

# THE STA

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Established 1911

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March 17, 2008

Nancy M. Morris, Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549-1090

**RE: Securities and Exchange Commission Release No. 34-57362  
File No. SR-DTC-2006-16, Notice of Filing of Proposed Rule  
Change Amending FAST and DRS Limited Participant  
Requirements for Transfer Agents**

Dear Ms. Morris:

The Securities Transfer Association (“STA”) appreciates the opportunity to comment on the Proposed Rule Change of the Depository Trust Company (“DTC”) referenced above (the “Proposal”). Founded in 1911, the STA is the professional association of transfer agents.

As you may recall, DTC filed a prior version of this Proposal, which was published by the Securities and Exchange Commission (“Commission”) on May 25, 2007. The Commission received 29 comment letters, including the STA’s letter of June 22, 2007. Most of these comment letters were decidedly negative, opposing the proposed Rules on the grounds that they were overbroad, anti-competitive, usurped the SEC’s exclusive jurisdiction to regulate transfer agents, failed to satisfy the Regulatory Flexibility Act of 1980, and were not based on a demonstrated need or history of exposure. Most important, it was noted that, through their Proposal, DTC, an SRO, was seeking to make eligibility requirements and rules for non-members, yielding significant deleterious effects.

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DTC's revised Proposal has taken some of these negative comments into consideration by removing some of the more objectionable provisions from its prior draft. Nevertheless, all of the above-referenced issues remain. The STA continues to believe that the Commission would be abdicating its jurisdiction to regulate transfer agents if it were to permit DTC to implement the Proposal as it is currently written.

### **Introduction**

We will comment below on each of the specific new FAST and DRS limited participant requirements contained in the Proposal but first will address a point of confusion that appears to be the Proposal's guiding principle: its flawed assumption that transfer agents are custodians for DTC by virtue of the fact that transfer agents maintain securities records that may include records of securities that are registered to DTC or its nominee Cede & Co. The Proposal relies heavily on the concept of custody in several places. A custodian, as the term is commonly understood in financial services, is a financial institution that holds securities or other financial assets on behalf of its customers. DTC apparently believes that transfer agents are custodians for DTC and therefore assumes it has standing as a customer to its vendor to make demands of transfer agents. However, a transfer agent is not a custodian for DTC, but serves as the appointed agent of the issuer, under appointment documents executed by the issuer and the transfer agent setting forth the duties and obligations of the transfer agent. DTC overlooks two key attributes of transfer agents.

First, a transfer agent is the agent of the issuer and has one customer, the issuer. The transfer agent has discretion whether to serve a particular issuer and to negotiate with the issuer mutually agreeable financial terms for the services required. The transfer agent does not have any such discretion regarding whether to maintain a record of a particular security holder's position; if the security holder is a direct owner of the issuer's securities, the transfer agent must maintain a record of that position. The security holder does not have any standing to require any operational or other standards of the transfer agent. This is the prerogative of the issuer by agreement with the transfer agent, and, of course, the transfer agent's regulators.

Second, a transfer agent is a recordkeeper; it does not actually hold securities as a custodian for a registered holder. Its vaults generally hold only blank or cancelled stock certificates. Certificates reflecting actual ("live") securities are held by the registered shareholder.

In the case of DTC's position held as a registered holder under its FAST system, there is no certificate except in the most nominal sense--a legended certificate referencing the transfer agent's systems for the number of shares, which has no separate value distinct from the transfer agent's records. The number of securities represented by that registered position changes daily, in only one place: the systems of the transfer agent. Thus, the value is nothing more than a systems record. As the clearance and settlement system

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moves rapidly away from physical stock certificates toward a book-entry model, this fundamental attribute of transfer agents' limited role as recordkeeper becomes increasingly unmistakable.

