

previously approved a structure in which certain committees of the board of directors of NYSE Euronext, including the audit and compensation committees, were authorized to perform functions for various subsidiaries, including the New York Stock Exchange, LLC ("NYSE").<sup>8</sup>

*The BX Audit Committee.* Currently, the BX audit committee is primarily charged with: (1) Overseeing BX's financial reporting process; (2) overseeing the systems of internal controls established by management and the BX board, as well as the legal and compliance process; (3) selection and evaluation of independent auditors; and (4) direction and oversight of the internal audit function. BX states that the NASDAQ OMX audit committee<sup>9</sup> will assume the duties currently performed by the BX audit committee once that committee is eliminated. The Exchange states that the responsibilities of BX's audit committee are fully duplicated by the responsibilities of the NASDAQ OMX audit committee.<sup>10</sup> In addition, BX states that its regulatory oversight committee has broad authority to oversee the adequacy and effectiveness of BX's regulatory and self-regulatory organization responsibilities, and therefore is able to maintain oversight over internal controls in tandem with the NASDAQ OMX audit committee. Further, BX states that the practice of NASDAQ OMX's Internal Audit Department ("Department"),<sup>11</sup>

which performs internal audit functions for all NASDAQ OMX subsidiaries, is to report to the BX regulatory oversight committee on all internal audit matters relating to BX, which will be formally reflected in the Department's written procedures. BX also represents that, to ensure that the BX board retains authority to direct the Department's activities with respect to BX, the Department's written procedures will be amended to stipulate that the BX regulatory oversight committee may, at any time, direct the Department to conduct an audit of a matter of concern to it and report the results of the audit both to the BX regulatory oversight committee and the NASDAQ OMX audit committee.<sup>12</sup>

*BX Management Compensation Committee.* BX also proposes to eliminate its compensation committee, and to prescribe that the functions of that committee be performed by the NASDAQ OMX compensation committee or the full BX board, when required. The NASDAQ OMX By-Laws provide that its compensation committee considers and recommends compensation policies, programs, and practices for employees of NASDAQ OMX. According to BX, many employees performing work for BX are also employees of NASDAQ OMX, and certain senior officers of BX are also officers of NASDAQ OMX and other NASDAQ OMX subsidiaries because their responsibilities relate to multiple entities within the NASDAQ OMX corporate structure.<sup>13</sup> As a result, NASDAQ OMX establishes compensation and compensation policy for these employees.

To the extent that policies, programs, and practices must be established for any BX officers or employees who are not also NASDAQ OMX officers or employees, BX states that the BX Board will perform such actions without the use of a compensation committee, subject to recusal by Staff Directors,<sup>14</sup> unless the persons in question are also

employees of Boston Options Exchange Regulation LLC ("BOXR").<sup>15</sup>

The Commission notes that the proposed elimination of the BX audit and management compensation committees is comparable to a structure for the NYSE that the Commission previously considered and approved.<sup>16</sup> The Commission finds that the proposed elimination of the BX's audit and management compensation committees is consistent with the Exchange Act.

## II. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>17</sup> that the proposed rule change (SR-BX-2009-021) be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>18</sup>

**Elizabeth M. Murphy,**  
*Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-60196; File No. SR-DTC-2006-16]

### Self-Regulatory Organizations; The Depository Trust Company; Order Granting Approval of a Proposed Rule Change as Amended Relating to FAST and DRS Limited Participant Requirements for Transfer Agents

June 30, 2009.

#### I. Introduction

On October 12, 2006, The Depository Trust Company ("DTC") filed with the Securities and Exchange Commission ("Commission") proposed rule change SR-DTC-2006-16 pursuant to Section 19(b)(1) of the Securities Exchange Act

<sup>15</sup> BOXR is the subsidiary of BX that has been delegated responsibility to regulate the market operated by Boston Options Exchange Group LLC ("BOX"), an options exchange that is a facility of BX but in which neither BX nor any of its affiliates has a financial interest. Section 17 of the By-Laws of BOXR (which are part of its Limited Liability Company Agreement) provides that the compensation of BOXR's officers shall be determined by the BOXR Board. Because of BOXR's special status as a regulatory subsidiary, this provision will remain operative following the implementation of the rule change proposed by this filing. The Commission notes that, under the By-Laws, BX's regulatory oversight committee must be informed about the compensation and promotion or termination of the BX chief regulatory officer and the reasons therefor, to allow it to provide oversight over decisions affecting this key officer. See BX By-Laws Section 4.13(e).

<sup>16</sup> See *supra* note 8.

<sup>17</sup> 15 U.S.C. 78s(b)(2).

<sup>18</sup> 17 CFR 200.30-3(a)(12).

<sup>8</sup> Securities Exchange Act Release No. 55293 (February 14, 2007), 72 FR 8033 (February 22, 2007) (SR-NYSE-2006-120).

<sup>9</sup> The NASDAQ OMX audit committee is composed of four or five directors, all of whom must be independent under the standards established by Section 10A(m) of the Act and the listing rules of The NASDAQ Stock Market LLC. All committee members must be able to read and understand financial statements, and at least one member must have past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background that results in the individual's financial sophistication.

<sup>10</sup> Specifically, BX states that: the NASDAQ OMX audit committee has broad authority to review the financial information that will be provided to shareholders and others, systems of internal controls, and audit, financial reporting and legal and compliance processes and, because NASDAQ OMX's financial statements are prepared on a consolidated basis that includes the financial results of NASDAQ OMX's subsidiaries, including BX, the NASDAQ OMX audit committee's purview necessarily includes these subsidiaries. In addition, BX states that the NASDAQ OMX audit committee currently is charged with providing oversight over financial reporting and independent auditor selection for NASDAQ OMX and all of its subsidiaries, including BX, and the NASDAQ OMX audit committee has general responsibility for oversight over internal controls and direction and oversight over the internal audit function for NASDAQ OMX and all of its subsidiaries. See Notice, 74 FR at 23460.

<sup>11</sup> See Notice, 74 FR at 23460-61.

