



White Paper on Securities Ownership

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White Paper on Securities Ownership

Introduction

This White Paper outlines how you, the investor, own and hold securities electronically through your broker-dealer, how your securities account is covered by multiples layers of protection, and how you enjoy significant access to the securities markets and other benefits that in the past had only been available to investment professionals. Holding securities electronically through your broker-dealer protects your investments similar to cash held in your bank account – but also provides some additional benefits. This includes:

- Laws that:
 - clearly state you are the owner of the securities
 - prevent the broker-dealer from doing anything without your consent, except holding and safeguarding your securities
 - place your securities beyond the reach of the broker's creditors
 - mandate insurance similar to that which protects your bank account
 - nearly eliminate of the risk of theft, damage, or other loss
- Important service offerings such as the ability to transact or check your account online in real time from a computer, cell phone, or other device
- Offers free or low-cost trade commissions and/or other transaction processing fees

- Allows easy adaptation of new and evolving technologies, and
- Plays a critical role in ensuring that securities markets are reliable and efficient.

In Section 1, we summarize how holding securities electronically works and why it evolved from a system based on paper stock certificates. In Section 2, we elaborate on the many benefits investors enjoy by holding securities electronically. In Section 3, we explain how investors have complete ownership of their securities, and how brokers must maintain custody and control of investors' securities, which they may not loan or subject to creditors without investors' express consent (and generally for the purpose of allowing investors to participate in a requested transaction).

Section 1: The Basics of Holding Securities at Your Brokerage Firm

Electronic Ownership

Most individual shareholders hold their securities in a brokerage account through a broker-dealer.¹ This form of ownership is referred to by various terms, such as "book-entry. In this form of ownership, the investor does not hold paper stock certificates to represent that ownership stake. Rather, the securities that a person owns are reflected on the account statements that they receive from their broker-dealer (either via post mail or by email) or through online access.² Regular account

¹Many institutional investors are required to place their securities with a qualified custodian, which may be an affiliate of their broker that they use for their transactions. See rule 206(4)-2 under the Investment Advisers Act of 1940.

²The issuer of your securities may allow you to hold a security in your name directly (and electronically) on the books of the issuer's transfer agent. This option can be available when the issuer's transfer agent participates in the direct registration

statements are legally-mandated, and provide a detailed accounting of purchases and sales of securities and other transactions, such as date and time of trade execution, tax and performance reporting, and regulatory and other customer communications.³

Brokers are highly regulated, required to operate in the customer's best interest, and supervised by the SEC and by FINRA, as well as by state regulators, and are subject to regular inspections.⁴

Broker-dealer regulation includes rigorous legal requirements designed to protect the security of customer accounts, as well as the privacy of customer personal information.⁵

As explained further below in Section 3, brokers are required to keep investor assets segregated from the broker's business accounts, and such assets legally belong to you as the investor. Other than with your express consent, your broker-dealer may not loan out

your securities. Your securities are also beyond the reach of the broker's own creditors. Unlike the paper stock certificates that investors or their brokers held over 50 years ago, the securities you now hold in electronic form are not subject to theft, loss, or damage.⁶

Your securities are protected by other regulated entities as well. Brokerage firms often electronically hold your securities at a trusted third-party, like a highly-regulated "clearing agency," as explained in more detail in Section 3. Clearing agencies provide an extra level of protection that was not available decades ago when securities were primarily represented by paper certificates held in your brokers' vault and subject to loss, damage, or theft.

Finally, as also explained further below, registered broker-dealers maintain federal insurance which protects your securities up to a \$500,000 value.⁷ SIPC insurance covers investor losses if losses remain after other safeguards have been exhausted.⁸ Many

system ("DRS"). When you hold your shares on the books of the issuer's transfer agent, the shares are held in your name, and are not held in your brokerage account and ownership of the shares will not appear on your brokerage account screens or statements. Rather, the transfer agent is required to provide you with statements that evidence your ownership of the shares, and the transfer agent may provide other services as well.

³ FINRA Rules 2231 & 2232.