Yet DTC states that the advent of mandatory book-entry eligibility for listed securities is the triggering event that prompts its need to have dominion over an entire industry. In fact, the list of proposed "custody" requirements (*e.g.*, insurance requirements with minimum coverage amounts, theft, fire and vault requirements) becomes *less* appropriate, *not more*, as securities certificates become supplanted by book-entry positions. Similarly, DTC as a registered holder lacks standing to impose any of its proposed regulatory related requirements (*e.g.*, access to Commission regulatory examination reports, annual auditor attestation reports, notice and inspection rights for DTC, or registered holder statement requirements). DTC's attempt to impose this new authority over the transfer agent industry, while never appropriate for one commercial participant in the financial services industry to impose on another participant, is especially untimely now, as the appropriate regulatory body, the Commission, readies a series of rulemaking releases covering similar subject matter.

Although we believe that DTC lacks authority to impose any of its proposed requirements on the transfer agent industry, we have specific objections to each of them, which we discuss below.

### **Insurance Requirements**

The STA objects to the costly and onerous insurance requirements of the Proposal, particularly as they relate to smaller agents. For this class of agent in particular, the premiums, if obtainable, will be significantly increased over current levels. Perhaps there could be more gradations or levels of coverage which reflect the size and number of transactions of particular agents. For some smaller transfer agents, the large minimum coverage amounts proposed will actually exceed the value of the DTC's securities on the books of the agent, and may not be available at affordable rates. Although the Proposal would allow a waiver of the required levels, as this would be at DTC's sole discretion, the potential for waiver offers no real relief to transfer agents.

Finally, the STA objects to all of the proposed notice requirements to DTC, including notification to DTC in the event of the issuance of a new or substitute policy, an actual lapse in coverage, and proof of new or substitute policies. Importantly, it is the STA's belief that DTC and other registered holders have sustained virtually no economic losses as a result of under-insured transfer agent activities, and, accordingly, the proposed insurance requirements are unnecessary, onerous to some and overly broad. DTC has failed to establish any relevant loss history or potential risk (particularly with regard to book-entry securities) to justify such onerous and costly requirements.

### **Safekeeping Requirements**

The STA believes that DTC should have no authority to dictate the physical security levels maintained by transfer agents, such as the rating of their vaults, the nature of their alarm systems and so on.

As stated above, DTC is not a transfer agent's customer. Moreover, 17Ad-12 already requires transfer agents to hold securities in a manner reasonably free of risk of theft, loss or destruction. The Commission Rule is sufficient and renders this proposal superfluous.

### **Execution of DTC's Documentation**

The Proposal requires that all FAST transfer agents execute a new Balance Certificate Agreement and agree to DTC's Operational Criteria and other documentation. The STA opposes the DTC's practice of establishing self-serving boilerplate agreements and procedures and refusing to negotiate their terms with transfer agents. Under the Proposal, DTC would have the ability to be completely inflexible with a transfer agent over a six-month period and then in its "sole discretion, to terminate or to continue the agent's FAST status." DTC's forms remain largely unchanged from the original documents dating back to the 1980s, despite the movement to book-entry recordkeeping and other changes in securities processing that would permit eliminating the outdated use of physical certificates representing DTC's position.

Additionally, DTC's operational requirements state that transfer agents must maintain a physical balance certificate for each issue. In a world moving to book entry positions and mandatory DRS, this anachronism leads to needless work and exposure, and makes no sense.

### **Auditor Reports**

The Proposal would require transfer agents to provide an annual report from an external certified public accountant, attesting to the soundness of the transfer agent's controls (in the form of a SSAE-10 or SAS-70 report) relating to FAST. These reports would be in addition to the independent accountant's audit of internal controls already required by Rule 17Ad-13 of the Securities Exchange Act of 1934. These additional audit report requirements would be superfluous and would introduce substantial additional expense. It is unclear whether any accounting firms are even willing to undertake performing such an examination, and under what conditions or what cost. DTC as a registered holder, and not a transfer agent's customer, has no right to impose such requirements on a transfer agent. For smaller agents that do not currently obtain SSAE-10 or SAS-70 reports, this additional cost would be a significant and unwarranted burden.