<sup>12</sup> See Notice, 74 FR at 23461.

<sup>13</sup> *Id.*

<sup>14</sup> See BX By-Laws Article I(t). Staff Directors are directors of BX that are also serving as officers. Because the BX board would not be responsible for setting the compensation of any Staff Directors who are also officers of NASDAQ OMX, these directors would be permitted to participate in discussions concerning compensation of BX employees, but BX states that they must recuse themselves from a vote on the subject to allow the determination to be made by directors that are not officers or employees of BX. BX also states that, if a Staff Director is not also an employee of NASDAQ OMX, that Staff Director must also absent himself or herself from any deliberations regarding his or her compensation.

of 1934 ("Act").<sup>1</sup> On March 29, 2007, and May 3, 2007, DTC filed amendments to the proposed rule change. On May 25, 2007, the Commission published notice of the proposed rule change as amended by Amendment 1 and Amendment 2.<sup>2</sup> On December 31, 2007, DTC again filed an amendment. Notice of the amended proposal was published in the **Federal Register** on February 20, 2007.<sup>3</sup> On June 23, 2008, DTC again filed an amendment. Notice of the amended proposed rule change was published in the **Federal Register** on June 19, 2008.<sup>4</sup> The Commission received 47 comment letters in total to the proposed rule change.<sup>5</sup> For the reasons discussed below, the Commission is granting approval of the proposed rule change, as amended.

## II. Description

Prior to the establishment of DTC's Fast Automated Securities Transfer program ("FAST"), transfers of securities to or from DTC on behalf of its participants occurred by sending securities certificates back and forth between DTC and transfer agents. In the case of securities being deposited with DTC, DTC sent the certificates received by its participants to the transfer agent for registration into the name of DTC's nominee, Cede & Co., and the transfer agent returned the reregistered certificates to DTC. In the case of securities being withdrawn from DTC, DTC sent the certificates registered in the name of Cede & Co. to the transfer agent for reregistration into the name designated by the withdrawing participant, and the transfer agent returned a reregistered security certificate to DTC for delivery to the withdrawing participant or delivered the reregistered security certificate to another entity as directed and sent a security certificate to DTC representing the remainder of DTC's position. The process of physically transporting securities certificates between DTC and transfer agents exposed DTC, its participants, and the transfer agents to the risk of loss during transit and resulted in significant expenses.

DTC's FAST program was designed to eliminate some of the risks and costs

related to this production and transportation of securities certificates. Under the FAST program, transfer agents hold FAST eligible securities in the name of Cede & Co. for the benefit of DTC.<sup>6</sup> As additional securities are deposited or withdrawn from DTC, transfer agents adjust the size of DTC's position as appropriate and electronically confirm these changes with DTC. Transfer agents acting as "FAST agents" are holding in custody for DTC those securities that would otherwise be held at DTC. As such, the FAST program reduces the movement of certificates between DTC and the transfer agents and therefore reduces the costs and risks associated with the creation, movement, and storing of certificates for issuers, transfer agents, broker-dealers, and DTC.

The FAST program has grown substantially since first being introduced in 1975.<sup>7</sup> Recently all the major securities exchanges have made changes to the listing requirements to require companies to make their securities eligible to participate in the Direct Registration System ("DRS").<sup>8</sup> Because FAST eligibility is a prerequisite to an issue being eligible for DRS, DTC expects that the number of FAST eligible securities will continue to expand.<sup>9</sup> Furthermore, because being a FAST agent is a criterion for a transfer agent's eligibility for participation in

DRS, DTC anticipates significant growth in the number of FAST agents.<sup>10</sup>

As a result of discussions with industry representatives, including transfer agents, broker-dealers, issuers, insurance companies, and various industry associations, DTC amended its filing four times in order to address concerns with the various proposals. The provisions contained in DTC's proposed rule change, as amended by the four amendments, are the provisions discussed in this order.

### (1) Amendments to DTC's FAST Requirements

Despite the FAST program's robust past growth and expected future growth, the transfer agent eligibility requirements for FAST have not substantially changed since the implementation of FAST in 1975 and do not: (i) Take into account the increased volume and value of securities processed by the transfer agents, (ii) reflect improved technology and currently available safeguards that could enhance the safekeeping of securities held by the transfer agents on behalf of DTC, and (iii) require the use of standardized audit reports addressing transfer agents' processes and controls.

In light of the FAST program's growth, DTC re-examined the transfer agent eligibility requirements of the FAST program with a view toward ensuring that DTC's assets in the custody of transfer agents, which ultimately belong to DTC's participants and their customers, are adequately protected. As more fully described below, DTC has identified aspects of these FAST eligibility requirements that need revising or additional components. The revisions and additional requirements include: (i) Insurance requirements that take into account the level of transaction volumes of securities processed by transfer agents, (ii) safekeeping requirements to clarify and to enhance security and fire protection standards and to take into consideration technological advances that allow for economical security improvements, and (iii) bookkeeping requirements to ensure compliance with applicable laws and regulations and

<sup>6</sup> For a description of DTC's current rules relating to FAST, refer to Securities Exchange Act Release Nos. 13342 (March 8, 1977) [File No. SR-DTC-76-3]; 14997 (July 26, 1978) [File No. SR-DTC-78-11]; 21401 (October 16, 1984) [File No. SR-DTC-84-8]; 31941 (March 3, 1993) [SR-DTC-92-15]; and 46956 (December 6, 2002) [File No. SR-DTC-2002-15].

<sup>7</sup> DTC introduced the FAST program in 1975 with 400 issues and 10 agents. Currently, there are over 930,000 issues and approximately 90 agents in FAST.

<sup>8</sup> DRS provides an investor with the ability to register her securities in her own name on the issuer's records and to efficiently transfer by book-entry movements her securities positions to her broker-dealer rather than holding a physical certificate or holding indirectly through a financial intermediary (e.g., a broker-dealer) in "street name." DRS also allows for the transfer of a DRS position from the books of the issuer to the account of a DTC broker-dealer participant and vice versa through the facilities of DTC using FAST.

