

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-49930; File No. SR-DTC-2003-09)

June 28, 2004

Self-Regulatory Organizations; The Depository Trust Company; Order Granting Approval of a Proposed Rule Change Relating to Establishing a New Service to Destroy Certain Certificates

I. Introduction

On June 12, 2003, The Depository Trust Company (“DTC”) filed with the Securities and Exchange Commission (“Commission”) a proposed rule change SR-DTC-2003-03 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”).<sup>1</sup> Notice of the proposal was published in the Federal Register on January 23, 2004.<sup>2</sup> The Commission received ten comment letters, which are discussed in Section III. For the reasons discussed below, the Commission is approving the proposed rule change.

II. Description

DTC filed this proposed rule change to establish a new service, which DTC calls the Destruction of Non-Transferable Securities Certificate Program. The new service will allow DTC to destroy certain certificates that represent positions in securities for which transfer agent services are not available and have not been available for six years or longer. DTC notes that the issuers of the securities in question are often inactive or insolvent and that the lack of transfer agent services generally renders the certificates non-transferable. The new service will reduce DTC’s custodial expenses for such non-transferable securities and will allow participants to avoid certain fees to which they would otherwise be subject for the ongoing custody of the non-transferable issues. The filing also was to implement a DTC fee increase relating to DTC’s

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1 15 U.S.C. 78s(b)(1).

2 Securities Exchange Act Release No. 49080 (January 14, 2004), 69 FR 3405.

custody of such non-transferable securities that are not designated for destruction by DTC participants, but as noted below the fee increase was implemented in a separate filing on December 23, 2003.

(1) Background. Over the years, DTC has moved aggressively to reduce the number of securities certificates held in its vaults, principally through expansion of the Book-Entry-Only (“BEO”) program, bearer-to-registered conversions, and Fast Automated Securities Transfer (“FAST”) program. These efforts have been spurred by the desire of the industry and regulators to move towards a book-entry or dematerialized environment. Because significant costs and risks are associated with ongoing maintenance of custody, control, and audit of certificates, certificate reduction reduces DTC’s costs and risks. As a result of these efforts, DTC has significantly reduced the number of corporate, municipal, and bearer certificates it holds.

At the same time, however, the number and percentage of certificates held in DTC’s vaults that represent securities for which transfer agent services are not available has grown considerably. DTC refers to these certificates as “non-transferable securities certificates.” Typically, they are equity securities of a company that has become inactive or insolvent. Currently, DTC holds approximately 1.2 million such certificates, representing nearly 22% of its entire certificate inventory.

To address the costs and risks presented by the rising inventory of non-transferable certificates, DTC, having considered helpful input provided by many participants and industry groups, has developed its Destruction of Non-Transferable Securities Certificates Program.

(2) Previous Commission Orders Approving Certificate Destruction. DTC has twice in the past adopted programs pursuant to which it destroys certificates. The Commission approved DTC programs to destroy certificates representing (1) worthless warrants, rights, and

put options whose expiration dates have passed<sup>3</sup> and (2) matured book-entry-only debt.<sup>4</sup> During 2003, DTC destroyed a total of 35,652 certificates pursuant to these two programs.

(3) PREM. Many participants currently use DTC's Position Removal ("PREM") function to remove positions in non-transferable securities certificates from their participant accounts. Currently, those positions are moved to a DTC internal PREM account. However, the certificates representing those positions are still held in DTC's vaults with all the costs and risks associated with storing such certificates, maintaining the related accounts, and monitoring the status of such issues.

(4) Modifying the PREM Process. Prior to this rule change, the only effects of a participant's "deleting" its position in an issue using PREM were to eliminate: (1) the custody fees associated with the position and (2) the reporting of the position on the participant's securities position listing statements. Under the new program, DTC will notify its participants that using PREM to remove a position from its participant account or maintaining a position in PREM constitutes an acknowledgement by the participant that not only may DTC cease crediting the security to the participant's securities account, it may at its option based upon PREM criteria include the certificates representing the position in DTC's Destruction of Non-Transferable Securities Certificate Program. DTC will implement this new program with issues in which all participant positions have been moved to PREM.

(5) Destruction Process. Authorized DTC personnel will oversee and witness the destruction of the certificates. DTC will maintain detailed ledger control over the certificates through the point of destruction. In addition, prior to their destruction the certificates will be computer imaged by DTC. For all destroyed certificates, DTC will maintain an accurate record

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3 Securities Exchange Act Release No. 28642 (November 21, 1990), 55 FR 49725 [File No. SR-DTC-90-11].