⁴ FINRA is a self-regulatory organization that oversees brokers under the supervision of the SEC. Brokers must register with FINRA and, with some exceptions, the SEC. Many brokers are also registered with New York Stock Exchange Regulation, which also exercises supervisory authority over its broker members, and with one or more state regulators. Gallagher, Daniel M. "US Broker-Dealer Regulation." Reframing Financial Regulation: Enhancing Stability and Protecting Consumers (2016): 137-54.

⁵ Harvard Law School on Corporate Governance, "Cybersecurity Amendments to Reg S-P" (June 3, 2024). See

also SEC Regulation S-P, SEC Regulation S-ID and FINRA Rule 3110, which specifically requires firms to adopt procedures concerning transmittals of customer funds that include a means of customer confirmation.

⁶ Although lost, stolen or damaged paper stock certificates could be replaced, relevant procedures include cost and delay.

⁷ The \$500,000 limit includes up to \$250,000 in cash.

⁸ Under the Securities Investor Protection Act, in the event that a broker becomes insolvent, the Securities Investor Protection Corporation oversees the appointment of a trustee to protect brokerage customers, and customers' securities – whether in electronic or another form -- are transferred directly to the customers or to their accounts at another broker. If a customer still has a loss at the end of this process, SIPC insurance protection would be triggered to provide compensation. See Section 3, "How are Investors Protected?" See also "When SIPC Gets Involved, at the following URL: When SIPC Gets Involved.

brokerage firms also maintain additional, private insurance, often referred to as “Excess SIPC” coverage, which provides additional coverage beyond \$500,000 per account.⁹

The Evolution of How Securities Are Held

The prior system of stock ownership was based on paper stock certificates, which an individual investor could hold themselves or deposit with their broker, and if with a broker, then the certificate would ordinarily be re-named into the broker’s name and stored in its vault. Each time that an investor wished to sell securities, the broker-dealer would have to retrieve the certificate from the investor or from the broker’s vault and then send the certificate physically to the buyer’s broker within five days in order to complete the trade.¹⁰

Electronic ownership became the predominant means of holding securities because the prior system based on paper stock certificates was unable to keep pace with modern trading volumes. In the 1960s, during what is called the “paperwork crisis,” the securities markets were paralyzed when trying to move paper securities certificates between investors to cover daily transaction volumes of approximately five million shares a day in 1965, which increased to 12 million a day in 1968.¹¹

Those market volumes, viewed as overwhelming at the time, are a mere fraction of trading volumes today;¹² thus, today, the more efficient and effective electronic holding system is a must. Not only did the new electronic holding system eliminate the need for manual transfer to paper certificates, the new system could take advantage of the early use of computers and further advances in technology over time.

Section 2: Investor Benefits from Electronic Securities Holdings

While today’s markets rely on electronic securities ownership and a technologically-based infrastructure to process modern trading volumes at the blazing speeds that investors expect, the electronic infrastructure also brings numerous other benefits to investors, among them:

- Fast and reliable trade execution/settlement, where investors can trade online, or from cell phones or other devices, in a matter of seconds, ensuring best execution and instant price discovery confirmation. In the world of paper stock certificates, there could be significant logistical delays before trade execution, pricing could change, and settlement would take days, further delaying any follow-on transactions.¹³
- The efficiency that results from electronic

⁹ All broker-dealers registered with the SEC are required to become members of SIPC. This includes all broker-dealers, except for a small amount who qualify for a narrow intra-state exemption. A broker-dealer that conducts all of its business in one state does not have to register with the SEC, but it must register with the state and follow state requirements.

¹⁰ Certificates and Computers: Wells, The Remaking of Wall Street, 1967 to 1971. Business History Review, (Summer 2000) (“The Remaking of Wall Street”).

¹¹ The Remaking of Wall Street, at 200.

¹² Approximately 10.9 billion shares are traded on U.S. equity markets every day. See SIFMA “Q&A US Equity Market Structure” (March 5, 2021).