<sup>9</sup> Securities Exchange Act Release Nos. 54289 (August 8, 2006), 71 FR 47278 (August 16, 2006) [File No. SR-NYSE-2006-29]; 54290 (August 8, 2006), 71 FR 47262 (August 16, 2006) [File No. SR-Amex-2006-40]; 54288 (August 8, 2006), 71 FR 47276 (August 16, 2006) [File No. SR-NASDAQ-2006-08]; 54410 (September 7, 2006), 71 FR 54316 (September 14, 2006) [File No. SR-NYSE Arca-2006-31]; 55482 (March 15, 2007), 72 FR 13547 (March 22, 2007) [File No. SR-Phlx-2006-69]; 55481 (March 15, 2007), 72 FR 13546 (March 22, 2007) [File No. SR-CHX-2006-33]; and 55480 (March 15, 2007), 72 FR 13544 (March 22, 2007) [File No. SR-BSE-2006-46].

<sup>10</sup> For a description of DTC's rules relating to DRS, see Securities Exchange Act Release Nos. 37931 (November 7, 1996) [File No. SR-DTC-96-15]; 41862 (September 10, 1999) [File No. SR-DTC-99-16]; 42366 (January 28, 2000) [File No. SR-DTC-00-01]; 42704 (April 19, 2000) [File No. SR-DTC-00-04]; 43586 (November 17, 2000) [File No. SR-DTC-00-09]; 44969 (August 14, 2001) [File No. SR-DTC-2001-07]; 45232 (January 3, 2002) [SR-DTC-2001-18]; 45430 (February 11, 2002) [File No. SR-DTC-2002-01]; 48885 (December 5, 2003) [File No. SR-DTC-2002-17]; and 52422 (September 14, 2005) [File No. SR-DTC-2005-11].

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> Securities Exchange Act Release No. 55816 (May 25, 2007), 71 FR 30648 (June 1, 2007).

<sup>3</sup> Securities Exchange Act Release No. 57362 (February 20, 2008), 73 FR 10849 (February 28, 2008).

<sup>4</sup> Securities Exchange Act Release No. 57959 (June 12, 2008), 73 FR 57959 (June 19, 2008).

<sup>5</sup> *Infra* note 22. The comment letters can be found at <http://www.sec.gov/comments/sr-dtc-2006-16/dtc200616shtml>.

standardized audit reports addressing transfer agents' processes and controls.

DTC is therefore amending and restating the minimum requirements for transfer agents' participation in the FAST program in order to improve the safekeeping of securities that transfer agents hold for DTC and to provide improved safekeeping requirements as more transfer agents participate in the immobilization and dematerialization of securities. DTC's revised minimum requirements are as follows.

1. The transfer agent must be registered with the Commission or its appropriate regulatory authority, except where the transfer agent's participation in the FAST program is limited to acting solely for municipal issues or unlisted corporate debt issues (transfer agents must provide DTC with evidence of such limited use), and must follow all applicable rules under the Exchange Act and all other applicable Federal and State laws, rules, and regulations applicable to transfer agents, including OFAC regulations.

2. The transfer agent must execute and fulfill the requirements of the appropriate form of "Balance Certificate Agreement"<sup>11</sup> with DTC.<sup>12</sup>

3. The transfer agent must sign and fulfill requirements of the "Operational Criteria for the FAST Transfer Agent Processing"<sup>13</sup> and must comply with all applicable provisions of DTC's "Operational Arrangements" ("OA"),<sup>14</sup> as amended from time to time.<sup>15</sup>

4. In order to provide for the operational proficiency and efficiency of the program, the transfer agent must complete DTC's training on FAST functionality on being accepted as a FAST transfer agent.

5. In order to protect against the risk of loss, the transfer agent must carry and

provide evidence to DTC of a minimum of the following standard form Financial Institution Bond or a commercial crime policy providing similar coverage in proportion to transaction volume the agent processes, as follows:

a. \$10 million for a transfer agent with 25,000 or fewer transfer transactions per year as reported to the Commission;

b. \$25 million for a transfer agent with over 25,000 transfer transactions per year as reported to the Commission; and

c. In addition, the transfer agent must carry and provide evidence to DTC of a minimum of \$1 million in Errors and Omissions insurance.

In the event that a transfer agent can demonstrate to DTC that its existing coverage and/or capitalization would provide similar protections to DTC as the requirements set forth above, it may apply to DTC for a waiver. DTC shall have sole discretion as to whether or not to grant any such waiver.

6. In order to facilitate consistent protection against losses relating to securities in the transfer agent's control, the transfer agent must notify DTC as soon as practicable of notice of any actual lapse in insurance coverage or change in business practices, such as increasing volumes or other business changes, that would result in the transfer agent requiring additional insurance coverage as outlined above. Such notice shall be delivered to:

DTC, Inventory Management—1SL, 55 Water Street, New York, New York 10041.

A copy of such notice shall also be delivered to:

DTC, General Counsel's Office, 55 Water Street—22nd Floor, New York, New York 10041.

7. The transfer agent must provide proof to DTC of any new or substitute policy with respect to any required insurance within five (5) days after the entry into force of such new or substitute policy.

8. The transfer agent must establish and maintain electronic communications with DTC that enable FAST positions to be balanced on a daily schedule.

9. The transfer agent must provide to DTC on an annual basis within ten (10) business days of filing with the Commission, a copy of the Annual Study of Evaluation of Internal Accounting Control filed with the Commission pursuant to Exchange Act Rule 17Ad-13. If a transfer agent obtains a SAS-70 audit report, the transfer agent shall provide DTC with a copy of the report within ten (10) business days of the transfer agent's receipt of the report.

10. FAST agents must safeguard all the securities assets as required by Exchange Act Rule 17Ad-12 and with at a minimum the following additional DTC requirements:

a. Maintenance of a theft and fire central monitoring alarm system protecting the entire premises and

b. Maintenance of all certificates in a vault, safe, or other secure location, which is accessible only by authorized personnel.

