



Mellon Investor Services

June 16, 2004

Via e-mail: rule-comments@sec.gov

Securities and Exchange Commission

450 Fifth Street, N.W.

Washington, DC 20549-0609

Attention: Jonathan G. Katz, Secretary

**SUBJECT: Concept Release: Securities Transactions Settlement
Release No. 33-8398; 34-49405; IC-26384
File No. S7-13-04
RIN 3235-AJ19**

Ladies and Gentlemen:

Mellon Investor Services LLC (“Mellon”) is pleased to submit its comments on the Concept Release, particularly with respect to Section IV thereof. Mellon is a leading provider of shareholder and related services. Mellon has played an active role in industry initiatives aimed at reducing or eliminating the use of physical certificates, including participation in industry committees sponsored by the Securities Transfer Association, the Securities Industry Association and the Depository Trust Company.

Mellon supports the Securities and Exchange Commission (the “Commission”) in its efforts to eliminate physical certificates. Mellon agrees that there is risk, inefficiency and extra cost relating to physical securities certificates and, as a general matter, believes that the benefits obtained through immobilization or dematerialization would outweigh the perceived advantages of holding securities in the form of physical certificates.

Mellon believes that the Direct Registration System (“DRS”) has been a useful and beneficial system that has been effective in promoting dematerialization. We believe there is a clear trend toward dematerialization, and over time, the number of outstanding physical certificates will steadily decrease without significant intervention by the Commission or other market participants. Our current experience shows that more than 94 percent of shareholders accept DRS ownership when receiving shares in connection with a DRS share distribution. This acceptance rate has increased from the roughly 70 percent acceptance rate that Mellon

experienced when DRS was first introduced. If dematerialization is to be accelerated, however, certain matters need to be addressed.

- First, DRS does not currently support restricted securities. Networking for Equities (“NFE”) remains a viable solution for electronic restricted stock processing, and Mellon supports further NFE development. Implementation of NFE is currently stalled because issues need to be resolved regarding the allocation between industry participants of NFE-related costs.
- Second, issuers today do not have sufficient incentive to make their securities DRS eligible. Mellon agrees with the proposal that DRS enrollment be required for all companies listed on an exchange or Nasdaq. We also note that today there is very little economic incentive for issuers to join DRS unless the issuer is engaged in a stock split, stock dividend or other significant stock distribution. In fact, because issuers incur costs when distributing annual statements to DRS holders that are not applicable to certificated holders, there may be an economic disincentive for issuers to join DRS, notwithstanding the reduction of certificate printing costs. The Commission can eliminate any such cost disincentive by requiring issuers or their transfer agents to deliver an annual account statement to all registered shareholders, regardless of whether the shareholder position is in DRS or is certificated.
- Third, certain state corporation laws still require that physical certificates be made available to shareholders upon request. Mellon believes that these states should be encouraged to remove these requirements.
- Fourth, physical certificate issuances resulting from DTC withdrawal by transfer (“WT”) transactions are currently much more prevalent than those arising from issuer-initiated DRS distributions. Since DRS was initially implemented, Mellon has seen little change in the percentage of WT transactions that create DRS positions, notwithstanding the fact that DRS has been upgraded to DRS/Profile, which gave brokers control over the form in which shares are issued. If WTs are required to default to a DRS position, consistent with the original design of DRS, with investors receiving a physical certificate only if they request one from the issuer or its transfer agent, then WT transactions should almost immediately meet or exceed the 94 percent acceptance rate of DRS positions Mellon currently sees among registered shareholders in DRS distributions.
- Finally, not all industry participants and investors are sufficiently knowledgeable about the benefits of DRS or its availability. To promote investor use of DRS, the Commission can support education initiatives aimed at informing issuers, brokers and investors about the benefits and detriments of all securities ownership options, including DRS, street-name, and physical certificates. The Securities Industry Association’s Immobilization and Dematerialization Guide is a good example. This topic should be added to the licensing curriculum for registered representatives and incorporated into the firm element of brokers’ continuing education.

Mellon supports the views expressed by the American Society of Corporate Secretaries and other commentators that elimination of share certificates should be hastened but cannot practically be immediately eliminated. Although transfer agents and brokers must bear the costs of maintaining or processing physical certificates, notwithstanding their steadily decreasing number, such costs must be weighed against the costs that issuers would bear in conducting the mandatory exchanges necessary to achieve full dematerialization. Such costs would include mailing communication materials to shareholders, answering shareholder inquiries, effecting certificate cancellations and providing mail loss insurance and lost instrument processing. Mellon estimates that at an average cost of between \$5 and \$10 per account, dematerialization could cost Mellon's clients alone up to \$220 million dollars. Complete dematerialization may make economic sense for an issuer only at a time when the issuer is conducting its IPO or is conducting a mandatory exchange in connection with a corporate action. We note that all of these costs, whether incurred initially by brokers, issuers or their transfer agents, are ultimately borne by the investing public.

Some market participants have recommended that the costs of physical certificates be borne by the shareholders that insist on holding their shares in that form. Such a change, which would entail amending exchange listing requirements to permit issuers to charge a specified fee to investors for obtaining a physical certificate, would have the effect of discouraging investors from requesting certificates. While this approach certainly has the benefit of allocating some of the costs of any inefficiencies caused by physical certificates to the investors who chose this form of ownership, Mellon would recommend that any such rule be implemented universally, through a listing requirement that specifies the amount that may be charged, so that shareholder-paid certificate-issuance fees are the same across all issuers. Otherwise, the decision to charge a fee for physical certificates would be left to each issuer, which would surely cause such fees to be unevenly applied, leading to potential shareholder confusion and complaints.

A very important benefit of an enhanced, more widely accepted DRS is that it would facilitate shareholder communication and improve the accuracy of the proxy tabulation process. As described in the Business Roundtable Petition for Rulemaking Regarding Shareholder Communications, filed with the Commission on April 12, 2004, the current communication system, including the proxy voting rules, is overly burdensome, inefficient and costly for issuers. Additionally, because of securities lending practices by nominee holders, broker over-votes are commonplace, resulting in shareholder disenfranchisement. Mellon agrees with the positions taken by the American Society of Corporate Secretaries in its Concept Release comment letter dated May 10, 2004 and its letter to the Commission dated April 30, 2004, in support of the Business Roundtable petition. An expanded and more widely accepted DRS would likely promote more book-entry registered ownership, thereby increasing direct issuer access to shareholders and making the proxy voting process more transparent and accurate.

Registered shareholders holding securities through a book-entry system have the same rights and privileges as shareholders holding physical certificates. In either case, the positions are directly registered on the books and records of the issuer and will not be transferred unless the issuer's

records show the position to be valid. Moreover, unlike an institution holding street-name shares, the transfer agent, whether it is the issuer itself or a commercial transfer agent acting as agent for the issuer, has no legal rights or interests in the securities. Therefore, in response to the Commission's questions number 12 and 13 in the Concept Release, Mellon does not believe that additional rules or regulations are needed to enhance the safety of book entry systems. However, Mellon does believe that rules or regulations designed to make registered ownership through DRS more appealing to investors would be advisable. Rules requiring distribution of periodic statements to holders and rules establishing consistent processes and requirements for DRS share transactions would be beneficial to investors and help make DRS ownership more consistent with other established forms of electronic ownership.

We thank you for the opportunity to comment on the Concept Release and would be happy to discuss with you any questions you may have about these comments.

Very truly yours,

William A. Harris
Vice President &
Assistant General Counsel

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