director, Office of Management and Budget; and others upon request.

W.J. Anderson

William J. Anderson
Director

GENERAL ACCOUNTING OFFICE
REPORT TO THE CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION, AND THE ATTORNEY GENERAL

SEC'S EFFORTS TO FIND LOST AND STOLEN SECURITIES

DIGEST

The Securities and Exchange Commission's (SEC) lost and stolen securities program in 5 years of operation has helped find about 1 percent of the 1.1 million securities, such as stocks and bonds, that were reported lost by or stolen from financial institutions or their customers. SEC reported that out of a total of $5.4 billion in reported losses, $86 million was found.

GAO believes that more securities could be found if

--SEC exempted fewer securities from the program's regulation,

--more financial institutions complied with the program's regulations, and

--SEC's program was linked with a similar federal program used by law enforcement authorities.

THE CONGRESS AUTHORIZES SEC'S LOST AND STOLEN SECURITIES PROGRAM

In 1975, the Congress enacted legislation requiring financial institutions, including securities firms and banks, to report lost or stolen securities to the SEC and to verify or check whether securities received by them are included in SEC's lost and stolen list. The Congress believed the program would help locate securities, assist law enforcement investigations, and deter the illegal use of lost and stolen securities. After proposing and finalizing regulations governing the program's operations, the SEC began recording lost and stolen securities in October 1977.

SEC's regulations require financial institutions to register in the lost and stolen securities program. As of December 31, 1982, the latest date for which information was available, SEC reported over 18,300 financial institutions registered with the program. Registration authorizes financial institutions to report lost

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or stolen securities and to check with the program securities that they receive in commercial transactions. Financial institutions pay a $25 or $35 annual fee to register with the program as well as a usage fee of $0.21 for each security either reported or checked.

GAO reviewed the SEC program to determine its effectiveness in finding securities. This review did not, however, cover the broader area of preventive measures that might be taken to reduce the loss or theft of securities. GAO used a questionnaire to solicit the views of financial institutions regarding program operations and administration. A sample questionnaire is shown in appendix I.

MORE LOST OR STOLEN SECURITIES CAN BE FOUND THROUGH THE PROGRAM

During the program's first 5 years of operations, SEC built up a list of 1.1 million reported lost and stolen securities valued by financial institutions at $5.4 billion. For the 5 years SEC reported finding 9,914 securities, or about 1 percent of the 1.1 million reported lost and stolen securities, valued at $86 million. (See p. 7.)

The number of securities found through the program has generally increased each year. In 1978, when SEC listed 175,000 lost or stolen securities, 1,071 securities were reportedly found. In the next 4 years, the number of securities reportedly found and the number still missing at year end were as follows:

Year	Number found	Number still missing at year end
1979	1,157	377,000
1980	1,152	595,000
1981	3,232	860,000
1982	3,302	1,100,000

However, GAO found that SEC has not accurately reported the dollar value of the lost or stolen securities or the number of securities actually found through the program. The $5.4 billion value of losses and thefts is understated because about a fourth of the lost and stolen securities are reported by financial institutions without specified dollar values. Further, SEC's reporting of 9,914 securities found through the program overstates the program's accomplishment. In 1980 GAO found that SEC, in calculating this figure, erroneously reported 455 out of 1,152 securities as found when, in actuality, they represented inquiries made by financial institutions during the training of new employees in how to use the program, or to verify that a security had been properly reported. (See p. 11.)

GAO recommends that at a minimum the Chairman, SEC, notify financial institutions to comply with the program requirements that call for dollar values to be specified for all securities that are reported to the program. GAO also recommends that the Chairman in any accomplishment report include only those securities actually found by the program. (See p. 12.)

EXEMPTIONS REDUCE THE PROGRAM'S REGULATORY SCOPE

SEC has exempted many securities from the program's reporting and checking requirements with the intent of minimizing the regulatory burden falling on financial institutions. These exemptions, however, reduce the program's ability to find lost or stolen securities. (See p. 14.)

Because of reporting exemptions granted by the SEC, some securities that should get on the program's list of lost and stolen securities do not. For example, SEC exempted securities that lack industry identification numbers because SEC believed such securities were relatively rare. On the basis of responses to its questionnaire, GAO estimates that about 100 institutions did not report certain losses because the securities did not have industry identification numbers. It was not possible to estimate the significance of this underreporting. In addition, certain lost or stolen federal government securities that were formerly reported to Federal Reserve Banks are no longer reported to either the banks or to the SEC. As a result, these securities are now exempted from reporting requirements. (See pp. 14-15.)

With SEC's exemptions, more than 70 percent of the securities handled by financial institutions need not be verified or checked with the program, according to industry studies. For example, the checking exemption for transactions valued at $10,000 or less substantially limits assistance to financial institutions' customers who have incurred losses or thefts of securities. According to GAO's questionnaire results, individual customers, as opposed to financial institutions, account for 81 percent of the lost and stolen securities reported to the program. However, the customer's average securities loss is $1,400. On the other hand, the financial institution's average securities loss is $21,000.

While financial institutions are not required to check securities involved in transactions valued at $10,000 or less, GAO found that about 30 percent of the securities found through the program during 1 year involved transactions of less than $10,000. Based on GAO's questionnaire survey it is estimated that about 36 to 54 percent of the approximately 5,000 financial institutions with a basis to judge believed that the program would be more effective if certain checking exemptions were narrowed or eliminated. (See pp. 15-17.)

GAO recommends, as an initial step toward improving the program's capability to find lost and stolen securities, that the SEC

--require lost or stolen securities formerly required to be reported to the Federal Reserve Banks be reported to the SEC program;

--assess the effect of the underreporting of lost and stolen securities without a securities industry identification number, and, if warranted, direct the program operator to assign identification numbers for these securities; and

--develop a pilot program to assess whether the $10,000 or less transaction exemption should be continued, weighing the regulatory compliance burden against the improvement in securities found for financial institution customers as well as the increased deterrent effects. (See p. 18.)

NONCOMPLIANCE WITH REGULATIONS REDUCES PROGRAM EFFECTIVENESS

Financial institutions are not complying with SEC's program regulations for reporting and checking securities. As a result, useful information on lost and stolen securities is not entered into the program or used in its operations. (See p. 20.)

Based on GAO's questionnaire survey, about 5,400 institutions, which handle over 2 million securities annually, have not registered in the program. Because they do not have access to the program, they do not contribute information about their lost and stolen securities and do not check to determine whether the securities they receive are lost or stolen. (See p. 20.)

About 16 percent of the registered financial institutions responding to GAO's questionnaire survey also were not reporting lost and stolen securities to the program as required. GAO also found, in a 6-month test of transactions, that two-thirds of the registered financial institutions required to contact the program had not checked any securities with the program. (See pp. 20-21.)

Few formal actions to obtain better compliance with the program's requirements for registering, reporting, and checking have been taken by SEC and the bank regulators. Such actions can range from obtaining a court order mandating compliance to administrative procedures requiring remedial measures. In addition, actions such as notification by letter of noncompliance can also be taken. More than 67 percent of the respondents to GAO's questionnaire survey believed that taking formal action against noncomplying institutions would make the program more effective. Meanwhile, from 57 to 70 percent of the approximately 5,000 institutions believe that the program has been effective. (See pp. 22-23.)

GAO recommends that the SEC, in consultation with the bank regulatory agencies who are responsible for bank compliance with the program, concentrate on obtaining improved compliance with lost and stolen securities regulations by ensuring, through appropriate enforcement and administrative actions, that financial institutions register with the program and that registered institutions report lost and stolen securities and check the status of securities received. (See p. 25.)

TWO PROGRAMS FOR LOST AND STOLEN SECURITIES SHOULD BE LINKED

All financial institutions are required to report lost and stolen securities to the SEC program, while law enforcement authorities report stolen securities to the National Crime Information Center (NCIC), managed by the FBI. The programs are operated independently, and little information is exchanged between them, further reducing the opportunity to find additional securities. (See p. 27.)

In 1981, GAO compiled a list of 13,833 stolen securities from both the NCIC and SEC lists. GAO found that SEC listed 3,981 securities that the NCIC did not, and the NCIC listed 4,168 that SEC did not. Both programs, because of their incomplete information, could provide misleading securities information. Financial institutions and law enforcement authorities do not, as a matter of course, check both lists. Thus, if a financial institution had inquired about one of the securities that SEC did not list, SEC would have replied that the security was not reported as lost or stolen. (See pp. 27-30.)

GAO recommends that the Chairman, Securities and Exchange Commission, and the Attorney General, Department of Justice, link the SEC and NCIC lists of lost and stolen securities. (See p. 32.)

AGENCY COMMENTS

GAO obtained comments on this report from the Securities and Exchange Commission and the Department of Justice. Their comments are reprinted in full in appendixes II and III, respectively. At the end of each chapter pertinent agency comments are evaluated.

The SEC agreed with some of the report's recommendations. SEC maintains that finding all lost securities is not the primary intent of the program. The program was established also to deter the illegal use of lost and stolen securities and to assist law enforcement investigations. SEC said that one of the key considerations in its design was the relative costs and benefits of attempting to recover lost and stolen securities. GAO concurs with SEC that relative costs and benefits need to be considered. This report, however, raises questions about program compliance. It is GAO's view that until compliance with the program's requirements is improved it is doubtful that all of the relative costs and benefits of the program could be fully assessed.

The Department of Justice generally agreed with the GAO recommendations but believes further study is needed before GAO's recommendation for linking both systems can be implemented. In its comments, Justice said that some of the deficiencies noted by GAO were anticipated at the beginning of the program, but felt that it was more important for the program to become operational. Justice further stated that it had planned to "fine tune" the program after some operational experience and that the GAO study now provides the opportunity to undertake the fine tuning.

While neither SEC nor Justice took strong exception to GAO recommendations, they did raise some valid points about program specifics or potential problems with implementing certain recommendations. GAO has clarified or modified the report in certain cases in light of these comments.

GAO also obtained oral comments from representatives of the bank regulatory agencies--Federal Reserve Board, Office of the Comptroller of the Currency, and Federal Deposit Insurance Corporation. Their comments were useful in clarifying certain information and are incorporated where appropriate in the text. FDIC raised a concern about attempts to drop or reduce the $10,000 checking exemption. Many small banks do not use the SEC program; a change in the checking exemption could affect their administrative burden. Concerns similar to FDIC's view is one of the reasons GAO recommends a pilot program that could weigh regulatory compliance burden against program improvement.

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CHAPTER 1

INTRODUCTION

Each year financial institutions and their customers lose or have stolen over a billion dollars in securities.[1] Because of the magnitude of losses, and the illegal use made of these securities, the Congress in 1975 amended the Securities Exchange Act of 1934 by adding Section 17(f), which authorized the Securities and Exchange Commission (SEC) to establish a lost and stolen securities program. The SEC is an independent regulatory agency responsible for administering federal securities laws. The SEC program would

--aid in locating lost and stolen securities,

--help law enforcement investigations involving securities, and

--deter illegal uses of securities.

The law requires that financial institutions, such as banks and brokerage firms, report and check on lost, stolen, and counterfeit securities with the SEC. Counterfeit securities represent an insignificant portion of the total number of securities reported. In 1982 only 313 counterfeit securities were reported compared to over 220,000 securities reported as lost or stolen.

To avoid duplication in regulation and enforcement, the Congress authorized the SEC to delegate supervision of bank compliance with the lost and stolen securities program to the bank regulatory agencies. The bank regulators are the Office of the Comptroller of the Currency, which regulates national banks; the Federal Reserve Board, which regulates state-chartered banks that are members of the Federal Reserve System as well as bank holding companies; and the Federal Deposit Insurance Corporation (FDIC), which regulates insured state-chartered banks that are not members of the Federal Reserve System.

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[1] In this report the term "securities" has the same meaning as in Section 3(a)(10) of the Securities Exchange Act of 1934 and includes common and preferred stock, corporate bonds and debentures, federal and local government bonds, and rights and warrants to purchase stocks and bonds.

HOW THE SEC's LOST AND STOLEN SECURITIES PROGRAM WORKS

The SEC, which selected a contractor to operate the program, began recording lost and stolen securities in October 1977. The program has three general requirements for financial institutions: register with SEC, report lost and stolen securities, and check securities received to see if they have been reported as lost or stolen.

The contractor operates the program at no cost to SEC. The contractor finances its operations by levying assessment fees on financial institutions based upon their participation in the program. Financial institutions pay a fee to register ($25 or $35 annually) as well as a fee based on the amount of use made of the program. The usage fee is $0.21 for each security that is either reported or checked with the program.

As of December 31, 1982, the latest date for which information was available, SEC reported over 18,300 financial institutions registered with the program. Table 1 shows the types of financial institutions registered. Securities organizations include brokers and dealers in securities, registered clearing agencies and their members, and the stock exchanges and their members. Transfer agents maintain the records that show who owns the securities of the corporation, and, when a transaction takes place, they cancel the securities received from the seller and issue new securities to the buyer. Many banks are also transfer agents; however, the figure for transfer agents does not include banks that also act as transfer agents.

Table 1

Financial Institutions Registered in SEC's Program

Banks	12,384
Securities organizations	5,431
Transfer agents	516
Total	18,331

Each registered financial institution is given a program access code to report and check securities. While preliminary reports can be made by telephone, a report form, which details information about the missing securities, must be submitted to the program operator. Certain information on a reported loss, such as the market value, certificate serial number, and the securities industry identification number, is then entered into a computerized list of lost and stolen securities.

Financial institutions are required to verify or check securities against the securities listing. In a typical transaction, a bank might check securities being used by a new customer as loan collateral, or a stockbroker might check securities being sold by a new customer.

A security can be checked either directly or indirectly. Direct checks are generally made by telephone. The information is entered into the computer, which searches to determine if the security has been reported as lost or stolen. Responses are received within minutes. Indirect checks are made by a financial institution through another financial institution that has direct access to program information. Indirect checking is generally chosen when an institution's volume of securities transactions does not justify a direct link to the program. Table 2 shows that 2,053 institutions directly checked and 16,278 indirectly checked securities as of December 31, 1982.