¹³ Most trades today are required to settle within one day. Amendments to Securities Exchange Act Rule 15c6-1 took effect May 28, 2024, shortening the settlement cycle for most broker-dealer securities transactions to the trade date plus one business day (T+1) from the trade date plus two business days (T+2).

securities holdings and trading has resulted in lower (and sometimes zero) commissions and other transaction costs. Overall commission rates have declined substantially from those that prevailed in the early 2000s. The total amount of commissions collected by brokers on trades of U.S. equities has dropped roughly 27% since 2011¹⁴ and one analysis published by Greenwich Associates in 2018 suggests that commissions declined by 50% since the early 2000s.¹⁵

- Holding securities electronically nearly eliminates the risk of theft, damage, or loss. Securities held in paper certificates are subject to damage, theft or loss. If you lose your paper stock certificate, it can take weeks or months to replace it, which means if you need to sell your security to meet a cash demand such as paying tuition or other expenses, you are unable to initiate the transaction until the certificate is replaced, and the certificate replacement costs are typically high.
- Legally required insurance sponsored by the Securities Investor Protection Corporation (“SIPC”), which is similar to that which protects your bank account, up to \$500,000, plus potentially excess insurance provided by brokers. There is no insurance that covers paper certificates that you hold on your own, other than insurance that you may have purchased yourself.
- Holding all your securities electronically, in a single brokerage account, enables you and/or

your advisor to see all your securities holdings and their performance in single place, including consolidated statements, year-end tax documents, continuously updated cost basis information, and dividend or other income payments. This compares to holding your securities directly such as in paper certificates, in which case you would have to retrieve this information and synthesize it yourself, collect documents from multiple sources, and receive dividend and other income in the mail or through separate electronic means.

- Brokers provide widely available, accessible, and flexible investment tools, such as financial planning, margin and consumer loans, securities lending, and banking and credit services.¹⁶ Without electronic securities holdings, these services may only be available through multiple different companies, involve extra logistics and delay, and involve potentially less favorable terms.¹⁷
- If you hold your securities electronically through a broker-dealer, the broker is required to notify you of the upcoming shareholders’ meeting where you are entitled to vote, and to process your vote for a portfolio company’s board of directors and other proposals presented to shareholders.¹⁸ This means that the broker is required to make sure that your timely vote is submitted to the company. Brokers will not only notify you of an upcoming shareholders meeting, but they typically offer you the ability to vote in convenient

¹⁴ Greenwich Leaders 2017 “U.S. Equities U.S. Equity Commission Pool Continues to Shrink” (2017).

¹⁵ Investor’s Exchange LLC “File No. S7-30-22; Release No. 34-96494; Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders” (October 19, 2023).

¹⁶ Increasingly, brokerage firms provide other services as well, such as alerts and insights including investment materials so you can monitor your account, and you can easily access your cash via a credit or debit card or send electronic funds on a

real time basis, such as closing home purchases or paying bills.

¹⁷ Through direct electronic holdings with a transfer agent participating in the DRS, an investor may benefit from some of these services, but each portfolio company may use a different transfer agent.

¹⁸ See NYSE Rules 451 and 452; FINRA Rules 2250 and 2251.

ways, such as by returning a voter instruction card, by telephone, or electronically.

- If securities must be transferred, such as in the event of a death, the transfer through a broker-dealer is streamlined and automated and often completed in a single day. The alternative could involve going directly to a different transfer agent for each portfolio company and obtain and execute their forms, and thus extra logistics and delay, and potentially additional cost.
- A broker-dealer provides timely notification of corporate transactions and similar events in which investors may want to participate, advice on participating and assistance with the logistics. Such transactions may include tender offers, mergers, and other transactions. Without the services of the broker, and investor would be responsible for becoming aware of the corporate event and related timelines, understanding the process, and submitting the forms and records necessary to participate.

These benefits together have helped to make the securities markets accessible in a meaningful way by a growing number of individual investors across the country. Retail traders and their trading activity has seen continued growth over the last five to ten years¹⁹ and recent data reports retail trader activity to be around \$1.4 billion per day on average in the U.S. equity markets.²⁰ It also provides investors with access to the deepest and most liquid markets in the world. Market infrastructure has evolved over time to support average daily trading

volumes that have grown from about five million shares in 1965 to an average daily volume 11 billion shares last year.²¹ A key pillar of the infrastructure is the electronic holding structure, which provides investors with important benefits without compromising the safeguards over investors' property and other interests.

Section 3: How Are Investors Protected?

