

June 16, 2004

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

**Re: Concept Release: Securities Transactions Settlement- S7-13-04**

Dear Mr. Katz:

Edward Jones appreciates the opportunity to respond to the Securities and Exchange Commission (the "Commission") request for comment on the above indicated concept release regarding 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.

Overall, Edward Jones supports the Straight-Through Processing Executive Committee of the Securities Industry Association's (the "SIA") response to the Commission's concept release. In principle, we support:

1. Same day affirmation/matching of institutional trades.
2. Deferring a decision on T+1 and focusing efforts on the STP building blocks.
3. Eliminating the use of physical certificates.

In our response, we thought providing specific detail on our (a retail firm with over 8,500 Investment Representatives, and over 6 million retail accounts) experience and perspective on physical certificates could provide new data and insight for the Commission's deliberation on next steps to reduced utilization of physical certificates. Therefore, the remainder of our comments will focus on this topic.

#### **I. Customers Already Accept Dematerialization and Holding Investments In Book Entry Form**

Over 99% of our client security positions are held in book entry form; however, our risks and costs associated with processing a small percentage of certificates are substantial. Our clients request less than 1% of their buy trades to be in physical certificate form.

As you know, Mutual Funds, Government Securities and Municipal Bonds have moved to book entry form without noticeable investor resistance. These products continue to generate strong sales for us despite the fact that only book-entry ownership is available. Also, book entry only ownership has not been a deterrent to client acceptance of IRA accounts. The below data shows the growth we have experienced in these book entry products and services and supports that clients already accept investing when no physical certificates are available.

|                | <i># of IRA accounts</i> | <i># of mutual fund positions</i> | <i>Government Securities sales</i> | <i>Municipal Bond sales</i> |
|----------------|--------------------------|-----------------------------------|------------------------------------|-----------------------------|
| 2001           | 1,239,285                | 6,200,000                         | \$2.6 billion                      | \$6.2 billion               |
| 2002           | 1,529,974                | 7,221,092                         | \$3.2 billion                      | \$7.3 billion               |
| 2003           | 1,779,799                | 8,854,988                         | \$2.6 billion                      | \$6.6 billion               |
| 2004 estimated | 2,100,000                | 10,600,000                        | \$2.7 billion                      | \$6.9 billion               |

## II. Direct Registration System ("DRS") Has Limited Availability And Limited Acceptance - It Needs A Push

**Physical Certificate Withdrawals:** Even though our clients' use of firm name ownership is very strong, we have a few clients that request physical certificates. In support of the industry's continued movement away from certificates, Edward Jones implemented a more aggressive certificate elimination policy in April 2001. In April 2001, our firm increased emphasis on firm name, strongly discouraging certificates by implementing a \$15 charge for physical certificates. At the same time, we changed our system so our Investment Representatives were presented a free DRS set up option concurrently with the \$15 certificate option.

**Acceptance of DRS:** As mentioned, we offer the DRS option for DRS-eligible issues as an alternative to a physical certificate when a client requests removal of securities from street name. We have seen a growing acceptance of DRS as an alternative form of ownership to a physical certificate, but utilization is still low.

To determine why utilization of the DRS option is so low, we did a survey of 50 random branches that each had a client withdraw a physical certificate in March 2004. We found that 43 of 50 clients were aware the security could be held in a DRS position. The most significant reason for investors choosing the physical certificate over DRS was the client was "simply more comfortable" holding the certificate. This appears more a function of habit and availability as the "comfort" factor seems overcome in products and services where certificates are not available (Mutual Funds, Government Securities, IRAs, etc.). We were pleased that this survey indicated a high level of DRS awareness as an option; however, we think we can do more to educate our Investment Representatives on DRS and encourage them to more proactively discuss this option with clients requesting physical securities.

The below statistics show that where available, clients selected the physical certificate for \$15 over the free DRS option.

|                | <i># of Certificates Ordered Out</i> | <i># of DRS Positions Established</i> | <i>DRS Positions as % of Total Certificates Ordered Out</i> |
|----------------|--------------------------------------|---------------------------------------|---|
| 2002           | 21,809                               | 301                                   | 1.4%  |
| 2003           | 16,679                               | 399                                   | 2.3%  |
| 2004 estimated | 16,000                               | 552                                   | 2.8%  |

To further improve acceptance of DRS, we participate in the DTCC DRS user group that discusses and recommends enhancements to DRS. As more issuers embrace the DRS form of ownership, we feel DRS will be a solid form of ownership that preserves the rights of investors having their ownership reflected on the issuer's books and records.