4 Securities Exchange Act Release No. 44169 (April 10, 2001), 66 FR 19592 [File No. SR-DTC-99-6].

that will be searchable both by certificate number and by date of destruction. DTC will retain copies of the computer images of these certificates and of related positional information following destruction of the certificates for at least six years. For at least the first six months after destruction the computer images will be kept in a place that is easily accessible by authorized DTC personnel. Such records will be: (1) available at all times for examination by the Commission or other appropriate regulatory agency in an easily readable projection enlargement; (2) immediately provided upon request by the Commission or other appropriate regulatory agency; (3) arranged and indexed in a manner that permits immediate location of any particular record; and (4) copied and stored separately from any original records.

Participants will be relieved of future DTC fees for any positions that the participant moves to PREM. If at a later date and in the unlikely event that transfer agent services are resumed for a security issue where the depository has already destroyed certificates, DTC will use its best efforts to have the destroyed certificates replaced and to return the position to the appropriate participants.

(6) **Withdrawing Certificates.** Alternatively, a participant may wish to withdraw its position in an issue of non-transferable securities certificates that is subjected to the custody fee which is described below. DTC will attempt to honor the participants' requests for participants if certificates in proper denominations are available in DTC's inventory. If proper denominations are not available, which as a practical matter may typically be the case, DTC will hold a certificate of greater value than that represented by the participant's long position and will charge the participant fees as described below.

(7) **Checking for Issues of Non-Transferable Securities Certificates.** Participants can systemically identify issues of non-transferable securities certificates by accessing either the

Corporate and Municipal Eligible Security Files or the Corporate and Municipal Change Files. If appropriate, participants can then move their positions in any such issues to PREM and avoid the fees associated with the continued custody of the positions. Participants can also subsequently elect to deposit into DTC additional certificates of non-transferable securities issues and then move them to PREM so that they may be destroyed.

(8) Fee. Since much of DTC's cost to custody certificates is now directly attributable to non-transferable securities certificates, DTC increased its monthly charge for each position of a security that has been non-transferable for six or more years and that is not in PREM from \$.17 to \$1.00 per position per month in such issues (in addition to any other applicable fees) on December 23, 2003.<sup>5</sup> DTC anticipates that it will increase the fee on January 1, 2005, to \$5.00 per position per month in such issues.<sup>6</sup> Currently, about 93% of all DTC non-transferable securities certificates are in PREM.

(9) The Benefits. As a result of this new procedure, DTC will provide uniform and consistent controls and procedures (as well as physical safeguards) for issues of non-transferable securities.

As further benefits, DTC believes that this new program will reduce both DTC's and overall industry expenses as follows: First, the program will eliminate the costs and risks associated with the ongoing maintenance of custody, control, insurance protection, and audit of these 1.2 million certificates. Second, DTC's destruction of such certificates on a centralized basis will provide the industry with scale economies for the destruction process.

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5 The fee of \$1.00 per position was filed with the Commission under Section 19(b)(3)(A) of the Act on December 29, 2003, and as such was effective when filed. Securities Exchange Act Release No. 49100 (January 20, 2004), 69 FR 3959 (January 27, 2004) [File No. SR-DTC-2003-15].

6 As required by Section 19(b) of the Act, DTC will file any proposed fee change with the Commission.

DTC reports that it solicited comments from all DTC participants concerning the program through a DTC Important Notice dated January 22, 2003, a copy of which is attached to the DTC filing. In addition, DTC worked with the Securities Industry Association's Securities Operations Division's Regulatory and Clearance Committee and with DTC's Securities Processing Advisory Board. DTC reports that feedback from participants and from such industry groups, while generally positive and supportive, also led DTC to refine the proposal by extending the time period during which the securities must be in non-transferable status before they can be destroyed (i.e., six years) and by extending the timing of the implementation of the related fee.

