



Securities Transfer Association of Canada

Richard M. Barnowski
Secretary-Treasurer

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Mr. Jonathan G. Katz
Secretary
Securities & Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Email Rule-comments@sec.gov

RELEASE NO. 33-8398; 34-49405; IC-26384; FILE NO. S7-13-04

Re: Request for comment; Concept Release, Section IV Immobilization and Dematerialization of Securities Certificates

Dear Commissioners,

The Securities Transfer Association of Canada (STAC) represents six of the seven transfer agents providing registration and transfer services to all issuers listed on Canadian exchanges. The Canadian market is significantly different from the American securities market. There are 6 to 7 million registered shareholder records maintained by the seven transfer agents who administer shareholder accounts that include both U.S. and foreign holders. All seven transfer agents have real-time systems connected to the Canadian Depository for Securities (CDS) and receive deposit and withdrawal instructions electronically from the depository participants.

We are pleased to be invited to respond to your Concept Release specifically as it pertains to the Immobilization and Dematerialization of Securities Certificates.

In responding, we have used the definitions for Immobilization and Dematerialization as defined in the SIA Immobilization & Dematerialization Implementation Guide specifically:

Immobilization is any circumstance where an investor does not receive a physical certificate upon the purchase of shares or is required to physically deliver a certificate upon the sale of shares. Evidence of an investor's ownership will be maintained on the books and records of a broker/financial institution or corporate issuer. DRS and street-name ownership are both examples of book-based ownership where securities are "in the system" and thus immobilized. Simply stated, it refers to taking certificates out of circulation at the time of any transaction.

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Dematerialization is the processes of eliminating physical certificates as a record of security ownership, or where ownership of the security exists *only* as an accounting record.

1 Should securities be completely immobilized or dematerialized in the U.S.? If so, which would better serve the market – complete immobilization or dematerialization? Why?

When using the adjective “Completely” in relation to immobilized or dematerialized, the significant difference between the two environments is the time it takes to achieve the desired result. Immobilization takes certificates out of circulation at the time of any transaction so prolongs the period to achieve “complete”.

Complete dematerialization, where ownership only exists as an accounting record, is harder if not impossible, given the North American practice of “streeting” securities. Ownership in certificated form does not always confirm the true or current ownership. Dematerialization would also require changes to complex regulations, legislation and industry processes. There may also be legal and constitutional challenges to removing rights currently in place. Depending on how draconian the implementation, requests for ownership in certificated form may continue to trickle in for years to come.

STAC supports immobilization as the best overall solution. Immobilization will achieve the same results as dematerialization, but provides industry participants with some choice in the interim and mitigates the effect of proceeding with a more onerous dematerialization process.

2 What are the costs and benefits of complete immobilization or dematerialization?

Immobilization would spread some of the processing costs over time as the certificates are returned when there is a need or a sale and can be handled with normal processes and staffing levels. Processes and inducements can be designed to encourage active traders to surrender certificated holdings in a more timely fashion.

Dematerialization possibly requires the wholesale return of certificates to confirm ownership, which is logistically challenging. More importantly, certificates surrendered for the sole purpose of dematerialization is costly, with no real benefit to the presenter, the issuer or the transfer agent. If dematerialization was regulated into effect on a particular date, the one time surge in processing would create more costs and hardship to the industry than anyone could possibly plan for.

In both scenarios, other costs to each industry sector, as well as to each issuer affected, would vary based on scale and volume.

The benefits center around the efficiencies created by eliminating paper handling and reducing the time it takes to process transactions without paper.

3 Are there operational, legal, or regulatory impediments to immobilization or dematerialization?

Yes. The magnitude of some of the items listed below increases with mandated dematerialization versus a gradual immobilization program.

Operationally:

- Logistics and costs associated with the recall of certificates
- Follow-ups to holders who do not respond to returning certificates
- Resolving lost and replaced certificates

Legal:

- Changes to federal and state laws
- Changes to issuers' bylaws/articles
- Other legislation that refers to property ownership and transfer, pledging of collateral, etc.

Regulatory:

- Exchanges, securities commission and depository rules will have to be made consistent with legal changes

Other:

- Industry participants will have to update policy and procedures
- Audit programs
- Systems

4 What advantages might certificates have over securities held in book-entry-only form (i.e., proof of ownership in the event of a loss of electronic records of ownership)? What regulatory initiatives should be considered to address these advantages if the markets were to move away from certificates?