## III. A Small Percent of Customers Still Request A Physical Certificate

In spite of the progress that has been made and the fact most other securities (Government Securities, Municipal Bonds, and Mutual Funds) allow for book entry ownership only, clients still request physical securities from their account. Our experience is noted below:

|                | <i># Certificates Ordered Out</i> | <i>% of Certificates Ordered on All Buy Trades</i> |
|----------------|-----------------------------------|--|
| 2000           | 67,263                            | .95%   |
| 2001           | 33,003                            | .48%   |
| 2002           | 21,809                            | .28%   |
| 2003           | 16,679                            | .19%   |
| 2004 estimated | 16,000                            | .18%   |

Currently, the average cost for us to issue a certificate to a client is \$20 more than a DRS position. Therefore, to cover our cost, as well as further encourage book entry ownership, we are increasing the fee we charge our clients to receive a physical certificate from \$15 per certificate to \$25.

In May 2004, we did a survey of 234 clients who requested a certificate. We found the following information from this survey.

- 74% indicated they simply prefer holding the certificates themselves. Most (55%) of these clients were over 65 years old.
- 31% of securities were DRS-eligible.
- 16% were issued to another individual or registration (i.e. gifting). Most of these requests were under 10 shares.

Again, habit and availability were the main drivers of the physical certificate request. At some point we feel not making certificates available will be necessary to achieve the benefits of a certificateless environment.

#### **IV. The Costs of Supporting Physical Certificates Are Significant**

Even though the percentage of physical certificates we process is quite small (i.e. less than 1% of all buy transactions), the support costs are high. Our internal annual cost estimate for supporting physical certificates is \$1.6 million. This includes costs for labor, safekeeping, courier services, the NYSE medallion guarantee program, vault operations, shipping, and system support. We also incur DTCC charges of approximately \$1.5 million a year to handle physical certificates.

We do not feel there are incremental costs to process book-entry only positions. Book entry only trades, asset movements, dividends, and other custody activity are all done by electronic systems, which already exist, so the incremental cost is virtually zero. The largest cost of book entry securities is the mailing of a monthly/quarterly statement, which for customers with IRA accounts, Mutual Funds, Municipal Bonds and Government Securities already occur.

We discussed above our clients pay for the cost of requesting a physical certificate. They also incur the expense of replacing lost or stolen certificates. We feel clients who choose to hold physical certificates and accept this risk should bear the cost to replace them. Below are the processing fees we charge our clients plus the indemnity bond fees our clients must pay an insurance provider. One example of the risks associated with physical certificate ownership: We recently had a request to replace 50 certificates for one client. A cleaning person at the law firm representing the client in a divorce accidentally disposed of them, and it cost the law firm almost \$30k to replace all of them.

|                | <i># of Client Losses</i> | <i>Processing Cost to Replace</i> | <i>Indemnity Bond Fees</i> | <i>Total Client Cost to Replace</i> |
|----------------|---------------------------|-----------------------------------|----------------------------|-------------------------------------|
| 2003           | 645                       | \$96,750                          | \$90,897                   | \$187,647                           |
| 2004 estimated | 800                       | \$39,600                          | \$51,960                   | \$91,560                            |

#### **V. Specific Recommendations**

While we continue to promote book entry ownership, either firm name or DRS, our efforts alone will not eliminate their use at Edward Jones or in the industry. S.E.C. help is needed to achieve this objective. Therefore, we encourage and recommend the Commission support the SIA Dematerialization efforts by:

- Encouraging DTCC, transfer agents, broker dealers, and issuers to continue working together to enhance the functionality and features of DRS registration and the movements into and out of DRS positions. The Commission should require transfer agents to provide the investor with a transactional statement at the time a transaction takes place and require position statements to DRS holders once a year.
- By 2005, support a DTCC rule change to allow DTCC's system to default Withdrawal Transfer requests to DRS form where available.
- By 2005, support a NYSE rule change to allow NYSE-listed companies to charge the investor a fee for requesting a physical certificate.
- By 2006, implement a regulation requiring Transfer Agents to submit all stopped/escheated/cancelled certificates to the S.I.C. so that investors and Broker Dealers' risk on certificate sells can be further reduced.

- By 2006, implement a regulation whereby physical certificates presented for re-registration will only be available in DRS (where available) or street name.
- By 2008, support a NYSE and AMEX listing standard that requires listed securities issuers to support DRS.
- By 2010, implement a regulation to eliminate the issuance of new equity and corporate debt issues in physical form.

## **VI. Conclusion**

Our reality is that clients who choose to hold physical certificates are in the very small minority. Dematerialization of equities and corporate debt securities would not have a significant negative impact on our clients, as they would achieve more benefits from holding these securities in book entry form. Our experience and analysis clearly shows:

1. Over 99% of customers buying securities leave their securities in firm name.
2. When physical certificates are available, primarily equities, investors choose them over DRS.
3. Eliminating physical certificate availability has no meaningful impact on product sales and activity by retail investors.

We look forward to working with the Commission to achieve dematerialization. We thank you again for the opportunity to express our viewpoint. If we can provide additional information or if you would like to discuss our views further, please contact me at (314) 515-6377.

Sincerely,

Norman Eaker  
Principal, Edward Jones