### III. Comments

Ten commenters, consisting of five broker-dealers, four trade associations in the securities industry, and one self-regulatory organization submitted comment letters to the Commission on this proposal.<sup>7</sup> All ten letters endorsed DTC's proposal, stating generally that the destruction of the non-transferable securities certificates would promote efficiency and would reduce expenses within the securities industry.<sup>8</sup>

### IV. Discussion

We note that Section 17A(b)(3)(F) of the Act requires, among other things, that the rules of a clearing agency be designed to assure the safeguarding of funds and securities which are

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7 The commenters were: Phil Lanz, Managing Director, Bear, Stearns Securities Corp. (February 4, 2004); Robert D. Becker, Chairperson, Bank Depository User Group (February 1, 2004); John Cusumano, President, Customer Account Transfer Division, Inc. (February 11, 2004); Ralph Guzman, Senior Vice President, National Investor Services Corp. (February 6, 2004); Kristin Johnson, Operations Division, Edward Jones (February 9, 2004); Brian Urkowitz, First Vice President, Merrill Lynch (February 13, 2004); Frank M. Ciavarella, Cashiers' Division, Wachovia Securities (February 12, 2004); Edward Hazel, Securities Operations Division, Securities Industries Association (February 6, 2004); Thomas Davis, Morgan Stanley (received March 1, 2004); and Jack R. Weiner, Managing Director & Deputy General Counsel, DTC (June 2, 2004).

8 One commenter, Wachovia Securities, while supportive of DTC's proposal, appeared to raise the issue of the possibility of non-transferable securities certificates returning to circulation in the market place. In response, DTC submitted a comment letter stating that it had contacted the commenter to discuss the commenter's issue and that the commenter was supportive of the proposal and that the Commission should move forward with approving the proposal.

in its custody or control or for which it is responsible.<sup>9</sup> In Section 17A(a)(1)(B) of the Act, Congress stated its finding that inefficient procedures for clearance and settlement imposed unnecessary costs on public investors.<sup>10</sup> Section 17(a) of the Act and Rule 17a-1 thereunder provides that a registered clearing agency must maintain certain records for a period of five years.<sup>11</sup> (The Commission has previously taken the position that Rule 17a-1 includes records pertaining to worthless securities certificates.)<sup>12</sup>

DTC correctly stated in its rule proposal that the Commission has twice approved DTC programs that authorized DTC to destroy certain securities certificates. In 1990, the Commission approved a proposed rule change enabling DTC to destroy certificates representing expired and worthless warrants, rights, and put options, provided DTC maintained copies of such certificates for seven years after their destruction.<sup>13</sup> In 2001, the Commission approved a DTC proposed rule change that authorized DTC to destroy matured book-entry only (“BEO”) debt securities certificates, together with their related DTC letters of transmittal and DTC redemption summary payment forms, provided that DTC maintain microfilm or computer images of these BEO certificates and related paperwork for ten years following their destruction.<sup>14</sup> In both cases, the Commission indicated that it favored the efficiencies involved in eliminating custodial services for certain categories of worthless securities certificates provided there are proper disposal procedures in place and proper records being maintained of the destroyed certificates.

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9 15 U.S.C. 78q-1(b)(3)(A).

10 15 U.S.C. 78q-1(a)(1)(B).

11 15 U.S.C. 78q(a); 17 CFR 240.17a-1.

12 Supra note 3.

13 Supra note 3.

14 Supra note 4.

We note that DTC's new program provides that: (1) the securities certificates in question must have been held by DTC in non-transferable status for at least six years before DTC may destroy them and (2) DTC will maintain electronic images of the destroyed certificates for at least six years after the certificates are destroyed. Thus, for recordkeeping purposes, the certificates will be available either in original form or in imaged form for two consecutive periods of not less than six years, a total of not less than 12 years.<sup>15</sup>

In this case, we believe that the protections required by Section 17A(b)(3)(F) and goals set forth in Section 17A(a)(1)(B) of the Act and other applicable provisions are met by DTC's proposal. The new DTC program provides for: (1) secure certificate disposal procedures that will be overseen and witnessed by DTC personnel and (2) appropriate certificate imaging and recordkeeping.

#### V. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act and in particular with the requirements of Section 17A of the Act and the rules and regulations thereunder.

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15. See also Rules 17Ad-6(c) and 17Ad-7(d) under the Act, whereby transfer agents are required to maintain cancelled certificates for "not less than six years." 17 CFR 240.17Ad-6(c) and 17Ad-7(d).

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-DTC-2003-09) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>16</sup>

Margaret H. McFarland  
Deputy Secretary

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16. 17 CFR 200.30-3(a)(12).