In general, we are of the opinion that there are more disadvantages to holding securities in certificated form than there are advantages.

The principal advantage of holding a certificate is that you can take the asset with you. Registered certificates that are placed in "negotiable" form are another form of portability to avoid detection of ownership. There are always those, for various reasons, who wish to keep their ownership of certain assets private and portable.

All recordkeeping systems, especially when the electronic record is the prime record of ownership, must have adequate disaster recovery and back up plans that can be audited by a third party or regulator. Experiences after the tragic 911 event demonstrated that electronic recordkeeping systems were up and running from remote and back up sites within days, while certificated holdings took months to identify and ultimately replace.

Electronic ownership in nominee or DRS (both have an electronic trail back to the beneficial owner) enhances portability and provides investor choice over the degree of privacy.

5 Should the existence of a viable, widely available direct registration system that preserves the benefits of holding securities in the form of physical certificates be a prerequisite to complete immobilization or dematerialization?

Yes, systems that record individual ownership at the broker level or by the issuer's transfer agent are still necessary to ultimately keep track of ownership positions, be they book-based or certificated and are a prerequisite to certificated, immobilized or dematerialized environments. Share certificates are only one way to represent ownership. Broker and DRS statements are book-based methods.

Investors should be encouraged to hold securities in book-based form now. While choice is important, it should not come at the expense of security and reliability of securities markets. Some steps are being taken to encourage book-based ownership through default and/or assessing a more appropriate cost reflective of the expense to maintain a less efficient certificated environment.

6 What should be done to increase the availability and use of DRS or to otherwise improve DRS? For example, should the Commission adopt operational or processing rules specifically for processing book-entry transaction (i.e., DRS and dividend reinvestment and stock purchase plans), including, but not limited to, timeframes for processing these transactions?

To advance DRS all transfer agents or issuers with in-house registration functions must become electronically connected to the central depository (DTCC) for the purpose of electronic validation and movement of book-based securities between the direct and indirect systems. If the benefits of book-based securities are as stated in various SIA reports, then the cost of connectivity with the depository for the purpose of validating and moving book-based securities to and from the depository nominee holdings should be offset against the benefits and not assessed as fees to the transfer agent or issuer.

Regulators and Exchanges, with adequate notice and promotion to all industry participants, should make a DRS option for investors mandatory for both the Issuer and their transfer agent. Industry associations should establish best practices, including those for account-based processing. These best practices should be followed by all transfer agents/registrars involved in the transfer of securities. Enforcement can be through regulatory compliance and audits.

We are of the opinion that DRS records should not be commingled with other forms of book-based processes governed by separate administration agreements, such as stock purchase and dividend reinvestment plans.

Immobilization between the direct (DRS) and indirect (nominee) systems is a practical solution for the majority of securities. Connectivity between the participants in the direct and indirect

systems is essential for the efficient and secure movement of book-based securities between these two environments.

7 What are the back office costs at brokers-dealers to process securities certificates? What are the costs at transfer agents to process securities certificates? How do these costs compare to processing book-entry securities?

The SIA Immobilization & Dematerialization Implementation Guide discusses industry participant benefits and we will not repeat that information in our submission.

The expensive part of any operation involves the re-entry of data necessary to control and process large volumes of paper-based transactions. Other factors that affect costs are human error resulting in rejections or failed transactions, high volumes due to cyclical activity and risk management processes necessary to deal with the previous items. DRS and Straight-Through Processing (STP), once the initial development costs have been absorbed, is substantially more efficient and cost effective.

The transfer agent processing costs of a DRS transfer compared to an equivalent certificated transfer is estimated to be 40% to 60% less than the comparable process of a paper-based transaction. The variable part of a cost/benefit analysis depends on the percentage of transactions that are received paperless and over what period of time. In general, the payback period may be too long and many transfer agents would have to look at their development as the cost of doing business. This places more emphasis on the need for a "light" or low cost, acceptable version of DRS for small volume transfer agents.

8 What should be done to encourage more companies to issue their securities in a completely immobilized or dematerialized format? Should publicly traded companies be required to do so?

