

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-54410; File No. SR-NYSEArca-2006-31)

September 7, 2006

Self-Regulatory Organizations; NYSE Arca, Inc.; Order Granting Approval of a Proposed Rule Change Amending Rules to Mandate Listed Companies Become Eligible to Participate in a Direct Registration System

I. Introduction

On June 19, 2006, NYSE Arca, Inc. (“NYSE Arca”) filed with the Securities and Exchange Commission (“Commission”) proposed rule change SR-NYSEArca-2006-31 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”).¹ Notice of the proposal was published in the Federal Register on July 18, 2006.² One comment letter was received.³ For the reasons discussed below, the Commission is granting approval of the proposed rule change.⁴

II. Description

The Direct Registration System (“DRS”) allows an investor to establish either through the issuer's transfer agent or through the investor's broker-dealer a book-entry position on the books of the issuer and to electronically transfer her position between the transfer agent and the broker-dealer of her choice through a facility currently administered by The Depository Trust

¹ 15 U.S.C. 78s(b)(1).

² Securities Exchange Act Release No. 54126 (July 11, 2006), 71 FR 40768 (July 18, 2006) [File No. SR-NYSEArca-2006-31].

³ Letter from Loren K. Hanson, Director of Investor Relations, to Nancy M. Morris, Secretary, Commission (August 15, 2006).

⁴ The Commission has also granted approval to similar rule changes submitted by the New York Stock Exchange LLC (“NYSE”), American Stock Exchange LLC (“Amex”), and The NASDAQ Stock Market LLC (“Nasdaq”). Securities Exchange Act Release Nos. 54289 (August 8, 2006), 71 FR 47278 (August 16, 2006) [File No. SR-NYSE-2006-29]; 54288 (August 8, 2006), 71 FR 47276 (August 16, 2006) [File No. SR-NASDAQ-2006-08]; and 54290 (August 8, 2006), 71 FR 47262 (August 16, 2006) [File No. SR-Amex-2006-40].

Company (“DTC”).⁵ DRS, therefore, enables an investor to have securities registered in her name on the books of the issuer without having a securities certificate issued to her and to electronically transfer her securities to her broker-dealer in order to effect a transaction without the risk and delays associated with the use of securities certificates.

Investors holding their securities in DRS retain the rights associated with securities certificates, including such rights as control of ownership and voting rights, without having the responsibility of holding and safeguarding securities certificates. In addition, in corporate actions such as reverse stock splits and mergers, cancellation of old shares and issuance of new shares are handled electronically with no securities certificates to be returned to or received from the transfer agent.

In order to reduce the number of transactions in securities for which settlement is effected by the physical delivery of securities certificates and thereby reduce the risks, costs, and delays associated with the physical delivery of securities certificates, NYSE Arca will impose its DRS eligibility requirement pursuant to proposed new Rule 7.62(c).⁶ The proposed new rule does not require that securities listed for trading on NYSE Arca be in the DRS operated by DTC. Rather it requires listed companies’ securities be eligible for a direct registration system operated by a

⁵ Currently, the only registered clearing agency operating a DRS is DTC. For a detailed description of DRS and the DRS facilities administered by DTC, see Securities Exchange Act Release Nos. 37931 (November 7, 1996), 61 FR 58600 (November 15, 1996), [File No. SR-DTC-96-15] (order granting approval to establish DRS) and 41862 (September 10, 1999), 64 FR 51162 (September 21, 1999), [File No. SR-DTC-99-16] (order approving implementation of the Profile Modification System).

⁶ The exact text of the NYSE Arca proposed new Rule 7.62(c) is set forth in its filing, which can be found at www.nysearca.com/regulation/filings.

clearing agency, as defined in Section 3(a)(23) of the Act,⁷ that is registered with the Commission pursuant to Section 17A(b)(2) of the Act. Therefore, while the DRS operated by DTC is currently the only DRS facility meeting the requirements of new NYSE Arca Rule 7.62(c), the new rule will provide issuers with the option of using another qualified DRS if they so desire if one should exist in the future.

Currently, in order to make a security DRS-eligible in DRS operated by DTC, DTC rules require that the issuer must have a transfer agent which is a DTC DRS Limited Participant.⁸ NYSE Arca understands that the larger transfer agents serving NYSE Arca's listed company community are already eligible to participate in DRS. However, taking into account the diversity of the issuers and transfer agents across all the markets that will be required to make securities eligible for DRS and facilitate DRS eligibility, some transfer agents may need to take steps to become eligible to participate in DRS. In addition, NYSE Arca has been notified that some issuers may need to amend their corporate governing documents, such as their certificates of incorporation or their by-laws, before they can make their securities DRS eligible.