11. Personnel with access to the vault, safe, or other secure location and the codes for the centralized monitoring system must comply with Exchange Act Rule 17f-2, which includes but is not limited to rules for fingerprinting staff that physically handle certificates.

12. Unless prohibited by applicable law, the transfer agent when applying to be a FAST agent must provide DTC with a copy of the two most recent compliance or deficiency correspondences from the Commission as well as any follow-up correspondences. In addition, unless prohibited by applicable law, the transfer agent on an ongoing basis must provide DTC with notice of any alleged material deficiencies documented by the Commission that may affect the activities of the transfer agent as a FAST Agent within five (5) business days of the transfer agent being notified of such deficiencies.<sup>16</sup>

13. Unless prohibited by applicable law, during regular business hours and upon advance notice, DTC reserves the right to visit and inspect, to the extent such visits and inspections pertain to DTC's securities position, the transfer agent's facilities, books, and records. DTC, however, is not obligated to conduct such visits or inspections.

14. Existing FAST agents shall have a period of six (6) months from the date of the Commission's approval of this rule filing to comply with these requirements, including the submission to DTC of a signed Balance Certificate Agreement, signed Operational Criteria, and all supporting documentation referenced herein. If an agent is not compliant with these requirements upon the expiration of such period, DTC

<sup>11</sup> DTC currently maintains three forms of the Balance Certificate Agreement: One for transfer agents, one for issuers acting as their own agent, and one for parties using a processing agent. DTC is consolidating these forms into a single form, as attached as Exhibit 2 to its initial filing.

<sup>12</sup> DTC notes that these minimum requirements incorporate by reference the Balance Certificate Agreement between the transfer agent and DTC.

<sup>13</sup> The "Operational Criteria for the FAST Transfer Agent Processing" is attached as Exhibit 2(b) to DTC's initial filing.

<sup>14</sup> For more information relating to DTC's OA, refer to Securities Exchange Act Release Nos. 45994 (May 29, 2002), 67 FR 39452 [File No. SR-DTC-2002-02]; 24818 (August 19, 1987), 52 FR 31833 [File No. DTC-87-10]; 25948 (July 27, 1988), 53 FR 29294 [File No. DTC-88-13]; 30625 (April 23, 1992), 57 FR 18534 [File No. DTC-92-06]; 35649 (April 26, 1995), 60 FR 21576 [File No. DTC-94-19]; and 39894 (April 21, 1998), 63 FR 23310 [File No. DTC-97-23].

<sup>15</sup> DTC notes that these minimum requirements incorporate by reference the "Operational Criteria for FAST Transfer Agent Processing" and all applicable terms in DTC's "Operational Arrangements."

<sup>16</sup> DTC agrees to establish and maintain any and all such safeguards as are necessary and appropriate to protect the confidentiality of any notices, correspondences, or reports from the Commission to the transfer agent, and any follow-up correspondences, that the transfer agent provides to DTC. DTC also agrees that any information obtained from these notices, correspondences, or reports will not be used for any reason other than the intended purposes as authorized by this order and will not be shared with any person or entity outside of DTC. DTC will also notify the Commission if these documents are required to be remitted by DTC to any other federal or state authority.

shall have the right, using its sole discretion, to terminate or to continue the transfer agent's status as a FAST agent.

15. An agent acting on behalf of a transfer agent shall have the same rights and responsibilities under these requirements as if it were the transfer agent.

*(2) Amended and Restated Eligibility Requirements for DRS Limited Participants*

DTC is revising the eligibility requirements for DRS Limited Participants<sup>17</sup> and the eligibility requirements for DRS issues to promote consistency with the FAST program requirements as well as to further ensure the soundness of the DRS system.

In order to be eligible to be a DRS Limited Participant, a transfer agent must:

1. Participate in the FAST program and abide by DTC's requirements governing participation in the FAST program;

2. Execute a DTC Limited Participant Account agreement;

3. Deliver transaction advices directly to investors relating to DRS Withdrawal-by-Transfer requests and provide DTC with a file containing the information required by DTC (which must include, among other things, the transaction delivery date) in a format and using the functionality as specified by DTC from time to time;

4. Complete DTC's training program on DRS and Profile Modification System ("Profile") functionality;

5. Participate in the Profile surety or insurance program;<sup>18</sup>

6. Implement program changes related to DTC internal systems modifications within a reasonable time upon receiving notification from DTC of such modifications; and

7. Implement program changes to support and expand DRS processing capabilities as agreed to by the DRS Ad Hoc Committee.

Existing DRS Limited Participants shall have a period of six (6) months from the date of the Commission's approval of this rule filing within which

they must comply with these requirements. If an agent is not compliant with these requirements upon the expiration of such period, DTC shall have the right using its sole discretion to terminate or to continue the agent's status as a DRS Limited Participant.

*(3) Eligibility Requirements for DRS Issues*

In order for an issue to be eligible as a DRS issue, the issue must:

1. Have a transfer agent accepted as a DTC DRS Limited Participant and

2. Be included in the FAST program.<sup>19</sup>

*(4) DTC's Proposed Standard of Care Obligations With Respect to FAST*

DTC is also clarifying the responsibilities and liabilities of FAST agents with respect to their participation in the FAST program. DTC believes that historically the Commission has left to user-governed clearing agencies the question of how to allocate losses associated with, among other things, clearing agency functions.<sup>20</sup> In conjunction with its approval of DTC's rule filing whereby DTC adopted a uniform standard of responsibility with respect to certain of its services, the Commission noted that while it had "called on registered clearing agencies to undertake, by rule, to deliver all fully paid securities in their control to, or as directed by, the participant for whom the securities are held," in light of the fact that registered clearing agencies had demonstrated a high level of responsibility in safeguarding securities and funds, the Commission did not find that a standard of care based on a strict standard of liability was required either with respect to failures of the clearing agency or a sub-custodian.<sup>21</sup>

DTC notes that securities in the FAST program are held by a transfer agent and are not within the immediate custody and control of DTC. As such, DTC is adding a clarifying provision to DTC's

<sup>19</sup> An issue may not become a DRS issue if an "out of balance" position exists. An "out of balance" position occurs when DTC's records indicating Cede & Co.'s ownership position do not match the transfer agent's records indicating Cede & Co.'s ownership position.

