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June 16, 2004

Via Electronic Filing

Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: Concept Release: Securities Transactions Settlement

Dear Mr. Katz:

The Charles Schwab Corporation ("Schwab") appreciates the opportunity to comment on the Securities and Exchange Commission ("SEC" or "Commission") Concept Release on methods to improve the safety and operational efficiency of the U.S. clearance and settlement system, and to help the U.S. securities industry achieve straight-through processing ("STP") (the "Concept Release").¹ Schwab is a staunch and vocal advocate for improvements in market structure that will not only increase efficiencies, reduce costs and risk, but foster public trust and confidence in our markets.

Schwab generally agrees with many of the comments we understand are being submitted by the Securities Industry Association ("SIA") and the Depository Trust & Clearing Corporation ("DTCC"). Rather than restate the issues presented by SIA and DTCC, Schwab submits this response to emphasize the following points:

- Shortening the settlement cycle from T+3 to T+1 does not offer significant enough improvements to justify the substantial cost and disruption it would cause to the U.S. clearance and settlement system. Schwab joins in the industry consensus opposing such a reduction at this time;

¹ Securities and Exchange Commission Release Nos. 33-8398; 34-49405; IC-26384, March 11, 2004, 69 FR 12922.

- Dematerialization of security certificates offers the best opportunity for significantly improving the efficiency and safety of the U.S. clearance and settlement system, as well as being a necessary step in the path towards straight through processing. Schwab urges the Commission to mandate the elimination of physical certificates of all publicly traded issues through a phased approach over a two year period;
- Schwab believes that prospectus and confirmation delivery should be decoupled as an important step towards STP; and
- While agreeing that solutions for institutional transaction matching and affirmation need to be found, Schwab does not believe that such changes can be effectively mandated and enforced only through SRO rules binding on broker-dealers. Schwab urges the Commission to extend this dialogue and sponsor a discussion among all market participants, including Buy-Side firms, banks and fund complexes, to adopt, on a wider basis, industry solutions workable for all participants.

Our opinions are reflective of many perspectives. Schwab is a financial holding company, as defined in the Gramm-Leach-Bliley Act, comprised of multiple lines of business and subsidiaries that serve retail and institutional clients. These include, Charles Schwab & Co., Inc., as a broker dealer and service provider to Investment Managers and Institutions; U.S. Trust Corporation, as Custodian and Investment Manager; Charles Schwab Investment Management, as an Investment Manager for our proprietary mutual funds; Schwab Capital Markets, L.P., as an over the counter market maker; and CyberTrader Inc., as an electronic brokerage for active traders. We thus have a significant interest in regulatory and industry efforts to promote efficiency and increase the safety of the markets.

I.

Schwab Opposes Reducing the Settlement Cycle from T+3 to T+1

The idea of reducing the settlement cycle is premised on an often quoted, but mistaken, assumption, namely that nothing good ever happens between trade day and settlement day. T+1 settlement simply decreases the gross amount of unsettled trades subject to credit or market risk. But it also reduces the time to correct errors prior to settlement. The current three days between trade date and settlement provide a useful buffer in the clearance and settlement system that allows firms to resolve issues which could not possibly be handled in one day. Without the capabilities of STP, the loss of this buffer may actually increase operational risk.

In addition, the effort required in shortening the settlement cycle will clearly result in significant costs and disruptions to the industry. Aside from forcing market participants to make significant investments that do not offer a corresponding return to either those incurring the costs or the public, a mandate to move the settlement cycle from T+3 to T+1 will be a

distraction from other important projects, requiring firms to re-prioritize resources to implement a T+1 settlement cycle.

The industry has made substantive progress in recent years toward achieving its STP objectives, which provide benefits that accrue to both investors and market participants. Our opinion is that the industry is best served by a continued focus on STP, where there remains important work to be completed. Accordingly, Schwab opposes any T+1 mandate at this time.

II. The SEC Needs to Address the Issue of Physical Certificates

Resolving the debate over the use of physical certificates is a significant hurdle to any effort to achieve real and lasting improvements to the safety and operational efficiency of the U.S. clearance and settlement system. Schwab recognizes the competing interests in physical securities and appreciates that the issue may be too large for the Commission to resolve on its own. However, the Commission can and should take the following steps which will move this issue forward:

- Mandating book entry issuance of all new issues. The Commission should set an effective date by which equity issuers can no longer issue paper stock certificates;
- Supporting DTCC's recommendations for immobilizing certificates through preventions and disincentives;
- Strengthening and maintaining the DRS System through mandating that all new issues be DRS eligible;
- Developing and mandating book entry capability for unregistered securities (e.g., restricted stock); and
- Endorsing industry educational programs to encourage physical certificate holders to convert to book entry/street name registrations.