Table 2

Checking Status of Financial Institution

Type of institution	Number making direct checks	Number making indirect checks
Banks	1,316	11,068
Securities organizations	583	4,848
Transfer agents	154	362
Total	2,053	16,278

When a check of securities is made, the program operator informs the checking financial institution whether the securities are on the list. If they are, the program operator identifies the institution that reported the loss or theft. The operator also notifies the reporting institution and the Federal Bureau of Investigation (FBI), which is within the Department of Justice, that the securities have been found. Chapter 2 further discusses the program's results in finding lost or stolen securities. A financial institution must notify the program operator if it finds a security that it previously reported as lost or stolen. The recovered security is then removed from the list.

Exemptions from lost and stolen securities program

SEC has exempted various securities from the law's reporting and checking requirements. The reporting exemptions generally pertain to securities issued by federal agencies and certain international organizations and to securities that have not been assigned a securities industry identification number. The identification number is used to facilitate automatic processing of securities transactions.

The checking exemptions generally pertain to securities received from the issuer of the securities, from registered financial institutions, from established customers of those institutions, or those securities valued at $10,000 or less. The SEC adopted these exemptions to reduce the program's regulatory burden on financial institutions. The SEC's use of exemptions is discussed in chapter 3.

Relationship of program to law enforcement efforts

The Congress authorized the SEC to use the National Crime Information Center (NCIC) as the focal point for receiving lost or stolen securities reports. NCIC is a national computerized information system, operated by the FBI, that enables federal, state, and local enforcement agencies to share information about stolen property, such as securities. Because the SEC and NCIC could not reach an agreement on operating the program, the SEC established its own program for lost or stolen securities. Securities in NCIC's file were added to the SEC program in 1978. Chapter 5 further discusses the coordination of the program with NCIC and the law enforcement community.

OBJECTIVE, SCOPE, AND METHODOLOGY

We initiated this review to determine the program's effectiveness in finding securities. This review did not, however, cover the broader area of preventive measures that might be taken to reduce loss or theft of securities. Nor did we contact financial institutions to determine the reasons for any noncompliance with the law and related SEC program requirements. To obtain information from, and the opinions of, financial institutions concerning the program's effectiveness we designed a questionnaire that addressed the handling of securities, the checking of securities against SEC's program list, and the finding of lost or stolen securities. A sample questionnaire is shown in appendix I.

The questionnaires were mailed in November 1981 to 1,086 financial institutions randomly selected from a universe of

20,042 registered broker-dealers, transfer agents, and banks, and were designed to solicit responses about their experience with the program during 1980. We adjusted our original sample and universe because 224 questionnaires were either undeliverable or could not be used for various reasons. Of the remaining 862 questionnaires, 704--82 percent--were complete. These 704 questionnaires statistically represent an estimated 14,527 financial institutions.[2] To determine the validity of the questionnaire replies, we visited six randomly selected institutions to review documentation and discuss the institution's answers. In this regard we found no significant differences between their replies and supporting documentation and the replies of similar institutions.

During our review work, which began in October 1980, we learned that it could take a number of years before a lost or stolen security was found. Therefore, we decided to do most of our review work during 1981 and monitor the results of the program during 1982. Our review work was completed in June 1983, when SEC provided us with the program's 1982 results. Throughout the report we make estimates by applying percentages obtained from the 1980 questionnaire replies to program data reported by SEC for calendar year 1982, the latest available year. Although some time has passed since our review work was completed, our findings are applicable today because SEC has informed us that no major changes in regulations and policies have occurred in the program.

Furthermore, in determining the program's effectiveness we

--randomly sampled 1,000 of the 860,000 missing securities as reported at the end of 1981 to determine if SEC accurately reported the dollar value.

--reviewed the 1,152 securities that SEC reported as found through the program in 1980 to determine if SEC accurately reported the number of securities actually found through the program.

--compared the SEC list of lost and stolen securities with (1) the NCIC list of such securities to determine if these lists contained the same lost and stolen securities, (2) 400 randomly selected securities from three financial institutions' lists of securities that they were holding to determine if institutions checked securities with the

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[2]A 95 percent level of confidence was used in making this estimate.

list as required,[3] and (3) all 109 securities on 19 missing securities lists judgmentally selected by securities organizations from lists being circulated among institutions to determine if institutions reported lost or stolen securities to the program as required.

--reviewed SEC records of direct users that checked securities against the list during the first 6 months of 1981 to determine if institutions checked securities with the list as required.

--reviewed 50 cases judgmentally selected by the FBI, in which SEC notified the FBI that missing securities had been found, to determine if the SEC information assisted the FBI investigations.

We also discussed the program's operation with cognizant officials at banks and securities organizations, such as broker-dealers and transfer agents; officials responsible for ensuring program compliance at SEC, Office of the Comptroller of the Currency, FDIC, and the Federal Reserve Board; and law enforcement authorities at the Department of Justice, FBI, Secret Service, Postal Service, and in the 11 largest U.S. cities. In addition, we reviewed articles, publications, regulations, and records dealing with losses and thefts of securities and the legislative history of the program.

We obtained comments from the SEC and Justice. We also obtained oral comments from representatives of the Federal Reserve Board, Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation. Their comments were useful in clarifying certain information and are incorporated where appropriate in our report. We performed our review in accordance with generally accepted government auditing standards.

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[3] The random selection for two of the financial institutions' securities was made by us, while the third financial institution provided randomly selected securities to us.

CHAPTER 2

MORE SECURITIES CAN BE FOUND

THROUGH THE SEC PROGRAM

Since 1977 the number of lost and stolen securities has grown by about 220,000 a year. In 5 years, the program grew to 1.1 million lost and stolen securities valued at $5.4 billion. During the same period, the SEC reported that 9,914 securities, or about 1 percent of the 1.1 million lost and stolen securities, valued at $86 million were found through the use of their program. However, we found that the dollar value of securities reported as lost and stolen was understated, while the number of securities found was overstated. This chapter provides information on the number of securities that were lost, who lost them, and how they were lost. This chapter also discusses inadequacies in SEC's reporting of the program's accomplishments.

SECURITIES REPORTED AS LOST OR STOLEN

At the end of the first full year of operation in 1978, about 175,000 securities worth $1.5 billion were reported lost and stolen. By the end of 1982, the number had grown to 1.1 million securities worth $5.4 billion. This consistent growth in the SEC's lost and stolen securities program underscores congressional concerns about the magnitude of securities losses.

Securities reported as lost or stolen grows each year

Since the program began in 1977, the number and value of lost and stolen securities reported to SEC's program has grown year by year. The number and dollar value of securities reported to the SEC program and still missing at year end is shown in table 3.

Table 3

Number and Dollar Value of Securities Still Missing at Year End

Calendar year	Number	Dollar value (in billions)
1978	175,000	$1.5
1979	377,000	2.6
1980	595,000	3.6
1981	860,000	4.4
1982	1,100,000	5.4

According to SEC records, common stock is the security most often reported as lost or stolen. Over 80 percent of the reported securities are common stocks, with each theft or loss worth on average about $2,900. The remaining securities include preferred stock, corporate bonds, municipal bonds, and other types of securities. SEC's information agrees with the information we obtained from financial institutions. Based on our questionnaire survey approximately 85 percent of the securities lost in 1980 were common and other corporate stocks. These results were predictable because corporate stocks are widely held and traded by investors and are frequently used as collateral for bank loans.

Who lost the securities

Eighty-one percent of the securities reported to the program were lost by or stolen from customers, according to institutions that reported lost or stolen securities in 1980. By applying this percentage to the 1.1 million lost and stolen securities in the SEC program, we estimate that 891,000 securities were lost by or stolen from customers in 1982. The remaining 209,000 securities were lost by or stolen from financial institutions. Customers' actions commonly start the searches by which financial institutions determine that securities are lost or stolen.

Customers may lose or misplace their securities or have them stolen. For example, a customer may be unable to remember the location of the securities. The customer reports the misplaced securities to a financial institution, which in turn notifies the SEC program of the loss. In other circumstances, an executor may be unable to locate estate securities, or a brokerage firm's customer may have securities stolen during a burglary.

Securities lost by customers, while comprising a large percentage of the securities on SEC's list, represent a small percentage of total dollar losses. According to our questionnaire survey, customer security losses account for only 22 percent of the dollar losses reported to the program. In applying this percentage to the losses reported for the 5 years ending in December 1982, financial institutions lost securities worth an estimated $4.2 billion, and their customers lost securities worth less than $1.2 billion. Thus, the average security loss of financial institutions is about $21,000; for customers, it is about $1,400.

As might be expected, financial institutions that handle a high volume of securities have a greater likelihood of losing securities. Table 4, based on our questionnaire survey results, shows that 81.6 percent of institutions handling over 1,000 securities a month report losses. On the other hand, financial institutions that handle 10 or less securities a month report few losses.

Table 4

Securities Handled In An Average Month

Number of securities handled	Number of institutions	Number of institutions with losses	Percent of institutions incurring losses
10 or fewer	10,406	21	0.2
11 to 100	2,528	232	9.2
101 to 1,000	887	282	31.8
over 1,000	348	284	81.6

Financial institutions' securities losses mostly occur in the mail

Based on our questionnaire survey, financial institutions that had lost or stolen securities indicated that over 80 percent of their securities losses occurred while the securities were in the mail. Financial institutions use the mail system to transfer about 60 percent of their securities. Institutions that handled relatively few securities generally used certified and registered mail but institutions handling large volumes of securities mainly used first-class mail. According to the institutions that mail securities, 33 percent of the securities are transferred by first class mail, 16 percent by registered mail, and 9 percent by certified mail.

First-class mail accounts for a disproportionate share of securities losses of financial institutions. Although a third of the securities are sent by first-class mail, this method accounts for two thirds of the losses. Securities lost in first-class mail, according to postal service inspectors, generally cannot be traced to determine where the securities had been lost. This is because first-class mail does not create a record showing that an item was accepted into the postal system or delivered at its intended destination. Registered and certified mail account for 6 and 9 percent of the losses respectively.

SECURITIES FOUND THROUGH SEC'S PROGRAM

For the 5 years of operation ending December 31, 1982, 9,914 securities worth $86 million were found through the SEC program. These 9,914 securities represent one-tenth of 1 percent of the almost 8 million securities checked with the program during 5 years of operation. To determine whether a security has been reported as either lost or stolen, a financial institution must check the security against SEC's lost and stolen listing. Table 5, which is based on SEC reports, shows the number of securities checked with the program and found during years 1978 through 1982. These figures do not include recovered securities since they are detected without the use of the program's checking procedures and are located by the same institution that reported the securities. In the first year, 1,786,000 securities were checked. This number of yearly checks was not exceeded until 4 years later when 1,800,000 securities were checked in 1982.

Table 5

SEC Lost and Stolen Securities Program

Year	Number of securities Checked	Found	Percent found
1978	1,786,000	1,071	0.06
1979	1,688,000	1,157	0.07
1980	1,165,000	1,152	0.10
1981	1,345,000	3,232	0.24
1982	1,800,000	3,302	0.18
Total	7,784,000	9,914	

Over the 5 years of the program the 9,914 securities reported to be found is almost 1 percent of the 1.1 million securities reported to the program as lost or stolen since 1978. The number of securities reported found generally increased as the number of missing securities increased.

Seventy percent of the lost and stolen securities were found at large financial institutions. In 1982 large securities firms found about 60 percent of these securities, while another 10 percent of these securities was found at banks with deposits of over $1 billion. These results are to be expected because these institutions handle large volumes of securities. The remaining lost and stolen securities were found by transfer agents, small banks, and small securities firms.

NEED FOR IMPROVED REPORTING OF PROGRAM ACCOMPLISHMENT

The SEC has not accurately reported the dollar value of the lost or stolen securities or the number of securities actually found by use of the program. Accurate information is necessary so that the size of the lost and stolen securities problem can be determined and suitable regulatory requirements developed.

The value of lost and stolen securities is higher than the $5.4 billion reported by SEC. The SEC requires financial institutions to report, among other information, the value of the lost and stolen securities. We estimate that 232,000 of the 1.1 million lost or stolen securities have been reported without specified dollar values. Our estimate is based on a statistical sample of 1,000 securities included on the program's list in 1981. We found from this sample that 27 percent of the reports did not contain dollar values for the lost or stolen securities. However, we could not statistically estimate the total value of the reported but not valued securities. The wide variety and range of values of securities that were reported correctly prevented us from computing an estimate within accepted confidence and precision levels.

Further, the number of securities reported by SEC as found is inaccurate. Based on a review of the 1,152 securities reported as found through the program in 1980, we discovered that 455 of the securities, worth at least $14 million, appeared to have been erroneously reported as found by the SEC. This error primarily occurred because SEC included in its accomplishment report inquiries made by financial institutions to verify that a security had been properly reported or to train new employees in the program's checking procedures. While we only reviewed securities reported found in 1980, SEC advised us that no major changes in regulations and policies have occurred in the program.

At the end of the first year of operation, SEC's staff indicated a suspicion that financial institutions were making inquiries rather than finding lost or stolen securities. SEC, however, did not follow up to assure that the number of securities actually found was accurately reported.

PROGRAM COST TO FINANCIAL INSTITUTIONS

Our questionnaire survey of financial institutions indicates that financial institutions collectively incur an annual total cost of at least $5.4 million to comply with the program's requirements. Of this total, institutions paid the program contractor about $800,000 annually in registration and user fees. This cost is expected to increase because SEC approved an 11.5 percent fee increase for the program that went into effect on January 1, 1983. According to the survey results, the remaining $4.6 million is expended for costs, such as salaries paid to employees of the financial institutions. However, we are uncertain that this is a direct incremental compliance cost because employees used in the program could be used in many cases for other endeavors in the absence of the program and therefore similar costs could be incurred. Because the SEC has not accurately accounted for the number and dollar value of securities found through the program and because of the uncertainty over the magnitude of direct compliance costs, we could not compare total program costs to the dollar value of securities actually found to indicate the program's cost effectiveness.

CONCLUSIONS

Improved reporting of the value of lost or stolen securities and for those actually found is needed to more accurately assess the accomplishments of the program. The SEC cannot correctly gauge the program's growth in monetary terms because financial institutions did not report dollar values for about a fourth of the lost or stolen securities. Moreover, to accurately determine program effectiveness, SEC needs to ensure that reports of those securities found do not include data on securities not actually found by a financial institution.