<sup>20</sup> Securities Exchange Act Release Nos. 20221 (September 23, 1983) and 22940 (February 24, 1986). In this regard, DTC adopted a uniform standard with respect to certain of its procedures, or Service Guides, such that DTC is not liable for any loss incurred by a participant other than one caused directly by gross negligence or willful misconduct on the part of DTC. See Securities Exchange Act Release No. 44719 (August 17, 2001) [File No. SR-DTC-2001-01].

<sup>21</sup> Securities Exchange Act Release No. 22940 (February 24, 1986), 51 FR 7169 (order approving a rule change to establish a comprehensive standard of care and limitation of liability to its members).

Rule 6, a rule pertaining to DTC's standard of care as it applies to DTC participants, to make clear that DTC will not be liable to participants for the acts or omissions of FAST Agents or other third parties (including, but not limited to, any depository, custodian, sub-custodian, clearing or settlement system, transfer agent, registrar, data communication service or delivery service) unless a loss is caused directly by DTC's gross negligence, willful misconduct, or violation of federal securities laws for which there is a private right of action. In addition, DTC is making it clear that under no circumstance shall DTC be liable for the selection or acceptance of any third party as an agent of DTC, including a transfer agent participating in the FAST Program.

**III. Comment Letters<sup>22</sup>**

The Commission received a total of 47 comment letters on DTC's initial proposal and the subsequent four amendments (published in three notices for comment).<sup>23</sup> Specifically, the

<sup>22</sup> This order only addresses specific comments that relate to provisions in DTC's proposed rule change as the proposed rule change is being approved. It does not address comments on provisions that were either modified or deleted in response to comments.

<sup>23</sup> Letters from Loren K. Hanson, Assistant Secretary, Otter Tail Corporation (June 5, 2007); Steven D. Lucas, Director of Transfer Agent Compliance, Investors Bank & Trust Company (June 15, 2007); Walter E. Grote, Senior Vice President, Travelers Bond & Financial Products (June 19, 2007); The Surety & Fidelity Association of America (June 19, 2007); Thomas L. Montrone, President and Chief Executive Officer, Registrar and Transfer Company (June 19, 2007); Salli Marinov, President and Chief Executive Officer, First American Stock Transfer Company (June 20, 2007); Steve Nelson, President and Chairman of the Board, Continental Stock Transfer & Trust Company (June 20, 2007); Dennis Callahan, Chairman, Bank Depository User Group (June 21, 2007); Kevin Kopaunik, Fidelity Transfer Company (June 21, 2007); Jonathan Miller, President StockTrans, Inc. (June 21, 2008); Artie Retolatto, 1st Global Stock Transfer, LLC (June 21, 2007); James R. Alden, President, Shareholder Services Association (June 22, 2007); James Becker, Zions First National Bank (June 22, 2007); J. Donald Boggus, Jr., President and Chief Executive Officer, Crescent Banking Company and Crescent Bank and Trust Company (June 22, 2007); Albert Howell, Chairman, Regulatory and Clearance Committee, SIFMA Securities Operations Division. (June 22, 2007); Lennie M. Kaufman, Executive Vice President, Wells Fargo Shareowner Services (June 22, 2007); Lawrence Morillo, Chairman, Legal and Regulatory Subcommittee, SIFMA Operations Committee (June 22, 2007); J. Robert Morris, Managing Director, Valiant Trust Company (June 22, 2007); Cristeena G. Naser, Senior Counsel, Center for Securities, Trust & Investments, American Bankers Association (June 22, 2007); James R. Nielsen, Senior Vice President, U.S. Bank National Association (June 22, 2007); Charles V. Rossi, President, The Securities Transfer Association, Inc. (June 22, 2007); Steven Rothbloom, President and Chief Executive Officer, Computershare North America (June 22, 2007);

Continued

<sup>17</sup> DRS Limited Participants are transfer agents that participate in DRS through DTC. They are bound to certain provisions of the DTC rules. Securities Exchange Act Release No. 37931 (November 7, 1996) [File No. SR-DTC-96-15].

<sup>18</sup> In DRS, instructions to transfer shares are sent by a broker-dealer that is a DTC participant or by a transfer agent that is a DRS Limited Participant through Profile. Profile provides screen based indemnification against false instructions from the party submitting the instructions through DRS. The indemnity is supported by either a surety bond or an insurance policy.

Commission received twenty-seven comment letters on DTC's original proposed rule change, as amended by Amendments 1 and 2.<sup>24</sup> Twenty-three of

William Speirs, President, Securities Transfer Association of Canada (June 26, 2007); Susanne Trimbath, PhD, Chief Executive Officer and Chief Economist, STP Advisory Services, LLC (June 26, 2007); Thomas M. Sullivan, Chief Counsel for Advocacy, and Charles A. Maresca, Director, Interagency Affairs, U.S. Small Business Administration (June 27, 2007); Gary N. Nazare, Managing Director, Transfer Agency Services, The Bank of New York (June 29, 2007), Charles Douglas Bethill, Thacher, Proffitt & Wood LLP (December 28, 2007), Charles V. Rossi, President, Securities Transfer Association, Inc. (March 17, 2008); William Speirs, President, Securities Transfer Association of Canada (March 18, 2008); Steven G. Nelson, Chairman of the Board and President, Continental Stock Transfer & Trust Company (March 19, 2008); Martin J. McHale Jr., President, US Equity Services, Computershare (March 20, 2008); Loren Hanson, Assistant Secretary, Otter Tail Corporation (March 20, 2008); Kevin B. Halter, Jr., President, Securities Transfer Corporation (March 20, 2008); Mary C. Fernandez, Standard Registrar and Transfer Agency, Inc. (March 20, 2008); and Cristeena G. Naser, Senior Counsel, Center for Securities, Trust & Investments, American Bankers Association (March 20, 2008).