Education of the issuer and their investor relations department on the reasons to phase out certificates and the benefits/security of book-based holdings is important and vital to encourage more companies to move to DRS. If voluntary participation fails, then exchanges need to consider making their listings dependent on the issuer offering investors the option of book-based holdings of their registered securities.

Yes, publicly traded companies and their investors benefit from secure, modern and active securities markets and should be required to offer their shareholders the option of registering their securities in electronic form, confirmed with a statement of ownership.

9 What can broker-dealers do to facilitate complete immobilization or dematerialization on both the retail and institutional customer levels? Are registered representatives sufficiently educated about DRS and do they communicate to investors available options to holding a certificate?

Broker-dealers play a key part in investor education. They do so today in regards to the benefits of the book-based nominee environment. There are a large number of withdrawals that are

processed out of the book-based DTCC nominee system into certificated form. That indicates, for whatever reason, a sizable number of clients choose to hold securities registered in their name.

Broker-dealers might be more encouraged to hold client name securities in DRS if they could be assured that “Networking for Equities” (currently in pilot mode) was a viable method for them to manage this form of client asset other than by safekeeping physical share certificates.

Transfer Agents need to work with the registered representative to show that they can effectively use “Networking for Equities” to hold client name securities in DRS and maintain control over their client’s securities. Networking for Equities is a custodian version of DRS, where holdings can be kept in client name registered on the books of the issuer, yet allows the broker-dealer to retain control over their client’s assets. Networking for Equities provides for nightly reconciliation of client assets to their client recordkeeping systems.

10 What can transfer agents do to facilitate complete immobilization or dematerialization on both the issuer and investor level?

In addition to offering statement-based recordkeeping, the challenge for transfer agents is to communicate the benefits of book-based recordkeeping to issuers’ registered shareholders and the intermediary community.

DRS requires the issuer to consent to providing shareholders with the option or default of account-based recordkeeping. Costs associated with validating and processing book-based deposits (charge backs from DTCC, surety bonds, etc.) should be absorbed by the depository and offset against benefits derived by book-based processing rather than assessed as fees to the TA and Issuer.

Issuers, through their investor relations functions, need to communicate to investors their desire and need to move away from share certificates and make the default for all new share issuance book-based.

Until the book-based process is fully understood, there will be increased costs associated with implementing any change to investors. Despite written communications, experience has shown that there is a sizable increase (up to 20%) in calls to the transfer agent and individual requests for share certificates, which in many cases are more expensive to produce on a one-off basis than through bulk processing. It is only hoped that these costs will be short term.

Communications and workshops to the intermediary community are required on the ease of moving book-based securities between the direct and indirect systems to better serve their client needs.

11 What incentives or disincentives can be employed to discourage shareholders from requesting certificates? Would investors be less inclined to request a certificate if they were required to pay more to obtain, transfer, and trade certificated securities than

book-entry securities? Should investors who choose to hold certificate bear a greater amount of the overall costs associated with producing and processing those certificates?

Incentives for the average investor are not that obvious, since for the most part, once they pay the broker-dealer's fees, there are no other costs (other than safekeeping or if the certificate gets lost or stolen and has to be replaced) until they decide to sell the security. Where the investor does benefit from removing the requirements to move negotiable certificates around the system, is through stronger, competitive, more efficient and modern securities markets that are able to securely settle securities in shorter periods of time.

The disincentive of paying more has limited effectiveness. Experience has shown that despite charges to certificate a holding, certificated issuance remains high. Charges in the form of minimum fees for inactive accounts or "administrative" fees to discourage certificates are a disincentive to small retail investors and have not eliminated the desire of some investors to hold physical certificates. The industry needs to balance the use of disincentives with the education and communications of the benefits of both the Nominee and DRS book-based solutions to meet client needs without the use of certificates.

Holders of certificated securities also need to be aware that, while the right to hold securities in certificated form may be assured, those certificated securities may have to be converted back into book-based form (either into Nominee or DRS) prior to their securities being traded on the exchange.

Providing an alternative book-based method of registering securities in client name (DRS) allows an investor to make informed choices.

12 Are any rules or regulations needed to enhance the safety of book-entry systems operated by transfer agents or broker-dealers?

With complete book-based ownership, clarity over who is responsible for each stage of the electronic "hand-off" of a book-based transfer is essential. This is particularly important when securities are moved between direct and indirect systems.