RECOMMENDATIONS

We recommend that at a minimum the Chairman of the Securities and Exchange Commission notify financial institutions to comply with the program requirements that call for dollar values to be specified for all securities that are reported to the program. We also recommend that the Chairman include in any accomplishment report only those securities actually found by the program.

AGENCY COMMENTS

SEC agreed with our recommendation regarding the reporting of the number of securities actually found by use of the program. SEC said corrective action has been taken to include only those securities actually found in any reporting of the program's accomplishments. However, we have not verified whether the action is consistent with our recommendation. Also, SEC believes that the program has additional objectives besides finding all lost or stolen securities and that we did not fully consider other program objectives. We agree with SEC that the program had other objectives as authorized by the Congress and have pointed out on page 1 of our report that the program has three basic objectives: help find lost and stolen securities, deter the illegal use of lost and stolen securities, and assist law enforcement investigations. Our work reviewed the effectiveness of the program in meeting these three objectives. This chapter discussed how the program aids in locating lost and stolen securities. Chapters 3 and 4 discuss exemptions and compliance respectively as aspects of the program's deterrent objective, while chapter 5 comments on the program's assistance to law enforcement authorities. Concerning our recommendation for institutions to comply with the program requirements for specifying dollar values for all reported securities, SEC's letter did not comment on this point.

The Department of Justice concurs with our recommendations. Also, concerning the effectiveness of the program, the Department of Justice stated that its Criminal Division is particularly interested because that Division was the architect of the 1975 legislation that resulted in the creation of the SEC data bank on lost and stolen securities. Justice said the Division and the FBI worked closely with the SEC during the legislation's implementation. Justice further added that it recognized that the initial SEC program would eventually have to be adjusted as experience gained during operations became available. Justice said that some of the deficiencies noted by us were anticipated at the commencement of the program, but at that time it was more important, in its judgment, for the program to become operational. Justice further stated that it was planning to "fine tune" the program after some operational experience and that our study now provides the opportunity to undertake the fine tuning. Complete agency comments are shown in appendixes II and III.

CHAPTER 3

REPORTING AND CHECKING

EXEMPTIONS REDUCE PROGRAM EFFECTIVENESS

One of the reasons more lost and stolen securities have not been found is because the SEC has exempted many securities from the law's requirements. The exemptions permit securities to be processed outside the reporting and checking requirements of the program. For example, industry studies estimate that over 70 percent of the securities handled by financial institutions are not checked because of exemptions. The SEC established the exemptions to minimize the regulatory burden on financial institutions. However, based on our questionnaire survey, about 36 to 54 percent of the approximately 5,000 institutions that believe they have a basis to judge think that narrowing or eliminating some exemptions would improve the program's effectiveness in finding lost or stolen securities.

REPORTING EXEMPTIONS REDUCE OPPORTUNITY TO FIND LOST AND STOLEN SECURITIES

The SEC has granted financial institutions exemptions from reporting those lost and stolen securities that were issued by the federal government and certain international organizations or that have not been assigned industry identification numbers. The result of these exemptions has been that some securities that should get onto the program's list of lost and stolen securities do not. Increasing the number of securities on the list would increase the program's potential for finding lost or stolen securities.

In 1977, SEC determined that lost and stolen securities that had been issued by the federal government and certain international organizations were to be reported to Federal Reserve Banks and would be exempt from being reported and included on SEC's list of lost and stolen securities. In 1979, the Federal Reserve Banks notified the SEC that they no longer wanted to administer reporting for the foregoing securities. In response SEC withdrew the requirement that financial institutions report the securities to the Federal Reserve Banks. The SEC, however, did not revoke the exemption for reporting these securities to its own system. As a result, these securities are not now required to be reported to either the Federal Reserve Banks or the SEC, and consequently the SEC program cannot be used to determine whether such securities used in transactions are lost or stolen.

The SEC also approved reporting exemptions for lost or stolen securities that had not been assigned a securities industry identification number. The SEC adopted this exemption because most of the securities handled by financial institutions were thought to have identification numbers. This nine digit number identifies the securities issuer and the type of securities.

While we do not have information on the number of outstanding securities that do not have identification numbers, on the basis of our questionnaire we estimate that about 100 institutions that experienced security losses or thefts in 1980 did not report some securities because they did not have industry identification numbers. Our questionnaire did not ask for the number or specific type of lost or stolen securities that were not reported because of the lack of an identification number. But we could estimate from the questionnaire response that these approximately 100 institutions had at least 7,525 lost or stolen corporate stocks valued at almost $7.4 million, some of which may not have been reported to the program because they lacked identification numbers. Also, since the assigning of securities industry identification numbers started in 1970, many of the unreported lost or stolen securities by these institutions could be corporate stocks and other securities issued before 1970.

MOST SECURITIES ARE EXEMPT FROM BEING CHECKED

SEC granted checking exemptions for an estimated 70 percent of the securities handled by financial institutions. Consequently, when such securities are received, the institutions are not required to check them against the program's lost and stolen list. SEC adopted the exemptions to reduce the program's regulatory burden on financial institutions.

Development of the checking exemption

In 1976, SEC decided that the basic requirements in the law to check all securities with the lost and stolen securities program would be too burdensome for financial institutions. The agency originally proposed that the program's list would not have to be checked when the securities were received from corporate issuers, other financial institutions, or regular customers. However, because of comments from financial institutions that the program would still be burdensome, SEC added an exemption. The checking exemption that SEC added was for securities received in a transaction of $10,000 or less.

The banking and securities industries in separate studies conducted in 1976, before program operations started, estimated the effects of the checking exemptions. The studies estimated that the program would, without exemptions, require the financial institutions to check 4 million securities annually; with the exemptions, the checking would be reduced to 1.2 million securities--a 70 percent reduction. More recently, financial institution officials, who are experts in internal security to prevent securities losses, told us that a much higher percentage of the securitites--up to 90 percent in 1981--was not being checked with the program list because of the exemptions.

Without exemptions many securities could have been found

SEC believes that the checking exemptions should be continued because they reduce the regulatory burden on financial institutions, even though a SEC survey demonstrated that exemptions reduce the opportunities to find lost or stolen securities. The SEC conducted a 6-month survey in 1978, the most current study conducted by SEC, to determine whether 26 institutions had received lost or stolen securities because of exemptions from checking securities against the program list. The SEC survey found that these institutions obtained but did not check 776 lost and stolen securities, valued at nearly $14 million, because of exemptions. The SEC survey results are material when compared with the 1,071 securities, valued at $13 million, that were found through the program in all of 1978.

MANY INSTITUTIONS BELIEVE FEWER EXEMPTIONS WOULD INCREASE PROGRAM EFFECTIVENESS

The financial institutions that were in our questionnaire survey and were registered to use the program were asked whether the program would be more effective if certain exemptions were eliminated. We estimated that about 36 to 54 percent of the 5,000 responding institutions with a basis to judge believe that the program would be more effective if certain checking exemptions, as discussed below, were narrowed or eliminated. Of the institutions that responded that they did not have a basis to judge, at least 93 percent were small banks and broker-dealers, which usually handle few securities. As previously noted, securities are exempt from being checked if financial institutions receive them from (1) corporate issuers, (2) other financial institutions, or (3) regular cutomers. Securities transactions valued at $10,000 or less are also exempt from the checking requirement.

Corporate issuer exemption

Securities that a financial institution receives from the original corporate issuer are not required to be checked. The rationale for this exemption is reasonable--the securities are new and could not have been lost or stolen before issuance.

Other institutions exemption

Securities that an institution receives from other financial institutions are also exempt from the checking requirement on the reasoning that the first institution would have checked the securities with the program, as required by SEC regulations. This reasoning, however, is not fully borne out in practice because, as noted in the next chapter, many registered institutions are not checking with the program. If the first financial institution does not check a security, a lost or stolen security could pass among several additional institutions without being found. About 46 percent of the institutions with a basis to judge believed that eliminating this exemption would increase the program's effectiveness.

Regular customer exemption

Financial institutions are not required to check securities registered in their customers' names. Approximately 54 percent of institutions with a basis to judge believed that eliminating this exemption would increase the program's ability to find lost or stolen securities. Law enforcement personnel believed that this exemption permits criminals using false identification to use stolen securities without detection.

Small transaction exemption

About 36 percent of the institutions with a basis to judge believed that reducing the amount of the $10,000 or less exemption would increase program effectiveness. Although financial institutions are not required to check securities involved in transactions of $10,000 or less, about 30 percent of the securities found through the program in 1980 involved transactions of less than $10,000.

The small transaction exemption also curtails the program's assistance to financial institutions' customers who have incurred losses or thefts of securities. According to our questionnaire results customers accounted for 81 percent of the lost or stolen securities reported to the program but accounted for only 22 percent of the dollar value, for an average customer loss of $1,400. Therefore, customers are more likely than are financial institutions to have lost or stolen securities with a value of less than $10,000.

The small transaction exemption has the effect of channeling program assistance primarily to the financial institutions that have larger valued securities. Although the exemption reduces regulatory burden for the institutions, it also curtails assistance to the institutions' customers.

CONCLUSIONS

The SEC's use of exemptions has weakened the capability of the program to effectively find lost and stolen securities. We recognize that the SEC lacked adequate operating experience when the exemptions were established. However, the results of our work show that until certain exemptions are narrowed or eliminated, the program's success will be hampered.

RECOMMENDATIONS

As an initial step toward improving the program's capability to find lost and stolen securities, we recommend that the Chairman of the Securities and Exchange Commission

--require that lost or stolen securities formerly required to be reported to the Federal Reserve Banks be reported to the SEC program.

--assess the effect of the underreporting of lost and stolen securities without a securities industry identification number, and, if warranted, direct the program operator to assign identification numbers to these securities.

--develop a pilot program to assess whether the $10,000 or less transaction exemption should be continued, weighing the regulatory compliance burden against the improvement in securities found for financial institution customers as well as the increased deterrent effects.

AGENCY COMMENTS

The Department of Justice fully agreed with our recommendations. With regard to our review of the program's exemptions, SEC's Division of Market Regulation said it is prepared to seek further public discussion of cost-conscious ways to improve the program's usefulness. However, the SEC raised questions concerning the need for our recommendation requiring that lost or stolen securities without an industry identification number be reported.

The SEC agreed with our recommendation involving lost and stolen federal securities and those of certain international organizations that were formally reported to the Federal Reserve. However, the SEC stated that it only recently learned of the Federal Reserve's decision not to record such securities, not in 1979 as our report states. Our finding in this regard is based on the SEC's Commissioners May 1979 approval of its staff recommendation that the Federal Reserve no longer be required to record such securities.

The SEC believes that the benefits resulting from including in the program securities that lack an industry identification number would be, at best, minimal. The SEC also said that even if including these securities was feasible, the agency questions whether such action is cost justified since it believes the exemption covers short-term securities, some commercial paper, and a small number of long-term municipal securities issues. In this regard, we could not determine from our questionnaire whether these lost or stolen securities, which were not reported by the approximately 100 financial institutions, were the type of securities SEC comments suggest. But we believe that this under-reporting warrants SEC's attention to determine its significance and effect on the program. We have modified our related recommendation to reflect SEC's concerns. We revised the recommendation to one of assessing this potential problem before changing the program's exemption requirements. The draft had proposed that SEC require that such securities be reported to the program. The Department of Justice on the other hand agrees with our recommendation and believes all marketable securities should be reported to the SEC program.

In commenting on our recommendation regarding the $10,000 transaction exemption, the Division of Market Regulation will recommend to the SEC that industry comments be obtained on maintaining the $10,000 limit. The SEC believed that our report draft did not disclose that the $10,000 exemption was developed on the basis of industry participation. SEC also said that user expenses would increase "dramatically" if the exemption were eliminated. In discussions with Federal Deposit Insurance Corporation officials, they also had concerns about changing this exemption because it could increase the administrative burden on small banks, many of which do not use the program. The Department of Justice agreed with our recommendation.

Our report, as well as our draft, discusses the development of the checking exemptions and states that the $10,000 transaction exemption was added by SEC as a result of industry comments. We also cite separate banking and securities industries studies that discuss the effects of the checking exemptions. With regard to SEC's comment on user expenses, we recommend that a pilot program be implemented to determine what the benefits and regulatory burden would be because there is no firm data available, absent a pilot test, to reach conclusions about the wisdom of changing this exemption. With this factual evidence, SEC could weigh the regulatory compliance burden, including incremental and other cost factors, against any improvement in the securities found as well as any increased deterrent effect.

CHAPTER 4

FINANCIAL INSTITUTION NONCOMPLIANCE ALSO REDUCES PROGRAM EFFECTIVENESS

Many financial institutions are not complying with the requirements of the law and SEC regulations because they have not registered with the program or have failed to report and check on lost or stolen securities. About 37 percent of the financial institutions covered by our questionnaire have not registered with the program. Furthermore, of the institutions that have registered, many are not, either fully or in part, reporting securities to the program or checking on the lost or stolen status of securities that they receive. The financial institutions' noncompliance reduces the program's ability to identify lost or stolen securities. However, from 57 to 70 percent of the approximately 5,000 financial institutions with a basis to judge the program's effectiveness believe that the program has been effective in meeting its objectives.

COMPLIANCE NEEDED WITH REGISTRATION, REPORTING, AND CHECKING REQUIREMENTS

We estimate that over 5,400 institutions, nearly 37 percent, have not registered in the program. Moreover, many registered financial institutions are not reporting required losses and are not checking on the lost or stolen status of any securities. Financial institutions need to comply with the program's registration, reporting, and checking requirements if information on lost and stolen securities is to be fully developed and used to find securities, which would increase the program's effectiveness in finding securities.

Financial institutions not registered in program

Five years after the lost and stolen securities program started, a majority of the financial institutions have registered. However, based on questionnaire responses about 37 percent of the financial institutions had not registered. We estimate that about 5,400 institutions, which handle over 2 million securities annually, were not registered. Of those not registered, 85 percent were small banks. Approximately 12 percent of the institutions not registered were broker-dealers, and about 3 percent were non-bank transfer agents. A very small number of nonregistered institutions were medium and large sized banks.