The tragedy of September 11, 2001 showed that the continued reliance on physical certificates represents a serious and costly weakness in the U.S. financial system. Physical certificates that were stored or being processed in the World Trade Center were destroyed as those buildings were lost. While the industry was able to continue with settlement activity after September 11th without significant disruption, it was the processing of physical certificates that had to be suspended until September 15th. Replacing these physical certificates cost millions of dollars and resulted in significant expenditures of time and resources. These problems would have been avoided if the U.S. financial system, like many foreign jurisdictions, operated under either a dematerialized or an immobilized book-entry only system.

Ultimately, Schwab believes the reduction, if not elimination, of physical certificates offers the most significant opportunity to strengthen the U.S. settlement and clearance system. Operating under a dematerialized or immobilized book-entry only system would (i) be a significant step towards STP; (ii) greatly reduce the risks relating to lost or stolen certificates; and (iii) significantly reduce the operational cost associated with processing and storing physical certificates.

III.

Prospectus and Confirmation Delivery Should be Decoupled

Another important issue that needs to be addressed before considering a shortened settlement period is the requirement that a final prospectus be delivered prior to or simultaneously with written confirmation of sale. The critical issue is that investors have access to material information on an issue prior to or at the time of the trade in order to make an informed decision about their investment. Schwab agrees with the SIA that the Commission should change the prospectus delivery requirements to decouple delivery from the confirmation and allow the prospectus to be made available to investors either electronic and in paper form.

IV.

A Joint Agency Process Should Be Created for Coordinating Efforts at Improving the Settlement System

Improvements in the U.S. settlement system will only be truly achieved if and when regulations are rationalized to ensure that all market participants are held accountable for compliance. For example, the industry has struggled with the issue of institutional trade affirmation for quite some time now. While the benefits to the clearance and settlement system are self-evident, Buy-Side firms and Custodian banks have been resistant to make those changes that provide for same-day trade confirmation / affirmation and assurance of trade settlement.

Schwab agrees that an effective and enforceable trade affirmation rule is a worthy initiative that will substantially improve the efficiency and safety of the U.S. clearance and settlement system. In fact, Schwab would support a requirement that affirmations be made no later than 12 p.m. on T+1. Schwab agrees with the SIA recommendations regarding a phased approach to allow all market participants, including international institutions, to comply.

However, Schwab opposes the notion that securities intermediaries such as broker-dealers be required to police compliance with such a rule. The NYSE and other SROs have had trade affirmation rules on their books for some time. However, such rules have not been effective in changing the behavior of Buy-Side firms or their custodians; nor do the rules provide assurance that the affirmed trade will settle. Recognition of this fact is evidence that changes to the settlement cycle not only require overhauling systems, but also changing behavior. We believe that only by holding all market participants directly accountable for making required affirmations will the necessary changes to behavior occur.

There are many areas where the move to STP will require the participation of entities not within the jurisdiction of the SEC. We believe that it would be more efficient and effective for the SEC to work with the Federal Reserve and State regulators to evaluate these areas and coordinate means of improving efficiencies. A joint process would not only allow the agencies to avoid duplicative efforts, but would create the mechanism that would facilitate the drive to STP.

IV. Conclusion

Schwab shares the Commission's goal of modernizing and improving the U.S. settlement system. However, Schwab does not believe that reducing the settlement cycle from T+3 to T+1 is the appropriate direction to take at this time. The industry is best served by continuing to pursue its STP agenda whereby incremental progress toward strategic objectives is able to provide both immediate and long-term benefits.

Schwab believes that reducing and eventually eliminating physical certificates offers the most immediate opportunity for significant improvement. Other improvements will require significant coordination among all market participants. The fragmented regulatory structure and the number of constituencies involved may be the most significant obstacle in this effort of coordination. Therefore, Schwab urges the Commission to bring together all participants and their regulatory agencies to work towards these goals.

Schwab offers to work with the Commission on this important initiative. If the Commission or its staff have any questions, please do not hesitate to contact the undersigned at (212) 804-3756.

Sincerely,

Michael J. Alexander
Senior Vice President
Charles Schwab & Co., Inc.

cc: Maurisa Sommerfield