

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49080; File No. SR-DTC-2003-09]

### **Self-Regulatory Organizations; The Depository Trust Company; Notice of Filing of Proposed Rule Change To Establish a New Service To Destroy Certain Certificates and To Implement a Fee for Custody of Certain Certificates Not To Be Destroyed**

January 14, 2004.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> 15 U.S.C. 78s(b)(1), notice is hereby given that on June 12, 2003, The Depository Trust Company ("DTC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change (File No. SR-DTC-2003-09) as described in Items I, II, and III below, which Items have been prepared primarily by DTC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### **I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change**

DTC is filing this proposed rule change to establish a new service that will allow DTC to destroy certain certificates representing position in securities for which transfer agent services have not been available for a period of time. The filing is also being made to implement a fee relating to custody of certificates in such issues that are not designated for destruction by DTC participants.

#### **II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

In its filing with the Commission, DTC included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. DTC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of such statements.

##### *(A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change*

This proposed new DTC service will allow DTC to destroy certain certificates representing position in securities for

which transfer agent services are no longer available. This will allow participants to avoid fees to which they would otherwise be subject relating to DTC's ongoing custody of such issues.

(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. Certificate reduction reduces risk and cost. As a result of these efforts, DTC has significantly reduced the number of corporate, municipal, and bearer certificates held by DTC.

At the same time, however, the number and percentage of certificates held in the depository's vaults representing securities for which transfer agent services are not available has grown considerably. (These certificates are referred to in this filing as "non-transferable securities certificates.") Typically, these are equity securities of a company that has become inactive or insolvent. Today, DTC holds 1.2 million such certificates, representing nearly 22% of the depository's entire certificate inventory. Significant risks and costs are associated with the ongoing maintenance of custody, control, and audit of these certificates.

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, which is the subject of this filing.

(2) *Previous SEC Orders Approving Certificate Destruction.* DTC has twice in the past adopted programs pursuant to which it destroys certificates. The SEC has approved DTC programs to destroy certificates representing worthless warrants, rights, and put options whose expiration dates have passed<sup>2</sup> to destroy matured book-entry-only debt certificates.<sup>3</sup> DTC destroyed 5,652 certificates in the first half of 2003 pursuant to these programs.

(3) *PREM.* Many participants currently use DTC's Position Removal

(PREM) function to delete positions in issues of non-transferable securities certificates from their participant accounts. Today, those positions are then moved to a DTC internal PREM account. However, the certificates representing those positions are still held in DTC's vaults with all the risks and costs associated with storing such certificates, maintaining the related accounts, and monitoring the status of such issues.

(4) *Modifying the PREM Process.* Under today's process, the only effects of a participant's "deleting" its position in an issue using PREM are to eliminate the custody fees associated with the position and to eliminate the reflection of the position on the participant's securities position listing statements. Under the proposed program, DTC will notify its participants that using PREM to delete a position or leaving a position in PREM constitutes an acknowledgement by the participant that DTC may cease crediting the security to the participant's securities account and that DTC may at its option based upon PREM criteria include the certificates representing the position in its certificate destruction program. Upon receipt of Commission approval, DTC will implement the program beginning first with issues in which all participant positions have been put in 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 destruction the certificates will be computer imaged by DTC. An accurate record of all certificates will be maintained. The record will be searchable 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. The images will be kept for at least six years and will be kept for the first six months in a place that is easily accessible by authorized DTC personnel. Such records will be: (i) Available at all times for examination by the Commission or other appropriate regulatory agency in an easily readable projection enlargement; (ii) arranged and indexed in a manner that permits immediate location of any particular record; (iii) immediately provided upon request by the Commission or other appropriate regulatory agency; and (iv) copied and stored separately from the original records.

Participants will be relieved of future DTC fees for any positions that the participant moves to PREM. If at a later

<sup>2</sup> Securities Exchange Act Release No. 28642 (November 21, 1990), 55 FR 49725 [File No. SR-DTC-90-11].

<sup>3</sup> Securities Exchange Act Release No. 44169 (April 10, 2001), 66 FR 19592 [File No. SR-DTC-99-6].

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 replace the destroyed certificates 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 fee which is described below. DTC will attempt to honor the request 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 systematically 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 will increase its monthly charge (in addition to all other applicable fees) for each position of a security that has been non-transferable for six or more years and that is not in PREM. This fee will increase from \$.17 to \$1.00 per position per month in such issues (in addition to any other applicable fees).<sup>4</sup> DTC anticipates that the fee will increase on January 1, 2005, to \$5.00 per position per month in such issues. Today, 93% of all 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.

DTC believes that this new service will also reduce both DTC expenses and

overall industry costs. DTC will eliminate the cost of custodial and handling such securities and the associated insurance costs. In addition, DTC's destruction of such certificates on a centralized basis will provide the industry with scale economies for this process. Finally, this will allow DTC to reduce the risks associated with the ongoing maintenance of custody, control, and audit of these 1.2 million certificates.

DTC believes that the proposed rule change is consistent with the requirements of section 17A of the Act<sup>5</sup> and the rules and regulations thereunder applicable to DTC because it will permit DTC and its participants by ensuring that DTC can improve the efficiency of its operations.

(B) *Self-Regulatory Organization's Statement on Burden on Competition*

DTC does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, in the public interest, and for the protection of investors.

(C) *Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants or Others*

DTC solicited comments from all DTC participants concerning the program through an Important Notice dated January 22, 2003. A copy of the DTC Important Notice is attached as Exhibit B to its proposed rule change. In addition, DTC worked with the Securities Industry Association Securities Operations Division's Regulatory and Clearance Committee and DTC's Securities Processing Advisory Board. 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. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

Within thirty-five days of the date of publication of this notice in the **Federal Register**, or within such longer period:

- (i) As the Commission may designate up to ninety days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding,

or (ii) as to which DTC consents, the Commission will:

- (i) By order approve such proposed rule change or
- (ii) Institute proceedings to determine whether the proposed rule change should be disapproved.

**IV. Solicitation of Comments**

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. Comments may also be submitted electronically at the following e-mail address: *rule-comments@sec.gov*. All comments should refer to File No. SR-DTC-2003-09. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more effectively, comments should be sent in hardcopy or by e-mail but not by both methods. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, at the address above.

Copies of such filing will also be available for inspection and copying at the principal office of DTC and on DTC's Web site at *DTCC.com*. All submissions should refer to the file Number SR-DTC-2003-09 and should be submitted by February 13, 2004.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>6</sup>

**Margaret H. McFarland,**  
*Deputy Secretary.*

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<sup>4</sup> 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 (File No. SR-DTC-2003-15).

<sup>5</sup> 15 U.S.C. 78q-1.

<sup>6</sup> 17 CFR 200.30-3(a)(12).