Losses are not being reported as required

Financial institutions are not reporting all security losses and thefts as SEC regulations require. Sixteen percent of the responding registered institutions, which had lost or stolen securities during 1980, did not report any securities to SEC during that year. Through a series of very limited tests we found that over $1 million in lost or stolen securities were not being reported to SEC.

This information was obtained when we sampled lists of lost and stolen securities being circulated outside the program among securities organizations and unclaimed securities at a post office. We compared 80 securities on a limited sample of 18 such lists and found 3 securities that were required to be reported, but had not been. While the number of securities we located was small, they were worth over $1 million. At another location we found that 24 out of 29 securities selected from a list had not been reported. These securities were worth $95,000. Furthermore, at a U.S. Postal facility we found securities worth $22,000 that were stolen 6 months earlier but had not been reported to the program as required by SEC rules.

Finding these securities demonstrates that some financial institutions are not complying with the program's reporting requirements. The consequence is that if financial institutions had checked on the lost and stolen securities that had not been reported to the SEC program, they would have been told that the securities were not reported.

<u>Registered financial institutions do not check all securities</u>

Registered financial institutions are also not checking securities as required by SEC rules. Based on the responses to our questionnaire, we estimated that almost 8,000 registered financial institutions did not check any securities with SEC during 1980. More than 3,100 of these institutions have a practice, contrary to the requirements of the law, of not checking any securities with SEC's program. The remaining institutions, while having a practice of checking some securities, did not check any securities in 1980.

We analyzed the practices of direct user institutions checking securities with SEC's program during the first 6 months of 1981. More than two thirds of these institutions did not check any securities during this period. Of the institutions not checking securities, 64 percent were small banks and 30 percent were small securities organizations. We could not determine the total number of institutions not checking with the program during this 6 month period since our test only included direct users. As previously mentioned, 16,052 indirect users check their securities through direct users.

Procedures used to obtain program compliance

Responsibility for obtaining compliance with the requirements of SEC's lost and stolen securities program is divided among the SEC, Federal Reserve Board, Office of the Comptroller of the Currency, and FDIC. As previously stated, the Congress authorized the SEC to delegate supervision of bank compliance to the bank regulatory agencies. To evaluate compliance, the SEC examines broker-dealers, transfer agents, stock exchanges, and securities clearing organizations. The Federal Reserve Board and the Office of Comptroller of the Currency examine member banks; the FDIC examines the remaining insured state banks.

An opportunity to determine whether a financial institution is complying with regulations of the lost and stolen securities program occurs when one of the regulatory agencies makes an examination of the institution. During the examination, the regulatory agency determines whether the institution has registered with the lost and stolen securities program and is reporting and checking on missing securities. Regulatory officials told us, however, that their emphasis is on obtaining an institution's compliance with the program's registration requirement, as opposed to the reporting and checking requirements.

In addition to examinations, the regulatory agency sends out notices reminding financial institutions of the program requirements. According to SEC, 700 institutions registered with the program in 1981 and 189 registered in 1982. This suggests that many of these registrations may be the result of the reminders that the institutions received from the regulators.

SEC and the bank regulators have taken few formal actions to obtain better compliance even though they are aware of the registration, reporting, and checking compliance problems. More enforcement actions may be needed before financial institutions register in the program, report losses, and check securities. Such action could range from obtaining a court order mandating compliance to administrative procedures requiring remedial measures. In addition, informal actions, such as notification by letter of noncompliance, could also be taken. About 67 percent of responding institutions that had a basis to judge believe taking such actions against institutions not complying with the program requirements would increase the overall effectiveness of the program in finding lost or stolen securities.

FINANCIAL INSTITUTIONS BELIEVE THAT THE PROGRAM IS EFFECTIVE

Most of the financial institutions responding to our questionnaire believe that the program is an effective means of meeting its objectives. Forty percent of the institutions who had an opinion believed that the program should be continued. The institutions also indicated where additional opportunities exist for finding these securities.

Where the program is effective

Based on our questionnaire survey, about 5,000 financial institutions had an opinion on the effectiveness of the program. Their opinions show that

--70 percent of the institutions believed the program has been effective in deterring the use of stolen securities as loan collateral;

--65 percent believed the program has been effective in aiding law enforcement investigations of securities thefts;

--63 percent believed the program has been effective in protecting investors and in assuring that securities have not been lost or stolen; and

--57 percent believed the program has been effective in achieving the return of lost and stolen securities.

Of the institutions that said that they did not have a basis to judge, about 90 percent were small banks and broker-dealers.

Additional opportunity exists for finding securities

To determine the areas where the program could improve its effectiveness, we analyzed the results of our questionnaire survey that asked financial institutions opinions on the whereabouts of lost and stolen securities. Table 6, on the following page, shows the results of the opinions of the estimated 11,475 institutions.

The results indicate that no one knows where the lost and stolen securities are specifically located. The estimates, however, are noteworthy in that they are based on the collective opinions of financial institutions experienced in dealing with securities and the problems of lost and stolen securities. The estimates indicate that additional opportunities exist for finding lost and stolen securities. For example, certain institutions believe that lost and stolen securities reported to the program (and presumably those not reported as well) are being used as collateral for loans from U.S. financial institutions or are being sold to unsuspecting investors.

Table 6

Whereabouts of Lost or Stolen Securities

	Percent	Dollar value (in millions)
Securities are being used as collateral for loans from U.S. financial institutions	7.8	$ 420
Securities are being sold to unsuspecting investors	7.3	393
Securities have been sold overseas	5.1	274
Securities are being used as collateral for loans overseas	7.4	399
Criminals have destroyed the securities to prevent use as evidence	3.9	210
Accidentally destroyed by owner	8.1	437
Securities are lost within the organization reporting them as missing	6.6	356
Have no impression as to whereabouts	52.4	2,835
Other	1.4	76
Total	100.0	$5,400

Information that we developed during our review was consistent with the foregoing opinions. To determine whether the program could have found additional securities, we obtained from three institutions lists of securities that they were holding. We selected random samples from the lists provided by two institutions. The third institution provided us a sample that, we were told, had been randomly selected from their securities list. We checked 400 randomly selected securities held by the institutions as collateral and found five securities, worth $62,886, that were on SEC's list. While our test was limited in scope, it demonstrates that these three financial institutions are using securities in business transactions that have been reported to SEC's program.

Financial institutions believe the program should be continued

We asked the financial institutions in our questionnaire survey if they favored continuation or termination of the program. Almost 40 percent favored continuation as opposed to about 12 percent that favored termination, while the remaining 49 percent had no preference.

Our analysis of the institutions' responses on the future of the program showed that as the average monthly number of securities handled by an institution increased the likelihood that the institution favored continuation of the program also increased. About 67 percent of the institutions that handled over 1,000 securities a month favor continuation, compared to 37 percent that handled 10 or fewer securities a month.

CONCLUSIONS

Financial institutions' noncompliance with lost and stolen securities regulations reduces the program's effectiveness. The consequence is that lost and stolen securities may not be reported, and, if reported, may not subsequently be checked by institutions receiving securities. Improving compliance would increase the opportunities for securities to be found by users of the program. We believe that because the SEC and other regulatory agencies have taken few enforcement or administrative actions to obtain better compliance, financial institutions may perceive registration, reporting, and checking compliance to be of little importance to their organizations. Since SEC is primarily responsible for the program, we believe it should take the lead in assuring financial institution compliance with lost and stolen securities regulation.

RECOMMENDATION

We recommend that the Chairman of the Securities and Exchange Commission, in consultation with the bank regulatory agencies, concentrate on obtaining improved compliance with lost and stolen securities regulations by ensuring through appropriate enforcement and administrative actions that financial institutions become registered with the program and that registered institutions report lost and stolen securities and check the status of securities received.

AGENCY COMMENTS

Justice stated that the SEC and bank regulatory agencies should increase compliance efforts to ensure that financial institutions are registered with the program and that such institutions file the reports and make the inquiries required under the program.

In regard to compliance with the registration requirement, SEC stated that it is concerned about the number of financial institutions that have not registered and expects to continue to coordinate efforts to achieve full registration. However, the agency also stated that although the SEC's and federal bank examiners' approach to achieving full registration is imperfect, it nonetheless reflects the optimal use of limited resources.

In discussing compliance with reporting and inquiry requirements, SEC said that its financial institutions are examined for compliance with these requirements during examinations and that

SEC's examiners alert management at these institutions about compliance gaps and emphasize the benefits of compliance. Also, SEC mentioned that federal bank examiners attempt to take the same steps to achieve full program use. SEC said that it will continue to devote resources to improving industry compliance.

In addressing the taking of appropriate enforcement or administrative actions, SEC said that it has generally found that institutions that are not in compliance with program requirements respond to deficiency letters and to violations cited in bank examination reports. SEC also noted that absent formal administrative action, financial institutions have substantial economic incentives to participate actively in the program because of their exposure to financial loss.

We recognize that with limited resources, achieving total compliance by all financial institutions may be problematical. Nevertheless, in light of the noncompliance with the program requirements, a recognized way to increase compliance would seem to be a more forceful enforcement approach. Such an approach may also serve to forewarn others of the consequences of not complying with the program requirements. We also believe that until compliance with the program requirements is improved it is doubtful that all of the relative costs and benefits of the program could be fully assessed.

CHAPTER 5

LOST AND STOLEN SECURITIES PROGRAMS OPERATED BY THE SEC AND NCIC SHOULD BE LINKED

Financial institutions and law enforcement authorities do not have access to the combined information on lost and stolen securities developed by two independently operated federal programs. For information on lost and stolen securities, financial institutions use the SEC program, and law enforcement authorities use the National Crime Information Center (NCIC), a national information program managed by the FBI. Because little information is exchanged between the two programs, financial institutions and law enforcement authorities may be given inaccurate information about stolen securities. Linking the programs would increase the accuracy of information furnished to the institutions and authorities.

INCOMPLETE LISTS OF LOST AND STOLEN SECURITIES IMPAIRS EFFECTIVENESS OF PROGRAMS

The SEC and NCIC operate separate, uncoordinated programs for lost and stolen securities with little exchange of information. For the most part, financial institutions and law enforcement authorities do not have access to each others list of securities. Therefore, financial institutions and law enforcement authorities may be given erroneous information when they check the status of securities with one or the other program. The erroneous information may hamper the identification of lost or stolen securities and impede effective law enforcement.

Lost and stolen securities lists are incomplete

SEC's program is directed to benefiting financial institutions, while the NCIC program is operated to assist law enforcement authorities. Securities in NCIC's file were added to the SEC program in 1978; however, since then little information has been exchanged. In 1981 we individually compared each program's list to 13,833 stolen securities that we compiled from both the NCIC and SEC lists. We found that 5,684 securities--slightly more than one-third--were on both the SEC and NCIC lists. Of the remaining 8,149 securities, the SEC list had 3,981 securities not listed on NCIC. The NCIC list had 4,168 securities that were not on the SEC list. As a result of the incomplete listings SEC could have told a financial institution that a security was not lost or stolen, even though law enforcement authorities were investigating activities of criminals associated with the losses or thefts.

We analyzed 4,168 securities that were on NCIC's list but not SEC's. The securities were being sought by 167 law enforcement offices and authorities. Our analysis showed that

--50 percent of the securities were being sought by 29 federal law enforcement offices,

--31 percent were being sought by 19 postal inspection offices, and

--19 percent were being sought by 119 local law enforcement authorities.

If the securities on the NCIC list had been on SEC's lost and stolen securities list, the SEC program could have contributed to the law enforcement investigations. The SEC program could have provided law enforcement authorities the current status of the 3,981 stolen securities that were on its list but not on NCIC's. The fragmentation of information between the two programs hinders the achievement of the congressional goal of deterring the illegal use of securities.

Incomplete lists hinder the finding of lost and stolen securities

Because the two programs have exchanged little information on securities, financial institutions may unknowingly hold lost or stolen securities that could provide information about persons involved in stolen securities transactions. At the same time, law enforcement authorities may miss opportunities to apprehend criminals who are in possession of, or could provide information about, stolen securities. In the absence of procedures to exchange information between the SEC and NCIC programs, information on security thefts is often recorded by one of the programs. The following cases show that the effectiveness of the programs is reduced when security theft information is held by one program but not the other:

--Police departments were alerted by Interpol, a worldwide police organization, of a $1 million theft of securities from a financial institution that operated overseas branch offices. A liaison to Interpol reported the securities theft to NCIC but, because of an SEC reporting exemption, not to SEC. Consequently, information on the stolen securities was available on a worldwide basis to law enforcement authorities. In contrast, financial institutions would not learn of the theft if they checked the SEC program.

--Nearly $250,000 in securities were in a car when the car was stolen. The local police department reported the car theft to NCIC but, in an oversight, did not report the securities theft. The car owner, however, reported the securities theft to a stockbroker, who was required to report the theft to SEC. An NCIC official told us that the criminal investigation would have been greatly facilitated if the law enforcement group had had access to the SEC's information on the securities theft.

--A registered financial institution reported $5,100 in securities as lost to a local post office but, through oversight, not to SEC. Postal officials, in turn, reported the mail theft to NCIC. As a result, law enforcement authorities had access to information on the theft; financial institutions did not.

ACCESS TO BOTH LISTS CAN BENEFIT LAW ENFORCEMENT AUTHORITIES

The FBI was granted access to the SEC's lost and stolen securities list, and use of this information has benefitted FBI investigations involving stolen securities. Local law enforcement officials are generally unaware of the SEC program and therefore do not use it. Local law enforcement authorities, however, can provide valuable assistance in lost and stolen securities cases, especially when the FBI lacks investigative jurisdiction.

Benefits of having FBI use the SEC program

SEC granted the FBI direct access to the program for checking securities in May 1978; SEC also notifies them everytime securities are found through the program. FBI agents that we interviewed found the SEC program to be of assistance in securities investigations. The program, for example, provides the agents with information on whether securities have been stolen and of attempts to convert stolen securities to cash.