The Commission, as the regulatory authority for transfer agents, performs examinations and requires a specific auditor report under its rules. This existing regulatory framework

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should be sufficient to satisfy any of DTC's stated concerns. In any event, the Commission, not DTC, is the appropriate party to impose audit report requirements on transfer agents.

### **Services Rendered to DTC Without Compensation**

Based on the language of the Proposal, DTC apparently expects transfer agents to provide such services (as well as other enhanced services that DTC may mandate from time to time in its sole discretion) without compensation. This is clearly not acceptable to transfer agents and would not be allowed in any other commercial relationship. If one commercial party requests another to provide services to it, the service provider may decline to do so unless it receives acceptable compensation. If DTC refuses to pay transfer agents for services rendered, transfer agents should be entitled to refuse to provide such services without the threat that DTC could throw them out of FAST (thereby threatening their very existence). DTC may argue that transfer agents should simply pass these costs along to issuers, and indirectly their shareholders, but the STA maintains that neither of these parties should have to bear the cost of services provided to DTC. DTC should not be permitted to require more and more from transfer agents without the discipline of bearing the cost for its demands.

### **Shareholder Statements**

The Proposal would require transfer agents to send transaction advices to shareholders for DRS withdrawal-by-transfers as well as an electronic file to DTC (as requested by DTC). While the concept of sending such statements is not objectionable, the STA maintains that DTC has no authority to mandate notifications to shareholders with DRS shareholdings. This authority lies solely with the Commission, should it choose to propose and adopt rules to this effect. Moreover, to the extent that transfer agents are required to send electronic files to DTC, they should be paid for such services.

### **Regulatory Reports and Inspections**

The Proposal would require transfer agents to supply DTC with copies of Commission examination reports and notification within 5 business days of "any alleged material deficiencies documented by the Commission that may effect the activities of the transfer agent as a FAST Agent". It would also give DTC the right to visit and inspect a transfer agent's facilities, books and records.

Transfer agents rarely if ever offer such privileges to their customers. Since DTC is not even a customer, these proposed rights are completely out of line. The disclosure and access rights appear to be based on the faulty assumption that transfer agents are acting as DTC's custodian which, as previously discussed, is not the case. Most importantly, DTC

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is not entitled to this confidential information under applicable law and regulation, and has failed to demonstrate any need for it.

The Proposal also fails to explain the *purpose* of such notice or inspection rights, *i.e.*, what action DTC would or could take with respect to a transfer agent's alleged deficiency. Notices to DTC are pointless unless there is action that DTC would take upon receipt of such notices. DTC has no standing to take enforcement action—that right belongs to the Commission and other regulators. DTC has no standing to refuse to make payments to a transfer agent—any such right would belong to a customer. All DTC could arguably do is bar a transfer agent from the FAST and DRS programs. This would have such an impact to that transfer agent's customers and their shareholders that it seems inconceivable that the Commission would delegate to DTC such authority.

### **Standard of Care**

The Proposal would also absolve DTC from liability “for the acts or omissions of FAST Agents or other third parties, unless caused directly by DTC's gross negligence, willful misconduct, or violation of Federal securities laws for which there is a private right of action.” This standard would permit DTC to avoid responsibility for its own errors and force transfer agents to “carry the bag” if a third party (*e.g.*, a broker-dealer, or registered shareholder) were to suffer a loss caused by an error at DTC in its interactions with a transfer agent. DTC's exculpatory language would in almost all circumstances force the injured party to seek recovery from the transfer agent alone. DTC wishes to escape liability for even its own ordinary negligence, so that losses might be borne by a transfer agent that is at no fault whatsoever. In a dispute between DTC and a transfer agent, each party should bear responsibility for its own processing errors. There is no legitimate policy purpose that would be served in absolving parties of responsibility for their own errors. In addition, the effect of this position would be, similar to that described with respect to insurance above, to favor DTC and its constituency, street name holders, over record holders, again with no rationale beyond DTC's particular commercial interests.