<sup>24</sup> Letters from Loren K. Hanson, Assistant Secretary, Otter Tail Corporation (June 5, 2007); Steven D. Lucas, Director of Transfer Agent Compliance, Investors Bank & Trust Company (June 15, 2007); Walter E. Grote, Senior Vice President, Travelers Bond & Financial Products (June 19, 2007); The Surety & Fidelity Association of America (June 19, 2007); Thomas L. Montrone, President and Chief Executive Officer, Registrar and Transfer Company (June 19, 2007); Salli Marinov, President and Chief Executive Officer, First American Stock Transfer Company (June 20, 2007); Steve Nelson, President and Chairman of the Board, Continental Stock Transfer & Trust Company (June 20, 2007); Dennis Callahan, Chairman, Bank Depository User Group (June 21, 2007); Kevin Kopaunik, Fidelity Transfer Company (June 21, 2007); Jonathan Miller, President StockTrans, Inc. (June 21, 2008); Artie Retolatto, 1st Global Stock Transfer, LLC (June 21, 2007); James R. Alden, President, Shareholder Services Association (June 22, 2007); James Becker, Zions First National Bank (June 22, 2007); J. Donald Boggus, Jr., President and Chief Executive Officer, Crescent Banking Company and Crescent Bank and Trust Company (June 22, 2007); Albert Howell, Chairman, Regulatory and Clearance Committee, SIFMA Securities Operations Division. (June 22, 2007); Lennie M. Kaufman, Executive Vice President, Wells Fargo Shareowner Services (June 22, 2007); Lawrence Morillo, Chairman, Legal and Regulatory Subcommittee, SIFMA Operations Committee (June 22, 2007); J. Robert Morris, Managing Director, Valiant Trust Company (June 22, 2007); Cristeena G. Naser, Senior Counsel, Center for Securities, Trust & Investments, American Bankers Association (June 22, 2007); James R. Nielsen, Senior Vice President, U.S. Bank National Association (June 22, 2007); Charles V. Rossi, President, The Securities Transfer Association, Inc. (June 22, 2007); Steven Rothbloom, President and Chief Executive Officer, Computershare North America (June 22, 2007); William Speirs, President, Securities Transfer Association of Canada (June 26, 2007); Susanne Trimbath, PhD, Chief Executive Officer and Chief Economist, STP Advisory Services, LLC (June 26, 2007); Thomas M. Sullivan, Chief Counsel for Advocacy, and Charles A. Maresca, Director, Interagency Affairs, U.S. Small Business Administration (June 27, 2007); Gary N. Nazare, Managing Director, Transfer Agency Services, The Bank of New York (June 29, 2007); and Charles

the commenters opposed some or all of the provisions in the proposed rule change while three commenters supported the proposed rule change. DTC also submitted a comment letter addressing the concerns and issues raised by the opposing commenters.

In response to commenters' concerns raised by the first two amendments to DTC's proposed rule change, DTC amended its filing for a third time. The Commission received ten comment letters to the third amendment, with eight commenters continuing to oppose the filing<sup>25</sup> and one commenter requesting clarification as to the application of one of the requirements of the proposed rule change to issuer transfer agents.<sup>26</sup> In response to the concerns raised by these nine commenters, DTC submitted a comment letter.<sup>27</sup> The comments set forth by those opposing the proposed rule change were for the most part the same concerns as were expressed in the comment letters submitted in response to the first notice of the first proposed rule change as amended by Amendments 1 and 2.

After approximately one and a half years of negotiations between DTC and the transfer agent community, DTC amended the proposed rule change for a fourth and final time. The Commission received ten comment letters in response to the proposed rule change as modified by Amendment 4, with nine commenters opposing some or all of the proposed rule and DTC again submitting a comment letter addressing the commenter concerns.<sup>28</sup> Seven of the

Douglas Bethill, Thacher, Proffitt & Wood LLP (December 28, 2007).

<sup>25</sup> Letters from Charles V. Rossi, President, Securities Transfer Association, Inc. (March 17, 2008); William Speirs, President, Securities Transfer Association of Canada (March 18, 2008); Steven G. Nelson, Chairman of the Board and President, Continental Stock Transfer & Trust Company (March 19, 2008); Martin J. McHale Jr., President, US Equity Services, Computershare (March 20, 2008); Loren Hanson, Assistant Secretary, Otter Tail Corporation (March 20, 2008); Kevin B. Halter, Jr., President, Securities Transfer Corporation (March 20, 2008); Mary C. Fernandez, Standard Registrar and Transfer Agency, Inc. (March 20, 2008); and Cristeena G. Naser, Senior Counsel, Center for Securities, Trust & Investments, American Bankers Association (March 20, 2008).

<sup>26</sup> Letter from Ray Dunn, Director of Shareholder Services, The Southern Company (March 20, 2008).

<sup>27</sup> Letter from Charles Douglas Bethill, Thacher Proffitt & Wood, LLP (on behalf of DTC) (April 10, 2008).

<sup>28</sup> Letters from Martin J. McHale, President, U.S. Equity Services, Computershare (July 2, 2008); Loren Hanson, Assistant Secretary, Otter Tail Corporation (July 7, 2008); Charles V. Rossi, President, The Securities Transfer Association, Inc. (July 9, 2008); Kevin Kopaunik, Fidelity Transfer Company (July 10, 2008); Dorothy Miller, Vice President & Trust Officer, Hancock Bank (July 10, 2008); Stephen G. Nelson, President and Chairman of the Board, Continental Stock Transfer & Trust

nine commenters opposing the proposed rule change expressed their concerns in response to one or both of the prior published notices. None of the commenters opposing the proposed rule change, as amended by the fourth amendment, raised any issues that had not been raised in their prior comment letters.