The FBI furnished 50 cases to us in which securities were found as a result of SEC program information. FBI officials informed us that their agency had taken the following actions as a result of SEC's information:

--In 27 cases the notifications provided information useful to ongoing stolen securities investigations. For example, an FBI undercover agent arrested an individual trying to sell stolen securities worth $100,000. The individual's arrest resulted from the FBI using the SEC program and finding that the securities had been stolen. This arrest also resulted in the FBI finding an additional $605,000 in stolen securities.

--In 12 cases the notification resulted in the FBI initiating an investigation. For example, in May 1979 an employee of a financial institution stole $1 million in securities. The theft was reported to the SEC. As a result of the SEC notification, the FBI was able to locate and arrest the individual.

In four cases the FBI did not have the necessary jurisdiction to investigate the securities found by SEC's program. In the remaining seven cases the FBI found that the notification was incorrect, and that the securities had not been found. As stated in chapter 2, reports of securities found are sometimes erroneous.

Major local law enforcement authorities do not know about the SEC program

Local law enforcement authorities in 10 of the 11 largest U.S. cities told us they were unaware of, and did not use, the SEC program. These authorities could make important contributions to reducing and deterring security thefts. For example, in a case involving a $300,000 securities theft in which the FBI lacked jurisdiction, the local police department investigation resulted in the conviction of the thief.

We found that only one local law enforcement authority was aware of the SEC program. Because this law enforcement authority lacked direct access to use the SEC program it obtained program information indirectly through the cooperation of financial institutions registered with the program.

Police officials in these 11 largest U.S. cities told us that in their investigations they rely on NCIC to check on securities. As previously mentioned, however, in 1981 SEC had 3,981 stolen securities that were not on NCIC's list. Making such information available to local law enforcement authorities could improve the effectiveness of their investigations.

ACCESS TO BOTH LISTS COULD REDUCE INSURANCE COSTS OF FINANCIAL INSTITUTIONS

Financial institutions have an interest in locating lost or stolen securities to reduce their insurance costs. When replacement certificates are obtained for these lost or stolen securities, insurance is obtained and paid by the institution or customer claiming the loss to protect their interests if the lost or stolen security is illegally used in another commercial transaction. The insurance cost represents, in part, the expected cost of claims to the insurance company resulting from the illegal use of securities. Financial institutions checking comprehensive lists of lost and stolen securities could help deter the illegal use of these securities, thereby lowering insurance costs.

We were told by knowledgeable officials that the cost of this insurance is typically 3 or 4 percent of the face value of the security. One insurance company issued 13,053 policies in a year for $149 million in lost and stolen securities. To obtain this insurance we estimate that financial institutions and customers may have paid at least $4.5 million. We further estimate that if insurance had been obtained on the $5.4 billion in lost and stolen securities reported to SEC, policyholders could have paid over $162 million to insure against losses resulting from the illegal use of securities.

SEC AND NCIC PROGRAM LINK IS FEASIBLE

Linking the information of the SEC and NCIC programs by automatic data processing techniques would provide over 6,000 law enforcement authorities and 18,000 financial institutions with access to the complete listing of lost and stolen securities that the Congress intended them to have. Such a linkage is feasible, and numerous options are available to accomplish it. The linkage, for example, could be accomplished by the use of computer terminals. More automated approaches could be developed for the long term.

Before the adoption of the law authorizing SEC's lost and stolen securities program, NCIC was operating a stolen securities program for federal and local law enforcement authorities. To avoid duplication, the Congress authorized SEC to enter into an agreement with the Attorney General to use NCIC facilities to receive information on lost and stolen securities. In addition, the agreement was to allow financial institutions direct access to stolen securities on the NCIC list.

Questions were raised about using NCIC facilities. NCIC officials, for example, were concerned about merging a large number of SEC's lost securities transactions with NCIC's stolen securities transactions. Such a merger of information, according to NCIC officials, would reduce the ability of law enforcement authorities to take prompt action. As previously discussed the FBI has made effective use of the SEC program. Notification procedures could be developed to alert local law enforcement officials when securities were reported lost rather than stolen.

CONCLUSIONS

Information on lost and stolen securities is currently fragmented between the SEC and NCIC programs. Linking the programs' lists would provide complete information for finding securities and apprehending persons perpetrating securities-related crimes, as the Congress envisioned. The linkage would also increase the investigative capability of local law enforcement authorities who currently use NCIC's program, but not SEC's.

RECOMMENDATION

We recommend that the Chairman, Securities and Exchange Commission, and the Attorney General, Department of Justice, link the SEC and NCIC lists of lost and stolen securities.

AGENCY COMMENTS

SEC generally agreed with our recommendation, saying it makes sense to have the information on lost and stolen securities available to both law enforcement authorities and financial institutions. SEC said that it will discuss with Justice the feasibility and cost of various linkage approaches since our report did not detail specific procedures needed for the linkage. Justice believed that SEC should authorize direct checking access to the SEC system for certain federal agencies and major law enforcement authorities involved with stolen securities. Justice also said that the consolidation of the two systems raises serious policy questions that require further study. These policy questions involve the confidentiality of law enforcement information and NCIC notification procedures.

Our report did not address the specific procedures involved with the linkage because the link could be implemented in numerous ways. We did not want to hinder the agencies' efforts by indicating a preference for a particular approach or by preempting their collective judgment. We believe that the most efficient approach can best be determined by the two agencies who will use and operate the linkage. We did not intend to recommend a consolidation; each system would remain an independent entity connected by an automated processing link.

We recognize the need for confidentiality of law enforcement data. As stated in our discussion, the FBI has benefitted from the program's information and their experience could be useful to other law enforcement authorities regarding confidentiality of information. Justice also indicated this question could be resolved since it believed certain federal agencies and major law enforcement authorities involved with stolen securities should have direct checking access to the SEC system. In regard to Justice's concern over the notification procedures used by NCIC, we do not see the need for any changes due to the linkage. Under our recommendation, each system can maintain its own notification procedures or can modify them if the agency has such a need.

U.S. GENERAL ACCOUNTING OFFICE

SURVEY OF FINANCIAL ORGANIZATIONS' VIEWS CONCERNING SEC's LOST AND STOLEN SECURITIES PROGRAM

INTRODUCTION

The purpose of this questionnaire is to obtain information on your organization's views concerning the Securities and Exchange Commission's lost and stolen securities program. Under this program, a centralized data base of securities reported to have been lost or stolen is operated by SEC's designee, Securities Information Center (SIC) of Wellesley, Massachusetts.

The questionnaire can be completed in about half an hour to an hour. Most of the questions can be readily answered either by checking boxes or filling in blanks. A few questions may require a short written answer. Where records or figures are not readily available we would like to have your best estimates. The questionnaire is meant to be answered by an official familiar with the processing of securities and the reporting of losses or thefts of securities to SIC.

As mentioned in our letter, any information provided by your organization will be held in confidence. This questionnaire is numbered only so we can delete your organization's name from the follow-up procedure scheduled for those who do not return the questionnaire.

Throughout this questionaire there are numbers printed within parentheses to assist our keypuncher in coding responses for computer analysis. Please disregard these numbers.

Please return the completed questionnaire in the self-addressed envelope within 10 days, if possible. If you have any questions, please contact either Joseph Potter at (202) 272-2708 or Jeffrey C. Steinhoff at (202) 275-1581. We appreciate your participation and cooperation.

I. HANDLING OF SECURITY CERTIFICATES IN YOUR ORGANIZATION

1. Your organization was selected for this survey because it is subject to the SEC regulations for lost and stolen securities. A great variety of institutions are subject to these regulations. Which of the following categories best describes the primary function carried out by your organization when handling security certificates? *(Check one.)* 1(5)

   1. ☐ broker/dealer in securities (7-8)
   2. ☐ investment adviser
   3. ☐ transfer agent for company's own securities
   4. ☐ transfer agent for securities of two or more different companies
   5. ☐ bank — trust department
   6. ☐ bank — safekeeping
   7. ☐ bank — collateral loan
   8. ☐ paying agent or registrar
   9. ☐ floor/stock specialist
   10. ☐ municipal securities dealer
   11. ☐ other (please describe)

   ____

2. Approximately how many people in your organization physically handle security certificates as part of their day-to-day duties? *(Enter number.)*

   Number of employees that handle security certificates ________ (9-12)

3. Approximately how many security certificates are physically handled by your organization in executing transactions in an average month? *(Check one.)*

   1. ☐ 10 or fewer (13)
   2. ☐ 11 to 50
   3. ☐ 51 to 100
   4. ☐ 101 to 500
   5. ☐ 501 to 1,000
   6. ☐ 1,001 to 2,500
   7. ☐ over 2,500

4. When security certificates are physically moved or transferred by your organization to another location, approximately what percentage of them are transferred in each of the following ways?

1. First class mail	________%	(14-16)
2. Certified mail	________%	(17-19)
3. Registered mail	________%	(20-22)
4. Bonded courier	________%	(23-25)
5. Messenger service	________%	(26-28)
6. Employee delivery	________%	(29-31)
7. Other (Please specify)		
________________	________%	(32-34)
Total	100%	

5. Please estimate the total cost incurred by your organization in 1980 to physically move security certificates by mail, messenger and all other methods.

$________________ (35-40)

6. How often, if at all, does your organization conduct an inventory count of the security certificates in its possession, other than those conducted by auditors? *(Check one.)*

1. ☐ Daily (41)
2. ☐ Weekly
3. ☐ Monthly
4. ☐ Quarterly
5. ☐ Semi-annually
6. ☐ Annually
7. ☐ Do not conduct inventory counts **(Skip to question 8.)**
8. ☐ Other (Please specify)

____

____

7. Are the periodic inventory counts of security certificates conducted by your organization performed on a 100% basis or on a sample basis? *(Check one.)*

1. ☐ 100% basis (42)
2. ☐ Sample basis

II. DISCOVERY THAT SECURITIES ARE LOST OR STOLEN

8 Since 1/1/78 were any security certificates lost or stolen while in your organization's possession or while in transit to or from your organization? *(Do not include instances in which your organization simply could not locate a certificate(s) for a few days but had no reason to believe that a loss or theft had occurred.)*

1 ☐ Yes (43)

2 ☐ No **(If no, skip to question 15.)**

9. Of all the discoveries that securities were lost or stolen from your organization since 1/1/78, about how many were made under each of the circumstances listed below?

	Number	
1 Discovered by employees while processing transactions	______	(44-46)
2 Discovered by employees while conducting an inventory of securities	______	(47-49)
3. Discovered by independent auditors while conducting an inventory of securities	______	(50-52)
4. Discovered or reported by customers	______	(53-55)
5. Discovered or reported by transfer agent not in this organization	______	(56-58)
6. Other (Please describe)		
________________	______	(59-61)

10. During 1980 were any security certificates lost or stolen while in your organization's possession or while in transit to or from your organization? *(Again, do not include instances in which your organization simply could not locate a certificate(s) for a few days but had no reason to believe a loss or theft had occurred.)*

1 ☐ Yes (62)

2 ☐ No — **(If no, skip to question 15.)**

11 During 1980 how many security certificates had been lost or stolen while in your organization's possession or while in transit to or from your organization?

Number of lost or stolen certificates during 1980 ________ (63-67)

Dup (1-4)

(5)

12. Please estimate by type of security the number and market value (as of the date of loss or theft) of all securities that were lost or stolen from your organization during 1980.

	Number of Certificates	Market Value (In thousands)
1. Corporate stock	________ (6-10)	$________ (11 16)
2. Corporate debt	________ (17 21)	$________ (22 27)
3. State and local securities	________ (28-32)	$________ (33-38)
4. Federal securities	________ (39-43)	$________ (44-49)
5. Other (rights, warrants, etc.) (Please specify.) ________ ________	________ (50-54)	$________ (55-60)

13. Of the total security certificates lost or stolen while in your organization's possession or while in transit to or from your organization during 1980 (as reported in Question 11), please indicate the number believed to have been lost or stolen under each of the circumstances listed below?

(Dup (1-4) 3(5)

	Number
1. Lost while in transit as first class mail	________ (7 11)
2 Lost while in transit as certified mail	________ (12 16)
3. Lost while in transit as registered mail	________ (17 21)
4. Lost while in transit by messenger	________ (22 26)
5. Lost during physical movement of securities within your buildings(s)	________ (27 31)
6. Lost within your building(s) not during physical movement of securities	________ (32 36)
7. Stolen by employee of this organization	________ (37-41)
8. Stolen during burglary or robbery	________ (42-46)
9. Accidently destroyed	________ (47 51)
10. Lost under other circumstances (Please describe) ________ ________ ________ ________	________ (52 56)

(Dup (1-4) 4(5)

14. To which, if any, of the organizations listed below does your organization usually report an apparent loss or theft of securities? *(Check all that apply)*

	Organization	Check All to Which you Report: Loss	Theft
1.	State or local police	☐ (6)	☐ (7)
2.	FBI	☐ (8)	☐ (9)
3.	Secret Service	☐ (10)	☐ (11)
4.	Postal Service	☐ (12	☐ (13)
5.	SIC's data base in Wellesley, Mass.	☐ (14)	☐ (15)
6.	Federal regulatory agencies (FDIC), Federal Reserve, etc.)	☐ (16)	☐ (17)
7.	Insurance company	☐ (18)	☐ (19)
8.	Stock exchange	☐ (20)	☐ (21)
9.	Broker or dealer	☐ (22)	☐ (23)
10.	Transfer agent of issuer	☐ (24)	☐ (25)
11.	Paying agent of issuer	☐ (26)	☐ (27)
12.	Other, please specify ______	☐ (28)	☐ (29)

______

15. The subject of immobilization of security certificates with transfer of ownership being accomplished through the use of bookkeeping entries has been widely discussed within the financial community. We are interested in how extensively, if at all, the use of this method has increased or decreased over the past three years. Please enter, in the appropriate space below, the approximate dollar value of your 1977 and 1980 securities transactions and the approximate percentage of the securities transactions executed by your organization in 1977 and in 1980 in which the certificates were processed through a depository.