We offer for consideration two rules to enhance the safety of book based systems:

- a) An additional responsibility to be added to regulation 8 to ensure that the securities being added to the fungible nominee account operated by the central depository are warranted by the participant – to be deposited to the account of their client for which the securities had been registered. The intent of this request is to provide a clear electronic audit trail that ensures that the book-based securities registered to holder X are in fact deposited to an account of X within the participant nominee and not into the account of Y.
- b) A requirement placed on the participant firm to ensure that the beneficial holder file used for mailing proxies balances to the depository's omnibus account on

record dates. The intent of this request is to reduce the instance of possible over-voting.

An underlying premise of stock issuance is integrity of ownership records. The safety of book-based systems could be improved by ensuring that fungible nominee accounts are able to be unwound and reconciled to individual client holdings as maintained by the broker-dealer. Balancing of client positions on record date to the depository omnibus proxy is essential to ensure accurate voting of owners, accurate disbursement of all entitlements and so that disaster recovery processes can be accurate and audited across all layers of book-based ownership back to the issuer's records.

13 What can be done to engender public confidence in certificateless systems?

The investor must have confidence that their book-based assets are secure, accurate and accessible to them at all times and that they have the ease and convenience of portability to trade their book-based securities based on a competitive marketplace for services and fees. One way to do this is to have the regulators more actively involved in ensuring industry compliance or certification of the integrity of book-based record keeping systems used in both the direct and indirect systems.

Book-based systems are akin to other on-line services. The service provider must demonstrate these features before there is wide-spread usage. By making the default of all new security issuance book-based, with the option for the investor to elect a certificate, we can encourage them by positive experience to immobilize or dematerialize other physical certificates registered in their name.

Additional Comments:

As Canadian transfer agents involved in creating the Canadian DRS, there is an issue we would like to place before the commission regarding the inter-operability of DRS for cross-jurisdictional companies. This would apply equally to U.S. investors holding securities of Canadian companies that are not listed or traded in the United States.

Canada and the US have different DRS models.

The Canadian DRS Process:

The Canadian model provides only for DRS deposit and withdrawal transactions to be initiated by financial intermediaries acting on behalf of their customers. There is no ability for DRS holders to initiate transactions through the transfer agent. There is no Profile system required in the Canadian model.

To illustrate, a DRS investor wishing to move securities to or from DRS would provide that instruction to their financial intermediary. The financial intermediary would enter the

transaction into the depository's CDSX system and transaction details would be communicated electronically to the transfer agent.

1. On withdrawals from DRS (deposits to the intermediary's depository account), the transfer agent would cancel the DRS holding, increase the depository holding and electronically validate the transaction (or reject, if it does not pass validation).
2. On deposits to DRS (withdrawals from the intermediary's depository account), the transfer agent would reduce the depository holding, issue the DRS holding and electronically validate the transaction (or reject if inadequate DRS holder data was provided).

The validation of transactions occurs only after the transaction has been completed on the books of the issuer by the transfer agent. The depository credits or debits the intermediary's account only after receiving the validation transaction from the transfer agent. The validation is irrevocable, unless an order or judgment of a governmental agency or court requires the Transfer Agent to make an adjustment to the register of securities maintained by it and such adjustment affects securities registered in the depository's name.

Beyond the processes described above, other DRS processes for Canada and the U.S. are fairly similar. An Ownership Statement would be produced after each change to a holder's DRS account. The DRS holder would be provided a unique shareholder reference number by the transfer agent. This reference number becomes part of the input data required for the intermediary to effect the deposit of DRS securities to their depository account.

Concern:

Our concern lies with U.S. investors who purchase stock in companies listed in both countries or in Canada only. We can either issue certificates to all "out of country registered holders" or work towards some form of inter-operability between the two countries. The latter would be especially important if DRS is mandated by either country or both.

Recommendation:

What we would like to see is inter-operability between the DTCC and CDS systems, so that an intermediary in either country could make a deposit of DRS securities (to the appropriate transfer agent) from either country on behalf of their clients.

Yours truly,

SECURITIES TRANSFER ASSOCIATION OF CANADA

Per:

A handwritten signature in black ink, consisting of a stylized, cursive 'S' shape with a horizontal line crossing it near the bottom.