



# Securities Transfer Association of Canada

**William Speirs**  
President

July 11, 2008

Florence E. Harmon, Acting Secretary  
Securities Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549-1090

**Subject: Securities and Exchange Commission Release No. 34-57959,  
File No. SR-DTC-2006-16, Notice of Filing of Amended Proposed Rule  
Change Amending FAST and DRS Limited Participant Requirements  
for Transfer Agents**

Dear Ms. Harmon:

The Securities Transfer Association of Canada (“STAC”) appreciates the opportunity to comment on the revised proposed rule change referenced above. STAC represents nine of Canada’s transfer agents. Our members maintain the shareholder registers for the vast majority of Canadian corporations and to our knowledge every Canadian corporation listed on the NYSE, AMEX or NASDAQ exchanges.

As noted in our comment letters of June 26, 2007 and March 18, 2008 to the prior versions of the proposed rule change, STAC supports the SEC initiatives to immobilize securities certificates. However, while we note that this revision eliminates one objectionable requirement from the previous filing, we still have most of the same reservations regarding the DTC Proposed Rule Change (“Proposed Rules”), which amends DTC’s requirements for the Fast Automated Securities Transfer Program (FAST).

## The Lack of a Custodial Relationship

The Proposed Rules state that acting as a “FAST agent” creates a relationship between the transfer agent and DTC with the transfer agent assuming the role of custodian for DTC. Much of DTC’s case for the appropriateness of its insurance, safekeeping and audit requirements rely upon this completely flawed premise.

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For example, as shown by the Canadian relationship model between the transfer agent and CDS Clearing and Depository Services Inc. (CDS), the maintaining of a securities register that includes the DTC securities records does not create a custodial relationship.

In 1993, CDS and the Canadian transfer agents entered into a No Certificate Issued (NCI) environment where the depository surrendered the certificates in their vault to the transfer agent who cancelled the certificates and provided CDS with a book-entry position on the share register in the depository's nominee name. No physical balance certificate is required. This process required daily balancing of the CDS holdings to the transfer agent's registered position for the depository. The transfer agents provide the depository with a file of CUSIP's and closing balances each night, which CDS uses to balance its holdings.

In 2003, when CDS revamped its clearing and settlement system into a straight through processing environment called CDSX, central to the design of the module for intermediary deposits and withdrawals was the requirement for the transfer agent to validate each intermediary deposit and withdrawal prior to the participant receiving credit in their depository account. Clearly, CDSX and DTC's FAST are equivalent processes.

When CDSX was introduced, CDS and the transfer agents entered into an agreement regarding the process for the registration of transfer of securities held by CDS. The following clause is part of this agreement:

#### 2.5 No Agency, Trustee or Custodial Relationship

In carrying out its obligations pursuant to this Agreement, the Transfer Agent shall have no rights or obligations with respect to the custody or investment management of the Securities registered in CDS Name. The provisions of this Agreement shall not be construed as creating an agency, trustee or custodial relationship between CDS and any Transfer Agent with respect to Deposited Securities, whether or not such Securities are evidenced by a certificate, statement or other instrument (although the parties may enter into a custodial relationship by a separate agreement).

This approach is consistent with a non-custodial relationship. The depository's securities positions are registered in their nominee name, not in a registration reflecting a custodial function of the transfer agent. The depository assesses its participants custody fees for these positions on the share register maintained by the transfer agent, but does not share these with the transfer agent, which it would if a sub-custody relationship existed. Both of these comments equally apply to DTC's FAST model.

Further, a custody relationship is a commercial one in which the vendor of the service has the discretion to offer its service to a particular customer and negotiate mutually acceptable terms. The transfer agent's customer is the issuer. Once the transfer agent has negotiated acceptable terms with the issuer, the transfer agent has no discretion regarding maintaining of any of that issuer's security holders – all, including those of DTC or its nominee Cede & Co, must be maintained.

Therefore, as this underlying premise is flawed, DTC's right to unilaterally impose or dictate certain processes or requirements is equally flawed.

### Insurance Requirements

The insurance requirements contained within this revised rule change proposal still contain the substantial minimum coverage amounts of the prior version – levels that are not justified with any actual loss history or potential risk by DTC. While the proposed rule change contains a waiver of the required levels, this is at DTC's sole discretion.

For smaller transfer agents, the significant minimum coverage amounts may not be obtainable and may exceed the value of the DTC's securities on the books of the agent. The creation of additional smaller levels of coverage that better reflect the lower transaction activities of such agents would be more appropriate.

Further, insurance coverage is one component of risk mitigation. The capitalization of the transfer agent is another. Permitting transfer agents to have reasonable levels of self-insurance based upon the transfer agent's capitalization would be a more effective way to align risk with insurance needs. While the Proposed Rules permit existing insurance coverage and capitalization to address this risk of loss requirement, the allowances for capitalization also need to be quantified and not left to the sole and unfettered discretion of DTC. For example, use of the definition within the NYSE rules, where it's stated that transfer agents must have capital, surplus (both capital and earned), undivided profits, and capital reserves aggregating at least \$10,000,000.

Therefore, a more comprehensive and inclusive review of the current insurance environment needs to be completed so that appropriate and justifiable insurance levels are required.

### Physical Balance Certificate Requirement

The FAST Balance Certificate Agreement provided in the proposed rule changes requires transfer agents to maintain and update a physical balance certificate for each FAST position yet precludes the transfer agent from charging DTC for safekeeping. This requirement is without benefit to DTC as it does not enhance DTC's ability to exercise a claim of ownership rights. From a transfer agent's perspective, it adds unnecessary and costly work while increasing the exposure to loss or destruction of the balance certificate. A book-entry position provides the same ownership rights to DTC without the cost and associated risk of safekeeping the paper.

DTC is on record as touting the benefits of electronic records over paper certificates for identifying and reconstructing ownership rights. In an article written by Joe Trezza for The Corporate Secretary & Governance Professional June 2007 on-line newsletter, James Balbo, DTCC Managing Director, Asset Services, is quoted as follows:

"Paper certificates are perishable, too," said Balbo. "In addition to being lost or stolen, they can be easily destroyed in natural or man-made disasters." He pointed to the estimated \$16 billion worth of paper certificates that were lost on 9/11 with the collapse

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of the World Trade Center towers. "By using its electronic records, the securities industry eventually was able to reconstruct the ownership of the securities. But the lesson was not lost. Paper proved far more perishable than computer files."

Therefore, the rule change should not include a requirement to hold physical balance certificates in safekeeping.

#### Audit Requirements

The Proposed Rules require transfer agents to provide to DTC a copy of the Annual Study of Evaluation of Internal Accounting Control and, where a transfer agent obtains one, a copy of the SAS-70 report.

The SEC, in its capacity as regulatory authority for transfer agents, performs examinations of transfer agent practices and, under Rule 17Ad-13, requires an audit report performed by an external auditor, attesting to the soundness of controls and integrity of computer systems. We believe that the SEC is the appropriate regulatory agency to create the requirements regarding the safety and security of securities and records and should be the sole recipient of such reports. The SEC has publicly stated its intention to revamp the audit requirements of 17Ad-13 and, if it considers it appropriate and timely, should do so.

#### Conclusion

The Proposed Rules need substantive revision as they are based upon a flawed premise of a custodial relationship. They are also one-sided – protecting DTC's business interests at the expense of transfer agents; imposing additional costs and processes while prohibiting the charging of related fees. Consultation and good faith negotiation with the transfer agent community is required to develop an appropriate set of Rules.

Yours truly,



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