To allow sufficient time for any such necessary actions, NYSE Arca will impose the DRS eligibility requirement in two steps. Companies listing for the first time should have greater flexibility to conform to the eligibility requirements. Therefore, Rule 7.62(c) will require all securities initially listing on NYSE Arca on or after January 1, 2007, be eligible for DRS at the

⁷ 15 U.S.C. 78a.

⁸ Securities Exchange Act Release No. 37931 (November 7, 1996), 61 FR 58600 (November 15, 1996), [File No. SR-DTC-96-15].

time of listing. This provision does not extend to securities of companies (i) which already have securities listed on the NYSE Arca, (ii) which immediately prior to such listing had securities listed on another registered securities exchange in the U.S., or (iii) which are specifically permitted under NYSE Arca's rules to be and which are book-entry only.⁹ On and after January 1, 2008, all securities listed on the NYSE Arca will be required to be eligible for DRS except those securities which are specifically permitted under NYSE Arca rules to be and which are book-entry only.

III. Comment Letters

The Commission received one comment opposing the proposed rule change.¹⁰ The commenter, speaking on behalf of an issuer that acts as its own transfer agent but works with a large commercial transfer agent that acts as co-transfer agent, expressed concern the proposed rule change would eliminate the issuer's role as transfer agent. The commenter believes that there can be only one transfer per company registered with DTC under the current DRS model, and since the issuer is not a DRS Limited Participant, its co-transfer agent would survive as the issuer's only transfer agent. The commenter believes that implementation of NYSE Arca's

⁹ The securities that NYSE Arca permits to be book-entry only include all debt securities, securities listed or traded pursuant to Rule 5.2(j), securities listed or traded pursuant to Rule 8, and nonconvertible stock. NYSE Arca's Rule 5(j) pertains to, among other things, equity linked notes, investment company units, index-linked exchangeable notes, equity gold shares, index-linked securities. Rule 8 pertains to currency and index warrants.

¹⁰ Supra note 3. But see comment letters to similar rule changes submitted by the New York Stock Exchange LLC ("NYSE"), American Stock Exchange LLC ("Amex"), and The NASDAQ Stock Market LLC ("Nasdaq"). Securities Exchange Act Release Nos. 54289 (August 8, 2006), 71 FR 47278 (August 16, 2006) [File No. SR-NYSE-2006-29]; 54288 (August 8, 2006), 71 FR 47276 (August 16, 2006) [File No. SR-NASDAQ-2006-08]; and 54290 (August 8, 2006), 71 FR 47262 (August 16, 2006) [File No. SR-Amex-20].

proposed rule would be a detriment because shareholders would not receive the quality of service from a commercial transfer agent that they currently receive from the issuer acting as its own transfer agent. Furthermore, this commenter contends that forcing companies to implement DRS is unproductive and costly because issuers will have to amend their bylaws and articles of incorporation to allow for book-entry positions even when the issuer intends to continue to issue stock certificates.

IV. Discussion

Section 6(b)(5) of the Act requires, among other things, that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.¹¹ For the reasons described below, the Commission finds that NYSE Arca's rule change is consistent with Section 6(b)(5) of the Act.

The use of securities certificates has long been identified as an inefficient and risk-laden mechanism by which to hold and transfer ownership.¹² Because securities certificates require manual processing, their use can result in significant delays and expenses in processing securities transactions and present the risk of certificates being lost, stolen, or forged. Many of these costs

¹¹ 15 U.S.C. 78f(b)(5).

¹² Securities Exchange Act Release No. 49405 (March 11, 2004), 69 FR 12922 (March 18, 2004), [File No. S7-13-04] (Securities Transaction Settlement Concept Release).

and risks are ultimately borne by investors.¹³ Congress has recognized the problems and dangers that the use of certificates presents to the safe and efficient operation of the U.S. clearance and settlement system and has given the Commission responsibility and authority to address these issues.¹⁴

Consistent with its Congressional directives and in its efforts to improve efficiencies and decrease risks associated with processing securities transactions, the Commission has long advocated a reduction in the use of certificates in the trading environment by immobilization or dematerialization of securities and has encouraged the use of alternatives to holding securities in certificated form. Among other things, the Commission has approved the rule filings of self-regulatory organizations that require their members to use the facilities of a securities depository for the book-entry settlement of all transactions in depository-eligible securities¹⁵ and that require any security listed for trading must be depository eligible if possible.¹⁶ More recently the Commission has approved the implementation and expansion of DRS.¹⁷

¹³ Id.

¹⁴ 15 U.S.C. 78q-1(a)(2)(A). Congress expressly envisioned the Commission's authority to extend to all aspects of the securities handling process involving securities transactions within the United States, including activities by clearing agencies, depositories, corporate issuers, and transfer agents. See S. Rep. No. 75, 94th Cong., 1st Sess. at 55 (1975).