The majority of the nine commenters that opposed DTC's proposed rule change, which were issuers, transfer agents, or industry associations representing issuers or transfer agents, an insurance company, an association representing insurance companies, the American Banking Association ("ABA"), the Office of Advocacy of the Small Business Administration ("SBA"), and one individual, opposed the proposed rule change for various reasons. Most of the commenters raised a number of general policy concerns such as: (1) DTC lacks the authority to impose rules on transfer agents, and the imposition of such rules is inappropriate given the commercial relationship between transfer agents and DTC; (2) the specific requirements are unduly burdensome, unnecessary, costly (particularly with respect to small transfer agents), and without sufficient justification; (3) the proposed rule change appears based on the premise that transfer agents act as custodian for DTC's securities as recorded on the records of the issuer—a premise that the transfer agents and banks reject as erroneous; and (4) many of the provisions proposed by DTC are inconsistent with the movement to a book-entry form of securities ownership.

The remaining commenters, which were predominantly industry associations representing broker-dealers, supported the proposed rule change because of their belief that DTC's proposed requirements are necessary to facilitate the continuing increase in the use of DRS, which they contend is necessary in order to achieve the industry's objective of decreasing or eliminating the use of securities certificates in the U.S. market, and to reduce the risks associated with the continuing increase in volume and value of DRS transactions.

The following describes commenters' concerns with the specific provisions remaining in DTC's proposed rule

Company (July 10, 2008); William Speirs, President, Securities Transfer Association of Canada (July 11, 2008); Barbara J. Trivedi, Shareholder Services Manager, Crescent Banking Company, Crescent Bank and Trust Company (July 10, 2008); Edward L. Pittman, Thelen Reid Brown Raysman & Steiner LLP (July 15, 2008); John Petrofsky, Associate Counsel, DTC (July 30, 2008).

change in its final form after all amendments.

*Jurisdiction.* Many of the commenters who are transfer agents or organizations representing transfer agents oppose the proposed rule change because they contend that the Commission and banking regulators are statutorily charged with the responsibility of regulating transfer agents, and DTC is not. They further argue that even though the transfer agents are “limited participants” of DTC with respect to their participation in DRS, transfer agents do not have the full procedural safeguards that statutorily exist for DTC participants pursuant to Section 17A of the Exchange Act.<sup>29</sup> The transfer agents are also concerned that the rule change gives DTC “unfettered” discretion to decide which transfer agents are eligible to participate in DRS, to impose significant requirements to change transfer agent systems and operations, and to terminate transfer agents as FAST agents and limited participants at DTC’s discretion.

*Insurance Requirements.* Almost all of those opposed to DTC’s rule filing objected to some or all of DTC’s proposed insurance requirements as being too costly and too onerous, particularly the “excessively” high minimum coverage levels, “excessively” low deductibles, and opposed the requirement of notifying DTC of changes in their insurance policies. The STA and several other commenters stated that they believe DTC and other registered holders have sustained virtually no economic losses as a result of under-insured transfer agent activity, thereby making the proposed insurance requirements unnecessary, overly broad, and without justification.

Many of the commenters that oppose the rule change contend that for some smaller transfer agents, the amounts of proposed minimum insurance coverage would exceed the value of DTC’s securities held by the transfer agent and therefore are not reasonable. One commenter representing a large number of commercial bank and non-bank transfer agents noted that it believes that none of its members currently meet the insurance and deductible requirements.<sup>30</sup> In addition, this commenter along with the ABA and several other transfer agents opposed the requirement for transfer agents to (1) notify DTC at least 30 days prior to any expiration or change in insurance limits as unrealistic due to the manner in which policies are renewed, and (2)

notify DTC within five days of any notice of threatened or actual lapse in coverage as an unreasonable burden on insurance carriers.

*Safekeeping Requirements.* Most transfer agents that opposed the amended proposed rule change took issue with DTC dictating specific physical security standards with respect to transfer agents’ safeguarding obligations. Many of these commenters suggested that the Commission’s safekeeping rule, Rule 17Ad-12, is sufficient to govern transfer agent safeguarding obligations.

DTC maintains that specific physical security standards are justified in light of transfer agents holding blank securities certificates, which can and have been fraudulently issued or endorsed.

*Audit Requirements.* Almost all the commenters opposing the proposed rule change objected to some or all of DTC’s proposed audit requirements. Most of the transfer agents and industry associations representing issuers and agents argued that requiring submission to DTC of a SAS 70 or SSAE-19 report certifying compliance with DTC requirements and Commission rules and requiring attesting to the soundness of the transfer agent’s controls is superfluous, unwarranted, and costly, especially in light of the requirement that an audit report be filed with the Commission by registered transfer agents pursuant to Exchange Act Rule 17Ad-13. The transfer agents contended that the existing Commission regulations should be sufficient to satisfy DTC’s concerns.

One issuer acting as its own transfer agent stated its belief that DTC rules have been developed to address large commercial transfer agent operations without taking into consideration other types of transfer agents. This commenter noted that pursuant to an exemption provided to small transfer agents under Commission Rule 17Ad-4, it is exempted from the Commission’s audit requirements. This commenter stated that small transfer agents pose significantly less risk to the public than large commercial transfer agents, thereby providing the basis for the Commission’s exemption. This comment also argued that as a publicly traded company, it has audit requirements, including internal controls that are audited internally and externally pursuant to federal regulation. Compliance with DTC’s rules, this transfer agent estimated, would cost in excess of \$10,000 per year for the audit when it conducts less than 1,000 transfers per year.

*Shareholder Statements.* Many transfer agents objected to DTC requiring that for DRS withdrawal-by-transfers, DRS Limited Participants send a transaction advice to shareholders by mail and to DTC by electronic file. While the concept of sending such statements was not objectionable to most of the transfer agents opposing this requirement, the STA maintains that DTC has no authority to mandate notifications to shareholders holding positions in DRS.

*Notice of Regulatory Action and On-site Inspection by DTC.* The STA and a number of transfer agents opposed the requirement to provide DTC with copies of Commission examination reports within five business days of “any alleged material deficiencies.” The transfer agents contend they do not provide this information to any other registered securityholder, DTC has failed to demonstrate a need for such information, and DTC is not entitled to this confidential information under applicable law or regulation. They also objected to the requirement that transfer agents allow DTC access to their premises for on-site inspections.