Although laws have been updated to reflect the prevalence of electronic securities holdings, they have not diminished the fact that investors own their securities.²² All investors, whether individual retail investors or institutional investors, such as mutual funds and pension funds, are covered by the same protections, including new layers of protection that did not exist before electronic holdings become prevalent. These new layers of protection include, for example, the ability of regulated clearing agencies to hold and protect the securities that brokers in turn hold on behalf of their customers, required insurance that protects your account up to at least \$500,000, and an entire new legal regime -- the Securities Investor Protection Act, or "SIPA" and SIPC -- designed to protect and preserve the securities that brokers hold on behalf of their customers.²³

As an Investor, You Own Your Securities

If you hold your securities electronically through your

¹⁹ Commodity Futures Trading Commission "Retail Traders in Futures Markets" (February 15, 2024).

²⁰ Reuters "Retail traders pile into US stocks; focus shifts to EVs from AI" (July 6, 2023).

²¹ Russel Investments "Quarterly Trading Report – Q4 2023: Rally time" (January 29, 2024).

²² See note 23 infra.

²³ Securities Investment Protection Act of 1970 15 U.S.C. §78aaa-III, as amended through July 22, 2010 and Title 17 Part 300.100 – 300.600 Rules of the Securities Investor Protection Corporation.

broker, you own your securities the same way you own the cash in your bank account. There is no legal difference in your ownership of your securities held electronically compared to holding a paper certificate in a safe in your home.²⁴ What securities you own is clear and unequivocal; as noted above, brokers are required to send you detailed account statements in paper and/or by email,²⁵ and most brokers provide a means for you to check your securities positions at any time online.

Brokers Must Hold and Safeguard Your Securities

Under federal law, your broker-dealer must maintain your securities, which means that it must keep investor securities in investor accounts, and it may not loan or subject them to its creditors, subject to exceptions described below where investors expressly consent in exchange for a benefit such as the opening of a margin account (an account where you can borrow money secured by the value of your securities).²⁶

As noted above, broker-dealers in turn typically hold securities electronically through a registered clearing agency.²⁷ Thus, if broker A holds 100,000 shares of Company XYZ on behalf of Customer A, and 50,000 shares of the same company on behalf of Customer B, the broker's account at the clearing agency will reflect electronic holdings of 150,000 shares of Company XYZ. The broker, or another broker with which it maintains a business relationship, is a member of the clearing agency where the account is held, and the clearing agency is registered with, and regulated by, the SEC.²⁸ Clearing agencies represent another layer of protection for your securities held by a broker.

A clearing agency can only be established and operated under specific laws adopted by Congress and rules administered by the SEC, and it is required to maintain a certain amount of liquidity and capital resources in order to maintain operations even in the event of market disruptions.²⁹ Clearing agencies must meet numerous

²⁴ While state laws have evolved to recognize electronic securities holdings, they preserved investors' clear property rights in the securities in their accounts. See, e.g., J. Rogers, Policy Perspectives on Revised U.C.C. Article 8, 43 UCLA Law Rev. 1431 (June 1996) (An explanation by the project Reporter of the purposes and effects of the updates to reflect electronic securities ownership) (the "UCC Reporter's Explanation"). Under Section 511(a) of the Uniform Commercial Code ("UCC"), brokerage customers whose accounts are held in "street name" have primary property rights in their securities, and the broker and its creditors cannot impair those rights. Section 511 of the UCC has been updated to recognize electronic securities holdings, the substantive protections afforded by state law have not changed from the days when holdings were represented by paper certificates held in brokers' vaults. The customer's property interest in his or her securities by law supersedes any interest of the broker or its creditors.

²⁵ FINRA Rule 2231 and 2232.

²⁶ Exchange Act Rule 15c3-3; FINRA Rule 4330; and 15

U.S.C. 78(h).

²⁷ Clearing agencies work together with depositaries that hold the electronic stock certificates, and which are also established and operated under regulatory supervision. The largest clearing agencies are affiliated with depositaries.

²⁸ As customers of brokerage firm trade, clearing agencies update the firm's consolidated account. For example, assume that Broker A has several customers that are invested in Company XYZ. On a given day, some of its customers sell or buy shares in Company XYZ, and when all customer transactions are netted against each other, the number of shares of that company that Broker A holds in aggregate on behalf of its customers decreases by 1,000 shares. The clearing agency debits the account of Broker A by 1,000 shares.