### **Implementation of Program Changes**

The Proposal would require transfer agents to implement program changes related to DTC systems modifications and to support and expand DRS processing capabilities. Although the changes related to DRS processing would have to be approved by the DRS Ad Hoc Committee\*, of which transfer agents are members, there is no similar requirement for changes related to DTC systems modification. The Proposal fails to address the reasonableness and necessity of changes and the attendant costs that may be incurred by transfer agents. The STA objects to DTC unilaterally determining what changes to make to FAST and DRS, and requiring transfer agents to make changes to their operations and systems to implement the same without any agreement upon the necessity of changes and costs incurred. There is absolutely no justification presented in

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the Proposal for the “blank check” that DTC is requesting. As the Proposal itself makes abundantly clear, DTC left to its own devices can inflict tremendous harm on transfer agents through unilateral rule changes concerning DRS and FAST requirements.

\*Moreover, the use of the DRS Ad Hoc Committee as the ultimate arbiter of disputes is highly objectionable. In the first instance, that Committee is dominated by DTC and its members. Additionally, it has no governing by-laws or rules with respect to who can vote, etc. Ultimately, therefore, DTC would likely control the implementation of costly programmatic changes and huge infrastructure investments by transfer agents under the Proposal as written. This is unacceptable.

### **The Proposal Gives DTC Unfettered Discretion**

The Proposal, in various provisions, gives to DTC what amounts to unfettered discretion to decide which transfer agents are eligible for DRS (now made mandatory by the three Exchanges), to terminate any agent at any time if it suits DTC, and to impose significant changes to both the FAST System and expanded DRS, regardless of the cost to transfer agents. As the relationship between transfer agents and DTC is a commercial relationship, we submit that it is improper for this SRO (in which transfer agents are not members) to retain unfettered discretion over our business.

### **Failure to Satisfy the Regulatory Flexibility Act of 1980**

One of the main goals of the Regulatory Flexibility Act of 1980 (the “RFA”) is to ensure that small businesses are given due consideration when agencies promulgate regulations. There is no evidence that any assessment has been done by DTC to examine the economic impact to small transfer agents or small issuers to ensure compliance with the requirements of the RFA. We urge the Commission to perform such an examination in its review of the Proposal.

### **DTC’s Usurpation of the Commission’s Jurisdiction**

Perhaps the most objectionable aspect of DTC’s Proposal is that it will have the effect of making DTC a supervising regulator of the entire transfer agent industry. Congress did not vest DTC with this authority; instead, it vested exclusive authority for regulating and overseeing transfer agents solely with the Commission. Moreover, DTC is an SRO which, through the Proposal, is seeking to regulate conduct and pricing for non-members. The STA submits that the Proposal presents a major structural problem in this regard, as SROs should not be provided such authority over non-members, and that the Commission needs to consider this irregularity in its review of the Proposal.

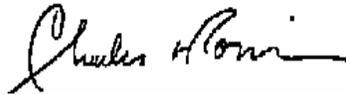
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**Conclusion**

Adoption of the Proposal would amount to an abdication by the Commission of its authority to regulate the transfer agent industry, handing this authority to a private sector entity whose ultimate goal is not the protection of investors but the protection of its own commercial interests. In addition, as the Commission is aware, DTC has a long history of streamlining its own operations by pushing additional service requirements on transfer agents while refusing to pay for almost all of these services, despite the concerted efforts of the STA to enlist the Commission's assistance in urging DTC to bargain with transfer agents in good faith. Furthermore, the advent of mandatory book-entry eligibility would give transfer agents no choice but to adhere to DTC rules, lest DTC in its sole and unfettered discretion throw them out of FAST and DRS and therefore out of business.

We thank you for the opportunity to comment on the Proposal and would welcome the opportunity to discuss our concerns further.

Very truly yours,

A handwritten signature in black ink, appearing to read "Charles V. Rossi". The signature is written in a cursive style with a prominent initial "C".

Charles V. Rossi  
President