	Dollar Value of Sales Transactions	Percentage of Sales Transactions in Which Securities Were Immobilized
1977	$______ (30-38)	______ (39-41)
1980	$______ (42 50)	______ (51 53)

III. SECURITIES AND EXCHANGE COMMISSION'S LOST AND STOLEN SECURITIES PROGRAM

16 Is your organization currently registered as a direct or indirect inquirer with SEC's lost and stolen securities program that is operated by the Securities Information Center (SIC) in Wellesley, Massachusetts? *(Check one)* (54)

1 ☐ Yes **(If yes, please skip to question 19.)**

2. ☐ No

17. Which, if any, of the following is the <u>primary</u> reason why your organization has not registered with SIC's lost and stolen securities data base? *(Check one.)* (55)

1. ☐ Our organization is not covered by the Securities and Exchange Act
2 ☐ We do not receive or hold customer securities
3. ☐ We are a broker or dealer of variable contracts
4 ☐ We are a broker of limited partnerships
5. ☐ We deal only in securities not assigned CUSIP numbers
6, ☐ We deal only in U S Government securities
7. ☐ Other (Please specify) ______

______

______

18. Although not registered with the data base maintained by the Securities Information Center, has your organization obtained access to that data base through the services of another organization that is registered with the data base? *(Check one)* (56)

1 ☐ Yes **(If yes, skip to question 24.)**

2 ☐ No **(If no, skip to question 55.)**

19. Is your organization registered as a direct or as an indirect inquirer with the SIC's lost and stolen securities program? *(Check one)* (57)

1 ☐ Direct inquirer

2 ☐ Indirect inquirer **(If checked, Please skip to question 23.)**

20. As a direct inquirer of the SIC lost and stolen securities data base, does your organization make inquiries to the data base for other organizations registered as indirect inquirers or does it make inquiries for only your organization? *(Check one.)* (58)

1. ☐ Makes inquiries for indirect inquirers
2. ☐ Makes inquiries for only this organization **(If checked please skip to question 24.)**

21. For how many organizations (indirect inquirers) does your organization make inquiries to the lost or stolen securities data base. *(Check one.)* (59)

1. ☐ 5 or fewer
2. ☐ 6 to 10
3. ☐ 11 to 20
4. ☐ 21 to 50
5. ☐ more than 50

22. During 1980 about how many times did your organization make inquiries to the SIC lost and stolen securities data base for the indirect inquirers for whom you provide this service to ascertain whether specific securities had been reported as lost or stolen? *(In making this estimate, please do not include any inquiries made for your organization on behalf of organizations or individuals not registered as indirect inquirers.) (Check one.)* (60)

1. ☐ 25 or fewer
2. ☐ 26 to 50
3. ☐ 51 to 100
4. ☐ 101 to 300
5. ☐ 301 to 500
6. ☐ 501 to 1,000
7. ☐ Over 1,000

(After answering this question, please skip to question 24.)

23. Which of the following statements best describes the principal reason why your firm chose to be an indirect inquirer? *(Check one.)* (61)

1. ☐ Not cost effective to be direct inquirer
2. ☐ Too few securities transactions
3. ☐ Direct inquirer handles our securities transactions as part of its services as a custodian, depository, registrar or agent
4. ☐ Were not aware we had a choice
5. ☐ Other, (please explain) ______________

____

IV. REPORTING OF LOST AND STOLEN SECURITIES TO SIC DATA BASE

24. Did your organization report to SIC any securities as lost or stolen during 1980. *(Check one.)* (62)

1. ☐ Yes
2. ☐ No **(If no, skip to question 27.)**

25. About how many separate reports of lost or stolen securities (not number of securities) did your organization make to the SIC data base during 1980? *(Enter number.)*

Number of Reports ______________ (63-65)

Dup (1-4)
5(5)

26. Consider all securities you reported to SIC as lost or stolen during 1980. Please enter below the number and market value of those securities that were lost/stolen in each situation listed.

Situation	Securities Reported to SIC: Number	Securities Reported to SIC: Market Value
1. Lost/stolen while in your organizations's possession.	______ (7-11)	______ (12-17)
2. Lost/stolen while being transferred from your organization.	______ (18-22)	______ (23-28)
3. Lost/stolen while being transferred to your organization.	______ (29-33)	______ (34-39)
4. Lost/stolen while in customers' possession.	______ (40-44)	______ (45-50)
5. Other (Specify).	______ (51-55)	______ (56-61)
Total securities Lost/stolen in 1980 reported to SIC.	______ (62-66)	$______ (67-72)

27. Under which of the following conditions does or would your organization ordinarily report securities as lost or stolen to SIC's data base? *(Check one.)* (73)

1. ☐ Report when missing (as soon as the security cannot be immediately located).
2. ☐ Report only when the security is presumed lost or stolen.
3. ☐ Other (Specify) ______________

____

28. During 1980 did your organization have any securities that were presumed lost or stolen which were not reported to SIC's data base? *(Check one.)* (74)

1. ☐ Yes
2. ☐ No **(If no, skip to question 30.)**

Dup (1-4)
6(5)

29. Which of the following explain why securities presumed lost or stolen were not reported to the SIC data base? *(Check all that apply.)*

1. ☐ Securities that have been missing have not had CUSIP numbers. (7)
2. ☐ Securities that have been missing were U.S. Government or Federal agency issues. (8)
3. ☐ Securities that have been missing had been recovered. (9)
4. ☐ Securities that have been missing had been received from a Federal Reserve Bank or Branch. (10)
5. ☐ Securities that have been missing had been in bearer form. (11)
6. ☐ Do not consider such reporting to be useful. (12)
7. ☐ Other reason(s) (Please specify) (13)

____

____

30. Are there any kinds of securities that if lost or stolen your organization would not ordinarily report to the SIC data base? *(Check one)* (14)

1 ☐ Yes
2 ☐ No **(If no, skip to question 32.)**

31 If yes, which if any, of the categories of securities listed below are not reported by your organization if they are lost or stolen? *(Check all that apply)*

1. ☐ Securities that do not have CUSIP numbers. (15)
2 ☐ U S Government or Federal agency issues. (16)
3 ☐ Securities received directly from the issuer or its agent (17)
4. ☐ Securities received from a Federal Reserve Bank or Branch. (18)
5. ☐ Securities in bearer form. (19)
6. ☐ Other categories (Please specify) (20)

____

____

V. INQUIRING OR CHECKING SIC'S DATA BASE

32. Which, if any, of the statements listed below best describes your organization's practices concerning when you make an inquiry to or check with SIC's lost or stolen securities data base to determine whether securities that came into your possession have been reported as lost or stolen? *(Check one.)* (21)

1. ☐ We check for all securities **(If checked, please skip to question 34.)**
2. ☐ We do not check for any securities **(If checked, please skip to question 35.)**
3. ☐ We check for all securities in transactions above a specified dollar amount (If checked, please enter the transaction amount above which inquiries are made $______________) (22 27)
4. ☐ We check for all securities of which the owner is not an established customer of our organization
5 ☐ We check for all securities of which the owner is not an established customer of our organization and the transaction involved is above a specified amount. (If checked, please enter the transaction amount above which inquiries are made $______________) (22 27)
6 ☐ Other practices (Please describe)

____

____

33. Which, if any, of the categories of securities listed below are among those concerning which your organization does not or would not check with SIC's lost and stolen securities data base? *(Check all that apply.)*

1. ☐ Securities received directly from issuer or agent. (29)
2. ☐ Securities received from an organization registered with the SIC lost and stolen securities data base. (30)
3. ☐ Securities received from a Federal Reserve Bank or Branch. (31)
4. ☐ Securities received from customers whose ownership we have verified from our records. (32)
5. ☐ U.S. Government and Federal agency issues. (33)
6. ☐ Securities that do not have CUSIP numbers. (34)
7. ☐ Other categories (Please specify.) (35)

____

____

34. During 1980 about how many times, directly or through another organization, did your organization check with the SIC lost and stolen securities data base for your own organization and for other organizations not registered as indirect inquirers with the data base to ascertain whether specific securities had been reported as lost or stolen?

	For Your Organization	For Other Organizations
1. None	1. ☐ (36)	1. ☐ (37)
2. 25 or fewer	2. ☐ (38)	2. ☐ (39)
3. 26 to 50	3. ☐ (40)	3. ☐ (41)
4. 51 to 100	4. ☐ (42)	4. ☐ (43)
5. 101 to 300	5 ☐ (44)	5. ☐ (45)
6. 301 to 500	6. ☐ (46)	6. ☐ (47)
7. 501 to 1000	7. ☐ (48)	7. ☐ (49)
8. Over 1000	8. ☐ (50)	8 ☐ (51)

35. Other than SIC's lost and stolen securities data base are there any other sources with which you routinely check to determine whether securities that come into your organization's possession have been reported as lost or stolen? *(Check one.)* (52)

1. ☐ Yes
2 ☐ No **(If no, please skip to question 37.)**

36. If yes, with which, if any of the following sources do you routinely check to determine whether securities coming into your organization's possession have been reported as lost or stolen? *(Check all that apply.)*

1. ☐ Transfer agent of issuer. (53)
2. ☐ Issuer. (54)
3. ☐ Internal records. (55)
4. ☐ Broker or dealer. (56)
5. ☐ Local police department. (57)
6. ☐ FBI. (58)
7. ☐ Other law enforcement authorities. (59)
8 ☐ Other (Please specify.) (60)

____

____

VI. RECOVERY OF MISSING SECURITIES

37. Please estimate the number of certificates and market value of securities that were lost or stolen from your organization during 1980 but were recovered by your organization?

1. ________ Number of certificates recovered. (61-65)
2. $______ Market value of certificates recovered. (66-71)
3. ☐ Not applicable — no securities were lost or stolen during 1980. (72) **(Skip to question 42.)**

38. For how many of the recovered lost/stolen certificates (reported in question 37) did SIC's lost and stolen securities data base aid in the recovery? *(Enter number.)*

__________ Number recovered in which SIC aided. (73-77)

Dup (1-4)
7(5)

39. For how many of the recovered lost/stolen certificates (reported in question 37) did your organization not report the recovery to SIC's lost and stolen data base? *(Enter number. If none, enter 0 and* **skip to question 41.)**

__________ Number recovered not reported to SIC as recovered by your organization. **If none, skip to 41.** (7-11)

40. For how many of the recovered lost/stolen certificates your organization did not report as recovered to SIC (Question 39) was each of the following the primary reason why you did not report the recovery? *(Enter number.)*

Reason	Number	
1. The securities had not been reported to the data base as missing, lost or stolen.	____	(12 16)
2. We believed that recovery reports were not required.	____	(17 21)
3. Administrative oversight.	____	(22 26)
4. Other reason. (Please specify.) ____________	____	(27 31)

41. Of the security certificates recovered by your organization during 1980 (as reported in Question 37) how many of them were returned in the following ways? *(Enter number.)*

1. Returned by transfer or paying agent.	____	(32 36)
2. Returned by the issuer.	____	(37 41)
3. Returned by a securities depository.	____	(42-46)
4. Returned by a bank not affiliated with our organization.	____	(47 51)
5. Returned by a broker or dealer not affiliated with our organization.	____	(52 56)
6. Returned by a law enforcement or investigative agency.	____	(57-61)
7. Returned by other organizations. (Please specify.)	____	
____________	____	
____________	____	(62-66)

42. Have any of your organization's inquiries of SIC's lost and stolen securities data base ever resulted in securities in your possession being identified as lost or stolen? *(Check one.)* (67)

1. ☐ Yes
2. ☐ No **(If no, skip to question 44.)**
3. ☐ Not applicable — we do not make inquiries to the data base **(Skip to question 44.)**

43. Which, if any, of the individuals or organizations listed below does your organization usually contact after being notified that securities in your possession have been reported as lost or stolen? *(Check all that apply.)*

1. ☐ State or local police. (68)
2. ☐ FBI (69)
3. ☐ Secret Service. (70)
4. ☐ Postal Service. (71)
5. ☐ Internal operating personnel. (72)
6. ☐ Individual or organization presenting the security. (73)
7. ☐ Individual or organization reporting loss. (74)
8. ☐ Federal regulatory agency having cognizance over our operations. (75)
9. ☐ SIC (76)
10. ☐ Other, please specify ____________ (77)

Dup (1 4)
8(5)

44. What is your estimate of the total cost incurred in 1980 by your organization to comply with the requirements of the lost and stolen securities program, including user fees paid? *(Check one.)* (7)

1. ☐ $500 or less
2. ☐ $501 to $1,000
3. ☐ $1,001 to $2,500
4. ☐ $2,501 to $5,000
5. ☐ $5,001 to $10,000
6. ☐ $10,001 to $25,000
7. ☐ $25,001 to $50,000
8. ☐ Over $50,000

VII. REGULATORY SUPERVISION

45. Which Federal or industry regulatory agency has primary responsibility for conducting periodic supervisory examinations of your securities processing operations. *(Check one.)* (8)

1. ☐ Securities and Exchange Commission.
2. ☐ Board of Governors of the Federal Reserve.
3. ☐ Comptroller of the Currency
4. ☐ Federal Deposit Insurance Corporation.
5. ☐ National Association of Securities Dealers.
6. ☐ A National Stock Exchange.
7. ☐ Federal Home Loan Bank Board.
8. ☐ Other (Please specify.) ________

____

46. **Has the agency primarily responsible for regulating your organization's securities operations provided you any information concerning your organization's responsibilities under the lost and stolen securities laws and regulations? *(Check one.)*** (9)

1. ☐ Yes
2. ☐ No **(If no, please skip to question 48.)**

47. How adequate or inadequate has this information been, in your organization's opinion? *(Check one.)* (10)

1. ☐ Very adequate.
2. ☐ Adequate.
3. ☐ Neither adequate nor inadequate.
4. ☐ Inadequate.
5. ☐ Very inadequate.

48. In your organization's opinion, what degree of importance, if any, has the cognizant regulatory agency placed upon assuring compliance with the requirements of the lost and stolen securities laws and regulations? *(Check one.)* (11)

1. ☐ Very great importance.
2. ☐ Great importance.
3. ☐ Moderate importance
4. ☐ Some importance.
5. ☐ Little or no importance

49. Does your organization believe that the agency primarily responsible for regulating your organization's operations is doing more than is appropriate, less than is appropriate, or about what is appropriate to assure that there is adequate compliance with the lost and stolen securities laws and regulations? *(Check one)* (12)

1. ☐ Much more than appropriate.
2. ☐ More than appropriate.
3. ☐ About an appropriate amount.
4. ☐ Less than appropriate.
5. ☐ Much less than appropriate.