²⁹ Securities Investor Protection Act of 1970, 15 U.S.C. § 78aaa et seq. ("SIPA") and Securities Exchange Act of 1934 15 U.S.C. 78a et seq.

operating requirements focusing on financial strength, sound governance, and secure operations, as well as strong measures to protect the security of their information technology and systems.³⁰ Like brokers, clearing agencies are subject to regular inspections by the SEC.

Only With Your Consent and For Your Benefit May a Broker-Dealer Loan or Subject Securities To Creditors

Brokers may loan your securities, or subject them to creditors, only with your express consent, which you would normally provide in exchange for a benefit to you, such as opening a margin account or to loan your securities to a third party for a profit.³¹ State law, which ensures that you own your securities, tracks the same exceptions.³²

Under SIPA, SIPC Provides Insurance and Protects

Investor Securities In Other Ways

In 1970, Congress created SIPC as part of SIPA with the goal of providing an additional layer of protection for brokerage customers.³³ SIPC protects brokerage customers by providing insurance that registered brokers are required to maintain for any losses up to \$500,000, including up to \$250,000 in cash, and as noted above, many firms maintain excess coverage above those levels.³⁴ Under SIPA, SIPC can also protect investor securities in other ways.³⁵

Conclusion

Many labels have been associated with the modern system of electronic ownership that most investors today use to hold and trade securities, and aspects of the underlying system for securities ownership and trading has grown complex in operation. Therefore, it is not surprising that there is some confusion. However, from the individual investor, the important things have

³⁰ Securities Exchange Act of 1934, 17 CFR § 240.17ad-22 - Standards for clearing agencies.

³¹ See Exchange Act Rule 15c3-3(b) – (d), FINRA Rule 4330, and Exchange Act Section 8(b), 15 USC 78(h). Rule 15c3-3 permits the broker with the investor's consent to secure the margin loan with securities identified to the account representing up to 140% of the customer's credit balance. Margin accounts typically permit brokers to lend securities that secure margin credit to third parties, but it may do so only with the customer's express permission, typically incorporated into the margin agreement. Margin loans are regulated in detail by the SEC and FINRA, and also by the Federal Reserve Board. See Rule 15c3-3(b)(3) and FINRA Rule 3330(b), Exchange Act Section 8(c), 15 USC 78(g).

³² UCC Section 8-511(b) provides that a creditor can have a security interest in customer securities over which it has control, which a broker or other third party can obtain only with the express consent of the customer. This permits the maintenance of customer margin accounts and securities loans secured by customer securities.

³³ Securities Investor Protection Corp. v. Barbour, 421 U.S. 412, 414 (1975). The role of SIPC and SIPA has resulted in successful outcomes. In the 2008 financial crisis, for example, in connection with the failure of Lehman Brothers, Inc., the trustee achieved a 100% distribution to Lehman's customers consisting of \$105.7 billion distributed to more than 111,000 customers through the account transfer and customer claims processes.

³⁴ Separately, brokers under Rule 15c3-3(e) must maintain reserve bank accounts on behalf of their customers in amounts that track the cash held in customer accounts, and such accounts have protection from the firm's creditors.

³⁵ For example, in the event of an insolvency of a brokerage firm, SIPC has the power to step in to protect customer assets, for example by having customer's securities distributed to customers or transferred to their accounts at an alternative broker. See, e.g., United States Courts, Securities Investor Protection Act (SIPA), at Securities Investor Protection Act (SIPA) | United States Courts (uscourts.gov).

remained simple:

- Investors enjoy significant benefits from holding their securities electronically through a broker, and enjoy a level of accessibility that in the past has been the province of professionals on Wall Street;
- Investors own their securities, just as they always have, and brokers must retain custody or control of them;
- Neither the broker-dealer nor third-party creditors can have an interest in customer securities without the customer's consent (and a benefit accruing to the customer); and
- The current, electronic market structure has brought new layers of protection for brokerage customers in the form of registered clearing agencies and depositaries, as well as SIPC and the legislative framework around it.