TRAVELERS

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Via E-mail
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Nancy M. Morris
Secretary, Securities and Exchange Commission
100 F. Street, NE
Washington, DC 20549-1090

Re: File Number SR-DTC-2006-16

Dear Secretary Morris:

As the second largest provider of commercial property and casualty insurance products in the United States, we are writing to express concern about SR-DTC-2006-16, a proposed rule change that will be problematic in practice for transfer agents and for the insurance industry as a whole.

The Depository Trust Company ("DTC") is proposing, in part, to restate the requirements for transfer agents participating in the direct registration system ("DRS"), and to re-examine the requirements of the Fast Automated Securities Transfer Program ("FAST") in order to ensure that assets in the custody of agents are adequately protected. In order to accomplish these objectives, the DTC proposes, in part, to update the insurance requirements for transfer agents "to take into account transaction volumes and values conducted by agents..." The proposed rules, however, are flawed. They (i) neglect non-financial institution entity practices, (ii) are ambiguous as to what will qualify as coverage "similar" to that required under the rules, (iii) require deductibles which are too low to be supported by underwriters, and (iv) unacceptably expand the insurer's exposure to loss while simultaneously expanding the DTC's rights.

With respect to crime coverage, the proposed rule fails to address financial institutions which are not banks and entities which are not financial institutions. The proposed rule requires transfer agents to evidence that they carry a minimum of Bankers Blanket Bond Standard Form 24, or "similar coverage," in proportion to the agent's transaction volume. However, a Form 24 is specific to banks. Other financial institutions avail themselves of other Financial Institution Bonds such as Form 14 (brokers/dealers), Form 15 (mortgage bankers and finance companies), Form 23 (credit unions) and Form 25 (insurance companies). Likewise, non-financial institutions, acting as their own transfer agent, typically address their crime insurance needs with some form of a commercial crime policy. While the proposed rule does provide that "similar coverage" is acceptable to satisfy this crime coverage requirement, what constitutes "similar" is open to interpretation. The rule should be modified to state simply that transfer agents must obtain a Financial Institution Bond or commercial crime policy.

Even more importantly, the maximum deductible required by the proposed rule should be eliminated or significantly increased, and should be based on exposure to loss. Large diversified financial services companies often elect higher deductibles in order to benefit from lower premiums. A transfer agent that is a part of such a company may experience opposition by underwriters who are unenthusiastic about providing a lower deductible when the parent company has already accepted a higher deductible. Additionally, underwriters do not set deductibles "in proportion to transaction volume," as the DTC has. Rather, underwriters set deductibles based on the size and exposure of the entire account. This view considers the account's exposure to loss from all of its business operations, including those acting in the capacity of a transfer agent. Thus, the DTC's approach is too narrow to provide adequate information to underwrite an account.

In addition, the insurance market is unlikely to support the majority of the proposed provisions relating to Errors and Omissions ("E&O") coverage. First, underwriters will be unwilling to identify the DTC as an additional insured in a policy that is meant to insure a transfer agent; this would unacceptably expand the insurer's exposure to loss from the DTC's own business activities. If an underwriter were to name the DTC as an additional insured, it would demand a premium commensurate with the DTC's actual exposure, not just the transfer agent's. Alternatively, underwriters may be more willing to satisfy a requirement that the DTC be named a joint loss payee under these policies with certain conditions in place. Typically, language will be added that states (i) the DTC will only be named as joint loss payee to the extent of its interest, (ii) the policy is for the benefit of the insured and the joint loss payee has no rights or benefits under the policy, (iii) the amount of any paid loss shall not exceed the limit of liability stated in the declarations, and (iv) a failure on the part of the insurer to provide notice under the policy will not impair the effectiveness of such notice.

Second, many entities, including financial institutions, elect to self-insure their E&O exposure, and will balk at a requirement to buy E&O coverage. Additionally, the maximum deductible requirement would be problematic for the reasons set forth above. While the proposed rule allows transfer agents to apply to the DTC for a waiver of the required deductible if its "existing coverage and/or capitalization would provide similar protections to DTC as the requirements set forth," the DTC still has "sole discretion as to whether or not to grant any such waiver," providing little assurance that the transfer agent could overcome the requirement.

Conjunctively, requiring insurance providers to provide notice to the DTC of any "threatened" or actual lapse of the transfer agent's insurance is an offensive and infeasible extension of an insurance provider's duties. Under the proposed rule, transfer agents are required to notify the DTC when they become aware of a lapse in insurance coverage or a change in business practices, and must provide proof of the new or substitute policy "for all required insurance at least 30 days prior to any expiration or change in insurance limits of a previous insurance policy." The terms of the new insurance coverage "must state that the insurance provider must notify DTC within five (5) days of notice of any threatened or actual lapse in the above coverage requirements." Insurance providers bear such burdens only for the named insured. Even then, it would be unreasonable to expect the insurer to provide notice for any "threatened" lack of coverage. A more realistic expectation would revolve around notice for actual non-renewal or cancellation of policies. Regardless, to expect insurance providers to provide such notice to the DTC, which is not a named insured, is unrealistic. Again, even as a loss payee, the DTC would not benefit from the policy, would have no rights under the policy, and would have no argument that the insurer's failure to provide notice under the policy impaired the effectiveness of such notice.

Finally, the proposed rule provides that the required "mail" coverage must identify the DTC as a loss payee "but shall not be invalidated by any act or neglect of the insured." As noted above, any joint loss payee provision would include language making clear that the joint loss payee has no rights under the policy. Moreover, such a provision would also state that the failure to give notice under the policy to the joint loss payee shall not impair the effectiveness of the notice. Thus, underwriters do not bestow upon joint loss payees any rights under the policy which could be "invalidated" in the first place. The proposed rule is therefore misleading and suggests joint loss payees enjoy rights which do not exist in the policy.

For these reasons, we strongly urge you to redraft these provisions in the proposed rule to eradicate the problems identified in this letter.

Very truly yours,

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