VIII. OPINIONS ON PROGRAM'S EFFECTIVENESS AND PROPOSED CHANGES

50. How satisfied or dissatisfied is your organization with each of the following aspects of your participation in SIC's lost and stolen securities program? *(Check one for each)*

	Very satisfied 1	Satisfied 2	Neither satisfied nor dissatisfied 3	Dissatisfied 4	Very dissatisfied 5	
1. Cost of participation.						(13)
2. Timeliness of responses to inquiries.						(14)
3. Timeliness of confirmations.						(15)
4. Accuracy of information in data base.						(16)
5. Completeness of information in data base. (Proportion of lost and stolen securities actually contained in data base.)						(17)
6. Other(s) (Please specify) ________ ________ ________						(18)

APPENDIX I

51. **Overall, how satisfied, if at all, is your organization with the results of its participation in the lost and stolen securities program? *(Check one.)*** (19)

1. ☐ Very satisfied.
2. ☐ Satisfied.
3. ☐ Neither satisfied nor dissatisfied.
4. ☐ Dissatisfied.
5. ☐ Very dissatisfied.

52. **Overall, how useful is SIC's data base to your organization? *(Check one.)*** (20)

1. ☐ Very great use.
2. ☐ Great use.
3. ☐ Moderate use.
4. ☐ Some use.
5. ☐ Little or no use

53. We would like your organization's assessment of the effectiveness of SIC's lost and stolen securities program. Please indicate by checking the appropriate column, how effective or ineffective you believe the program has been in meeting each of the objectives listed below

	Very effective 1	Effective 2	Neither effective nor ineffective 3	Ineffective 4	Very ineffective 5	No basis to judge 6	
1. Providing protection to investors.							(21)
2. Assuring recipients of securities that the securities have not been lost or stolen							(22)
3. Deterring the rental of stolen securities to bolster a firm's assets.							(23)
4. Deterring the use of stolen securities as collateral for loans.							(24)
5. Deterring the counterfeiting of securities.							(25)
6. Achieving the return of lost and stolen securities to their rightful owners.							(26)
7. Aiding law enforcement investigations of securities thefts							(27)

APPENDIX I

54 Next, we would like your organization's assessment of the effect of each of the actions listed below on the SEC program's ability to identify and recover lost and stolen securities Please indicate whether your organization believes that the action would increase, decrease, or have no effect on the program's ability to identify and recover lost and stolen securities.

	Greatly Increase	Increase	No Effect	Decrease	Greatly Decrease	No basis to judge	
	1	2	3	4	5	6	
1. Reducing the minimum $10,000 transaction size exemption to a lower level.							(28)
2. Requiring that all securities registered in customer names be checked against the lost and stolen securities data base.							(29)
3. Requiring that all securities received from other reporting institutions be checked against the data base.							(30)
4. Requiring the transfer agents to check all securities against the data base.							(31)
5. Requiring that all securities received from an issuer s agent be checked against the data base.							(32)
6. Including securities that have been assigned CUSIP numbers in the data system.							(33)
7. Taking action against organizations that fail to comply with requirements of the lost and stolen securities program.							(34)
8. Providing instructions to participants on how recovery of lost or stolen securities should be accomplished.							(35)
9. Making available to each participating organization a <u>hard copy</u> of the listing of lost and stolen securities reported to SIC's data base.							(36)

55. There have been a number of proposals advanced to deter the theft of securities or to otherwise aid in the prosecution of individuals accused of stealing securities To what degree would your organization support or oppose Federal Legislation that would make each of the changes listed below? *(Check one for each)*

Legislation that would:	Strongly Support 1	Support 2	Neither support nor oppose 3	Oppose 4	Strongly Oppose 5	
1. Make it a Federal crime to steal securities from any financial institution						(37)
2. Make it a Federal crime to knowingly possess stolen securities						(38)
3. Eliminate the need to prove that stolen securities had crossed state lines before enlisting Federal investigation						(39)
4. Eliminate bearer name certificates						(40)
5. Require financial institutions to move securities by book entry only						(41)

56. If all transactions in securities were on an automated bookkeeping basis would your organization's costs to conduct securities transactions increase, decrease or remain the same? *(Check one)* (42)

1 ☐ Greatly increase
2 ☐ Somewhat increase
3. ☐ Remain about the same
4. ☐ Somewhat decrease
5. ☐ Greatly decrease

57 About what percentage of your customers, do you feel, would be dissatisfied if securities certificates were eliminated and an alternate form of ownership record, such as confirmation used by mutual funds adopted? *(Check one)* (43)

1. ☐ less than 5%
2 ☐ 5%-15%
3 ☐ 16%-40%
4 ☐ 41%-60%
5. ☐ 61%-85%
6. ☐ 86%-90%
7. ☐ Over 90%

58. As of December 31, 1980, according to the SIC data base the volume of securities reported as having been lost or stolen totaled about 900,000 certificates valued at $3.6 billion. We would be interested in any impressions your organization might have as to the whereabouts of the securities now reported as lost and stolen. Please indicate below the approximate percentage (in terms of value) of lost or stolen securities whose whereabouts or ultimate disposition, you believe, is in each of the categories listed below

1. Securities are being used as collateral for loans from U.S. financial institutions ______ % (44-46)
2. Securities are being used as collateral for loans overseas ______ % (47-49)
3 Securities have been sold overseas ______ % (50-52)
4. Securities are being sold to unsuspecting investors ______ % (53-55)
5. Securities are lost within the organization reporting them as missing ______ % (56-58)
6 Accidentally destroyed by owner ______ % (59-61)
7 Criminals have destroyed the securities to prevent use as evidence ______ % (62 64)
8. Have no impression as to whereabouts ______ % (65 67)
9 Other, (Please specify)
______
______ ______ % (68 70)

100%

59. Some members of the financial community have expressed support for the lost and stolen securities program; others have questioned the value of the program. Considering the various benefits and costs of the program, would your organization favor the continuation of the program or would your organization favor the program's termination? *(Check one.)* (71)

1. ☐ Strongly favor continuation
2. ☐ Favor continuation
3. ☐ Have no preference
4. ☐ Favor termination
5. ☐ Strongly favor termination

60. If you have any additional comments on the lost and stolen securities program or on the general problem of lost and stolen securities please provide them in the space below. Thank you for your cooperation. (72)

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

DIVISION OF
MARKET REGULATION

February 14, 1984

Mr. William J. Anderson
Director
General Government Division
United States General
Accounting Office
Washington, D.C. 20548

Dear Mr. Anderson:

The Commission has authorized me to respond to your request of January 13, 1984, for comments on a draft report of the General Accounting Office ("GAO") concerning the Securities and Exchange Commission's ("Commission") Lost and Stolen Securities Program (the "Program"). In its draft report, GAO makes three basic recommendations: (1) that the Commission exempt fewer items from the report and inquiry requirements of the Program; (2) that we increase compliance with the Program's requirements, particularly by banks, through various formal proceedings; and (3) that we link the Program, on an automated basis, with the stolen goods reporting program managed by the Federal Bureau of Investigation ("FBI") at the National Crime Information Center ("NCIC"). */ Those recommendations reflect the GAO staff's assumption that the Program should be designed and operated primarily to "find" lost or stolen securities.

We appreciate the opportunity to comment on the draft report. While we agree with, and will attempt to implement, some of GAO's suggestions, we disagree with the GAO staff's perspective on the objectives of the Program, and we hope through this letter to correct what appears to be a basic misunderstanding. If you decide to issue a final report, we would appreciate your attaching a copy of this letter to that report.

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*/ The recommendations were based primarily on data collected and assumptions made by GAO staff concerning the Program year that ended on December 31, 1980. At that time, the Program was only three years old, and the Commission had just completed the initial stage of the Program. The Commission had only just begun to consider a contract to operate the Program for a four-year term ending June, 1985. The Commission subsequently awarded that contract to the Securities Information Center, a subsidiary of the Xerox Corporation.

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General Comments

We believe that the Program serves basically three objectives. First, it enables the Commission's contractor, the Securities Information Center, to maintain a data base of securities reported as lost, stolen or counterfeit. Second, that data base enables institutions that are considering giving value in exchange for securities certificates, as well as law enforcement authorities that discover suspect certificates, to access a computerized respository of information about lost, stolen or counterfeit securities. Third, the mere existence of that report and inquiry process enhances the commercial confidence that enables efficient certificate handling and serves to discourage sophisticated criminals from placing stolen securities into commerce for value.

Although "finding" lost or stolen securities through the "inquiry match" process is one objective of the legislation, we believe that that process is largely a collateral benefit of the Program. The legislative history confirms that finding all lost securities is not the primary focus of the Program. Indeed, Congress specifically urged the Commission to limit the instances in which inquiry is required to those "where the circumstances are or appear to be suspicious and where, in the exercise of good judgment, appropriate inquiry should be made". */ Moreover, the Committee of Conference instructed the Commission:

> [to] carefully weigh the benefits of mandating inquiry in any specific situation against the costs and effect on efficient business practices and [to] take into consideration the need to avoid requirements which may affect the legal status of a bona fide purchaser in a manner which would unjustifiably disrupt the course of normal commercial transactions. **/

Accordingly, we believe that Congress directed the Commission, in implementing the legislation, to require inquiries only after assessing the relative costs and benefits carefully. Given that mandate, it is to be expected that reported securities data will be extensive while the number of inquiries that result in matches will be relatively small when measured against the entire data base. ***/ In light of the Program's goals, including cost-

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*/ Conference Report to Accompany S.249, S. Rep. No. 75, 94th Cong., 1st Sess., 104 (1975).

**/ Id.

***/ An inclusive data base best assures financial institutions that any appropriate or necessary inquiries will either match or clear.

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effective inquiry requirements, the Report's implication that most stolen securities result in unrecovered losses is very misleading. Particularly given the legislative background to the Program, we are surprised that the GAO staff's recommendations emphasize collateral objectives of the Program and seem so cost-insensitive.

Specific Comments

A. Limiting the Exemptions

The draft report recommends that the Commission:

1. require lost or stolen securities required to be reported to the Federal Reserve Banks be reported to the Program;

2. require that lost or stolen securities without an industry identification number be reported to the Program and direct the contractor to develop identification numbers for these securities; and

3. develop a pilot program and assess whether continuation of the $10,000 or less exemption is appropriate and, if so, determine the limit at which the value should be set, weighing the regulatory compliance burden against the improvement in securities found for financial institutions as well as the increased deterrent effects. */

Current Program requirements and exemptions were established in the late 1970's after extensive public discussion. In accordance with Congressional direction, the Commission developed reporting and inquiry requirements as well as exemptions that avoid "straight-jacketing" the industry **/ or that "unjustifiably disrupt the course of normal commercial transactions." ***/ As we told GAO during their study, the Division is prepared to recommend to the Commission that it seek further public discussion of cost-conscious ways to improve the utility of the Program.

We will address the report's recommendations in the sequence offered.

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*/ The draft report also noted that the number of inquiries matching previous reports ("hits") was overstated in certain annual Program reports because hits that occurred during training of Program participants were erroneously included in the total. As we informed the GAO staff during their study, the contractor has corrected this oversight.

**/ See 121 CONG. REC. S6186 (Apr. 17, 1975).

***/ Conference Report, supra, at 104.

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1. U.S. Government and Agency Securities

To avoid duplication and to accommodate a request of the Board of Governors of the Federal Reserve System (the "BGFRS"), securities issued by the U.S. Government and various federal agencies have been exempted from the Program's report and inquiry requirements. Contrary to the draft report at page 14 , the BGFRS advised the Commission in 1980 that the Federal Reserve Banks no longer wished to process inquiries respecting lost or stolen bearer securities for which they were responsible and, thus, that reports and inquiries respecting these securities should be directed elsewhere. Following notice and comment, the Commission revised the Program to require that reports and inquiries about lost or stolen government bearer certificates be made to the Program. At that time, the Federal Reserve Banks continued to provide services similar to the Program with respect to registered securities issues of the U.S. Government, U.S. Government Agencies and certain international organizations. The Division has recently learned that the Federal Reserve Banks have since discontinued those services. Accordingly, the Division is prepared to recommend to the Commission that it propose appropriate amendments to Program requirements.

2. Securities Lacking Identification Numbers

Securities that lack uniform industry identification numbers (CUSIP numbers) currently are exempt from the Program's reporting and inquiry requirements. This exemption covers short-term securities such as tax and bond anticipation notes and some commercial paper as well as a small number of long-term municipal securities issues. The draft report recommends that the Commission eliminate this exemption.

We believe that the benefits of expanding the Program to include these securities are, at best, minimal. Many of the short-term securities are held to maturity by the original purchasers and do not actively circulate. The secondary markets for these securities are often illiquid, always short-lived and involve a small number of closely-knit traders. With respect to long-term municipal securities issues that lack CUSIP numbers, we understand that these issues are relatively few in number and are not actively traded.

The draft report fails to explain how including such issues in the Program, even if feasible, could be cost-justified. Any such system would require, of course, that all securities issues be easily and uniquely identified from the face of each certificate. Discerning between two distinct municipal securities issues having the same certificate numbers (which is common), often requires an examination of many different features noted on the certificate, such as the purpose and the first call date. The

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Municipal Securities Rulemaking Board, together with several securities and banking industry groups responsible for voluntary uniform securities identification standards, has been working for several years to develop a simple, uniform numbering system that can be applied to such issues. To expect an efficient contractor to undertake that same responsibility for the industry as a whole is fanciful. Moreover, any effort by the contractor to accommodate those securities absent an industry-wide numbering system would require the contractor to develop unique, valid identifiers and maintain a separate essentially parallel data base for internal purposes. Therefore, we continue to believe that the best approach to this problem is to support the Municipal Securities Rulemaking Board's efforts to reduce the number of municipal securities issued without a CUSIP number. */ We also believe that industry-wide efforts to immobilize certificates in securities depositories -- to stop these certificates from circulating at all -- is an important long-term remedy for this problem. We continue to devote special Commission resources to the campaign to immobilize securities certificates.