¹⁵ Securities Exchange Act Release No. 32455 (June 11, 1993), 58 FR 33679 (June 18, 1993)(order approving rules requiring members, member organizations, and affiliated members of the New York Stock Exchange, National Association of Securities Dealers, American Stock Exchange, Midwest Stock Exchange, Boston Stock Exchange, Pacific Stock Exchange, and Philadelphia Stock Exchange to use the facilities of a securities depository for the book-entry settlement of all transactions in depository-eligible securities with another financial intermediary).

¹⁶ Securities Exchange Act Release No. 35798 (June 1, 1995), 60 FR 30909 (June 12, 1995), [File Nos. SR-Amex-95-17; SR-BSE-95-09; SR-CHX-95-12; SR-NASD-95-24; SR-

While the U.S. markets have made great progress in immobilization and dematerialization for institutional and broker-to-broker transactions, many industry representatives believe that the small percentage of securities held in certificated form (mostly by retail customers of broker-dealers) impose unnecessary risk and disproportionately large expense to the industry and to investors. In an attempt to address this issue, NYSE Arca's rule change, along with those of the NYSE, Amex, and Nasdaq, should help expand the use of DRS. As a result, risks, costs, and processing inefficiencies associated with the physical delivery of securities certificates should be reduced, and impediments to the perfection of the national market system should be reduced. Additionally, those investors holding securities in listed securities covered by the rule change that decide to hold their securities in DRS should realize the benefits of more accurate, quicker, and more cost-efficient transfers; faster distribution of sale proceeds; reduced number of lost or stolen certificates and a reduction in the associated certificate replacement costs; and consistency of owning in book-entry across asset classes.

NYSE-95-19; SR-PSE-95-14; SR-PHLX-95-34] (order approving rules setting forth depository eligibility requirements for issuers seeking to have their shares listed on the exchange).

¹⁷ In 1996, the NYSE modified its listing criteria to permit listed companies to issue securities in book entry form provided that the issue is included in DRS. Securities Exchange Act Release No. 37937 (November 8, 1996), 61 FR 58728 (November 18, 1996), [File No. SR-NYSE-96-29]. Similarly, the NASD modified its rule to require that if an issuer establishes a direct registration program, it must participate in an electronic link with a securities depository in order to facilitate the electronic transfer of the issue. Securities Exchange Act Release No. 39369 (November 26, 1997), 62 FR 64034 (December 3, 1997), [File No. SR-97-51]. On July 30, 2002, the Commission approved a rule change proposed by the NYSE to amend NYSE Section 501.01 of the NYSE Listed Company Manual to allow a listed company to issue securities in a dematerialized or completely immobilized form and therefore not send stock certificates to record holders provided the company's stock is issued pursuant to a dividend reinvestment program, stock purchase plan, or is included in DRS. Securities Exchange Act Release No. 46282 (July 30, 2002), 67 FR 50972 (August 6, 2002), [File No. SR-NYSE-2001-33].

The Commission realizes that some issuers and transfer agents may bear expenses related to complying with the rule change. In order to make an issue DRS-eligible, issuers of listed companies must have a transfer agent which is a DRS Limited Participant and may need to amend their corporate governing documents to permit the issuance of book-entry shares. The Commission believes, however, that the long-term benefits of increased efficiencies and reduced costs and risks afforded by DRS outweigh the costs that some issuers and transfer agents may incur. Furthermore, the time frames built into the proposal should allow issuers and their transfer agents sufficient time to make any necessary changes to comply with the rule change.

While the proposed rule change should significantly reduce the number of transactions in securities for which settlement is effected by the physical delivery of securities certificates, the proposed rule change will not eliminate the ability of investors to obtain securities certificates provided the issuer has chosen to issue certificates. Such investors can continue to contact the issuer's transfer agent, either directly or through their broker-dealer, to obtain a securities certificate.

The commenter's concern that its role as an issuer transfer agent will be eliminated because there can be only one transfer agent per issue registered with DTC under the current DRS model is unfounded. DTC has procedures in place to permit a named transfer agent, which in this case would be the issuer, to file notice with DTC as the primary transfer agent but use a co-transfer agent for its DRS functions.

Accordingly, for the reasons stated above the Commission finds that the rule change is consistent with NYSE Arca's obligation under Section 6(b) of the Act to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with

respect to, and facilitating transactions in securities, to remove impediments to perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest .

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 6(b)(5) of the Act and the rules and regulations thereunder. IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-NYSEArca-2006-31) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.¹⁸

Nancy M. Morris
Secretary

¹⁸ 17 CFR 200.30-3(a)(12).