3. The De Minimus Exemption

The draft report also questions the continuing validity of the $10,000-or-less exemption from mandatory inquiry and implies that eliminating this de minimus exemption would be appropriate because more suspect securities might be found. As we told GAO during the course of its study, we will recommend to the Commission that it request industry comment on the continuing validity of a $10,000 threshold. As the draft report does not disclose, however, this threshold was developed on the basis of industry-supplied data and substantial comment, as suggested by the Congressional directives set forth in the Conference Report.

It must be noted that eliminating this exemption would increase user expenses dramatically. Indeed, when the Commission established this exemption, it estimated that requiring inquiries for all securities would increase perhaps ten-fold the number of required inquiries with, presumably, a parallel increase in aggregate compliance costs for all firms using the Program. Moreover, notwithstanding regulatory requirements, the Program permits inquiries at any time with respect to any certificates in the data base. Participants have strong economic incentives to inquire with respect to exempt securities, and we understand that many participants do make such inquiries.

---

*/ Under an existing rule of the Municipal Securities Rulemaking Board, however, nearly all municipal securities issued after April 1983, must have CUSIP numbers.

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B. Coordination Between the Program and Law Enforcement Activities

The Draft Report recommends that the Commission, the Attorney General and the FBI implement more extensive links between the Commission's data base and the FBI's NCIC data base. We would be happy to pursue such a dialogue with the Attorney General and the FBI. Indeed, the Commission's contractor routinely supplies the FBI with relevant data about reports where criminality is indicated and provides the FBI with unimpeded access to the Program's data base at any time.

The draft report recommends that the Commission, the Attorney General and the FBI develop a system, using remote computer terminals, to permit law enforcement officials to access directly the Commission's data base for reporting, and inquiring about, suspect securities. We agree with GAO that it makes sense to have the same information available to both law enforcement officials and Program participants. Unfortunately, the draft report does not discuss various problems that need to be resolved before either a remote computer terminal system or an SEC-NCIC interface can be implemented for use by various law enforcement officials. Some of these problems include different formats of information stored on the NCIC and the SEC computers, and how the costs of such an interface will be recovered. */ Nonetheless, we intend to renew discussions with the Attorney General and the FBI regarding the feasibility and cost of various links.

C. Improving Compliance with Program Requirements

The Draft Report recommends that the Commission, in consultation with the bank regulatory agencies, concentrate on obtaining improved compliance with lost and stolen securities regulations by insuring that:

1. all financial institutions become registered with the Program;

2. all registered institutions report lost or stolen securities and check on the status of securities received; and

3. appropriate enforcement or administrative actions are taken against institutions that do not comply with the Program's requirements.

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*/ Based on previous conversations with staff at the FBI and the contractor, we understand that the FBI data, among other things, do not include CUSIP numbers. CUSIP numbers, of course, are central to efficient certificate handling and automated recordkeeping systems.

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Page Seven

1. Compliance with Regulation Requirements

The Draft Report asserts that "approximately 5,400 institutions which handle over 2 million securities has (sic) not registered." The draft report notes that many of these institutions are banks and most, if not all, of those banks are regional institutions serving smaller, local communities. Although we acknowledge the desirability of 100% registration and compliance, we believe significant progress toward that goal has been made since the Program's inception in 1977. As of January 1, 1984, approximately 18,744 institutions were registered in the Program. Thus, we believe that the great majority of the financial institutions in national and regional financial centers are registered in the Program.

The Commission, through the contractor's efforts, has conducted a series of mailings to various financial institutions advising those institutions of the Program and their registration and compliance responsibilities. The Commission advises newly-registered broker-dealers of the Program and distributes the necessary registration forms. During inspections, Commission examiners advise existing, non-participating financial institutions about the Program and related compliance requirements. Failure to register in the Program is noted in deficiency letters and examination reports. We understand that federal bank examiners take the same steps to achieve full registration. We believe that although this approach to achieving full registration is imperfect, it nonetheless reflects the optimal use of limited resources. We are, however, concerned about the number of banks that have not registered and expect to continue to coordinate efforts to achieve full registration.

2. Compliance with Reporting and Inquiry Requirements

The draft report asserts that "all financial institutions are not complying with Program requirements for reporting and checking securities." Although some program participants do not comply with all reporting and inquiry requirements all the time, compliance has continued to grow since the program's relatively recent inception. Thus, the number of daily reports and inquiries grew to approximately 2,270 and 8,700 in 1983, respectively, from 1,366 and 4,481 in 1980. That growth is attributable in part to the Commission's and the Self-Regulatory Organizations' compliance efforts. The Commission, for example, examines its regulatees for compliance with the reporting and inquiry requirements during inspections and examinations. (These elements are included in Commission examination check lists.) Commission examiners alert management at these institutions about compliance gaps and emphasize the benefits of compliance. We understand that federal bank examiners also attempt to take the same steps to achieve full Program use. In addition, at various times

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since the Program's inception, the self-regulatory organizations and federal bank regulators have reminded Program participants of their reporting and inquiry obligations, with positive results. We will continue to devote resources to improving industry compliance.

3. Enforcing Program Compliance through Administrative and other Action

The draft report recommends that the Commission and the bank regulatory agencies take appropriate enforcement or administrative action against institutions that do not comply with Program requirements. This recommendation is based on a finding that few formal actions appear to have been taken to date. As GAO Staff should appreciate, the decision to institute disciplinary action depends on many factors, including the nature and degree of non-compliance; whether non-compliance is likely to continue; and available agency resources.

Although we agree with the draft report that enforcement action could have a prophylactic effect on all program participants, we have generally found that institutions that are not reporting or inquiring in compliance with Program requirements respond to deficiency letters and to violations cited in bank examination reports. In any event, absent formal administrative action, program participants have substantial economic incentives to participate actively in the Program because of their exposure to financial loss.

* * *

In light of our comments, we urge GAO to reconsider the findings of the draft report. If the report is nonetheless issued, we again request that a copy of this letter be appended to the report.

Sincerely,

Douglas Scarff

Douglas Scarff
Director

GAO Note: Page numbers have been changed to correspond with final report.

February 22, 1984

Washington DC 20530

Mr. William J. Anderson
Director
General Government Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Anderson:

This letter responds to your request to the Attorney General for the comments of the Department of Justice (Department) on your draft report entitled "SEC's Efforts to Find Lost and Stolen Securities."

Although the Department is not in a position to verify any of the statistical data presented in the draft report, we are generally pleased with the General Accounting Office's (GAO) findings and recommendations addressed to the Securities and Exchange Commission (SEC) relating to their lost and stolen securities program. We generally agree that measures can be taken to improve its overall success. In fact, the effectiveness of the program is of particular interest to the Criminal Division because that Division was the architect of the 1975 legislation that resulted in the creation of the SEC data bank on lost and stolen securities, and because the Criminal Division and Federal Bureau of Investigation (FBI) worked closely with the SEC during the legislation's implementation. It was recognized by the Department that the initial SEC program would eventually have to be adjusted as experience gained during its operation became available. Some of the deficiencies noted by GAO were anticipated at the commencement of the program, but at that time it was more important, in our judgment, for the program to become operational. It was planned to "fine tune" the program after some operational experience, and the GAO study now provides the opportunity to undertake the fine tuning.

The Department concurs fully with the recommendations made by GAO in Chapters 2, 3, and 4 of the draft report; however, the question of linkage of the National Crime Information Center (NCIC) securities file and the SEC data base, recommended in Chapter 5, present policy issues which we believe do not make linkage appropriate. In consonance with the recommendations made to the SEC in Chapters 2, 3, and 4, we believe that <u>all</u> lost marketable securities should be reported to the SEC program; that the SEC and bank regulatory agencies should increase compliance efforts to ensure that all covered entities are registered with the SEC program, and that such entities <u>file</u> the reports and <u>make</u> the inquiries required under the

-2-

SEC program; and that a pilot project be developed by the SEC to determine whether the exemption for transactions involving $10,000 or less can be adjusted to a lower level.

One recommendation we would add to those made by GAO is that the SEC authorize direct inquiry access into the SEC system to the ten or so major local police departments that investigate stolen securities. The appropriate cities to be included could be determined from the NCIC, which is managed by the FBI. The SEC could accept such police departments as members of the SEC program on a level comparable with financial institutions. The FBI already has access to the SEC system, and in view of the large number of thefts from the mail, we would suggest that the U.S. Postal Service also be given direct inquiry access. Further, in recognition of the U.S. Secret Service's new mission in regard to stolen United States obligations, it should likewise be given direct inquiry access. (See new 18 U.S.C. 510.)

Although the Department believes closer regulation of lost or stolen securities would result in more timely location and recovery of these securities, the question of linkage between the NCIC and SEC systems is a highly technical one involving serious policy issues that we believe do not make linkage appropriate. With assistance from the SEC, securities that have been documented as being stolen could be entered into the NCIC system; however, they could not be entered into the NCIC under the system's existing criteria if they were merely reported as lost. Lost securities could, however, be included in the Con Man Index (CMI) for fraudulent and suspect securities. The difference between the two systems being that the articles in the NCIC system are documented as being stolen and a "hit" in NCIC provides probably cause to support an arrest. The fraudulent and suspect securities file of CMI advises the recipient only that the securities contained therein are fraudulent or suspected of being fraudulent. This file could be expanded with little difficulty to include securities that are lost or at least not documented as being stolen, thus providing notification that would be beneficial in locating securities. Under the above conditions, the FBI would have no objection to placing documented stolen securities in the NCIC system and lost securities in the CMI system, should the SEC agree to furnish the necessary information. It is our belief that the above arrangement would materially assist in recovering both lost and stolen securities.

In addition to the technical differences between the NCIC and SEC systems, a paramount issue is that of security access to the NCIC securities file. Law enforcement officials investigating significant dollar losses in stolen securities frequently rely on information from informants who obtain a description of the securities, including the serial numbers, which can be checked against the NCIC restricted access securities file. There is a potential risk to the informant and to the confidentiality of the investigation if inquiries made against a combined NCIC/SEC data base result in a notification to the firm and to employees of the firm who may be involved in the theft of the securities. It is essential under proper law enforcement controls that inquiries to the NCIC computerized data base be conducted via telecommunications restricting access to authorized users. Federal, State, and local law enforcement organizations can be identified through the specific originating agency identifier assigned to their organization, and established logging procedures can identify the specific terminal. Inquiries against the NCIC securities file are received only from terminals interfaced with the NCIC system. This precludes unknown individuals who are in possession of the stolen securities from making telephonic inquiries which cannot be traced. The same procedures would be required for an NCIC/SEC linkage to be feasible.

As an integral part of the NCIC system, there are a number of stringent demands placed upon participating organizations. NCIC procedures require participating agencies to document their report of stolen securities, and when stolen securities are located and recovered, prompt notification must be made to NCIC. NCIC procedures then allow for automatic notification of the recovery to the entering organization and require the entering organization to immediately clear or cancel their records. Additionally, NCIC, because of its criminal focus, that is, furnishing a basis for probable cause, has a securities retention period limited to the year of entry plus four years, and requires yearly validation of the records by the entering organization to assure the quality, integrity, and completeness of the records in the NCIC system. On the other hand, the basically civil SEC system, which is a repository for missing as well as stolen securities, should maintain such records until the securities are actually recovered.

A further problem associated with linkage of the NCIC and SEC systems is that the majority of the lost securities entered in the SEC system are not considered stolen, thus no notifications are provided law enforcement agencies documenting their entries as stolen securities. In many instances, securities reported as lost are only temporarily lost because of poor administrative controls, and these same institutions fail to report the recovery of the securities because of similar administrative weaknesses that resulted in the loss of the securities in the first place.

The above problems point out the importance of the specific requirement that NCIC entries be based upon documentation reflecting theft rather than administrative loss. Such documentation adds to the reliability of the entries. The accuracy and completeness of the file is continuously maintained by requiring agencies entering records into the NCIC files to validate their active records on an annual basis. Further, NCIC procedures require inquiring agencies to contact entering agencies to confirm the validity of a record before an individual may be detained or arrested based upon possession of stolen securities.

In terms of the comments provided above, the potential for a consolidation of data bases between NCIC and SEC as recommended by GAO would necessitate considerable computer programming changes and the creation of specific caveats advising law enforcement agencies of the limited documentation provided on records entered by financial institutions pertaining to lost rather than stolen securities. To provide a definite response to GAO's proposed consolidation of the NCIC securities file and the SEC data base, it will be necessary to present the proposal to the Advisory Policy Board and regional working group members for their review and recommendations. As soon as the decisions and recommendations of the Board and the working group have been finalized, we will provide them to you.

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In concluding our comments, we are offering several suggestions which we believe will add to the clarity and accuracy of the report.

1. On page 9, at the end of line 27 we suggest that a footnote be added to explain how the other 42 percent of securities are transferred, as it represents a significant volume of securities and raises a serious question for the reader. (The securities must be transferred by bonded courier, messenger service, employee delivery or "other." See Question 4 in SEC Survey on page 2 of Appendix 1.)

2. On page 9, line 40, it appears that the number "6" referring to registered securities should be "16." (See line 40 on page 9 .)

3. On page 9, line 54 the term "recovered securities" is somewhat confusing. If we correctly understand the point being made, "securities recovered internally by an institution" is intended. The term "recovered securities" would by itself include both internal and external recoveries.

4. At the bottom of page 11, GAO seems to be stating that the primary value of the SEC program is in recovering lost and stolen securities. While this is surely very important, the most important purpose of the program is to deter the use of lost or stolen securities by the criminal element. Hence, the real measure of the program's success is how many lost or stolen securities actually penetrated the safeguards established by the program and are successfully reintroduced into the financial community without being detected. To the extent the penetration rate is low (or at least perceived to be low by the criminal community) the system is functioning satisfactorily.

Thank you for the opportunity to comment on the draft report. Should you have any further questions please feel free to contact me.

Sincerely,

Kevin D. Rooney
Assistant Attorney General
for Administration

GAO Note: Page numbers have been changed to correspond with final report.

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