*System Modifications and Enhanced DRS Processing Capabilities.* The STA and a number of transfer agents objected to DTC requiring transfer agents to implement program changes and system modifications to support and expand DRS processing capabilities. The transfer agents contend that such a requirement fails to address the reasonableness and necessity of any changes and fails to address the costs that may be incurred by transfer agents. Transfer agents objected to DTC unilaterally determining what changes to make to FAST and DRS without agreement from the transfer agents. They also objected to the use of the DRS Ad Hoc Committee as the ultimate arbiter of disputes because they believe the Committee is dominated by DTC and its participants and because the Committee has no governing by-laws or rules.

*Compensation.* The STA objected as commercially unreasonable that transfer agents provide DRS and FAST services to DTC without compensation. It argued that transfer agents should be entitled to refuse to provide DTC services if DTC refuses to pay for services rendered without the threat that DTC could throw them out of FAST and DRS.

*Standard of Care.* Transfer agents opposed DTC’s standard of care provision because they believe that it would permit DTC to avoid responsibility for its own errors and would force transfer agents to be responsible if a third party (*i.e.*, broker-

<sup>29</sup> 15 U.S.C 78q-1(a)(3).

<sup>30</sup> Letter from the Securities Transfer Association (“STA”).

dealer or registered shareholder) were to suffer a loss caused by an error at DTC with regard to transactions or transfers involving transfer agents. They contend that the exculpatory language would force injured parties to seek recovery from the transfer agent even in the event the transfer agent were not at fault instead of each party bearing responsibility for its own processing errors. The transfer agents state that a unilateral waiver would not be in accordance with standard industry practice or public policy.

*Regulatory Flexibility Act of 1980.* The transfer agents contend that no evidence of any assessment has been done by DTC to examine the economic impact on small transfer agents or small issuers to ensure compliance with the requirements of the Regulatory Flexibility Act of 1980.<sup>31</sup>

#### IV. Discussion

Section 17A(b)(3)(F) of the Act requires that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions, to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible, to foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions, and to remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions, and in general, to protect investors and the public interest.<sup>32</sup> For the reasons described below, the Commission finds that the rule change as amended is consistent with these provisions of Section 17A.

In Section 17A of the Act, Congress set forth its finding that the prompt and accurate clearance and settlement of securities transactions, including the transfer of record ownership and safeguarding of securities and funds related to clearance and settlement activities, is necessary for the protection of investors and those acting on behalf of investors.<sup>33</sup> Inefficient clearance and settlement procedures, Congress found, impose unnecessary costs on investors and those acting on their behalf.<sup>34</sup> The Commission's approval of DTC's registration as a clearing agency constituted an important step in its

efforts to facilitate the development of a national clearance and settlement system and a significant step in achieving the goals established by Congress.<sup>35</sup>

Consistent with this directive, the Commission has encouraged the immobilization and the dematerialization of securities holdings by supporting the use of alternatives to holding securities in certificated form in an effort to improve efficiencies and decrease risks associated with processing securities certificates.<sup>36</sup> 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 securities<sup>37</sup> and require that before any security can be listed for trading, it must have been made depository eligible if possible.<sup>38</sup> The Commission has also approved a number of rule filings relating to DTC's FAST program, which has facilitated significantly more efficient processing of transfers by eliminating the physical delivery of securities certificates between transfer agents and DTC.<sup>39</sup> More recently the Commission has approved the implementation and expansion of DRS by approving DTC's rules relating to the administration of

DRS facilities used by transfer agents and broker-dealers.<sup>40</sup>

DTC's FAST program authorizes transfer agents to hold securities on behalf of DTC in order to avoid having multiple physical certificates sent between transfer agents and DTC because of DTC's ever-changing ownership positions. Eliminating the need to transfer a physical certificate every time DTC's ownership position changes reduces risk and costs of processing transfers, which is a benefit to not only DTC, transfer agents, and issuers but also to the millions of beneficial owners of the securities holding in street name at DTC.

Because of the critical role the FAST and DRS programs play in the clearance and settlement of transactions in securities, which are legally owned by DTC and beneficially owned by DTC participants and their customers, the Commission believes that DTC has a legitimate interest in making sure that FAST agents and DRS Limited Participants comply with reasonable and appropriate requirements for participation in these programs in order that DTC can fulfill its statutory obligation to safeguard securities and funds that are in its custody or control or for which it is responsible. In response to the comments submitted in response to the proposed rule changes, DTC amended its proposal four times in an effort to reduce the cost and operational burden on transfer agents while still maintaining the appropriate level of safeguards necessary for DTC to comply with its statutory obligations. The Commission believes that the requirements, as amended, are fair and reasonable in light of the vital function the FAST and DRS programs play in the national clearance and settlement system and should help further improvements in the interactions between transfer agents and DTC, which is an essential component of improving the industry's dematerialization efforts.

In adopting these new rules, the Commission does not believe that DTC is attempting to "regulate" transfer agents as some commenters contended. Rather, the Commission believes that DTC is imposing reasonable obligations necessary for it to comply with its statutory obligations and only on those transfer agents that choose to participate in its FAST and DRS programs. Further, as a self-regulatory organization, DTC is required to file rule changes affecting the FAST or DRS program, and by extension, those transfer agents participating in these programs, with the Commission pursuant to Section

<sup>35</sup> Exchange Act Release No. 20221 (September 23, 1983), 48 FR 45167 (October 3, 1983).

<sup>36</sup> The use of certificates often results in significant delays and expenses in processing securities transactions and raises safety concerns associated with lost, stolen, and counterfeit certificates. The concerns associated with lost certificates were dramatically demonstrated during the September 11, 2001, tragedy when tens of thousand of certificates maintained in broker-dealers' vaults either were destroyed or were unavailable for transfer. See 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).

<sup>37</sup> 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).

<sup>38</sup> Securities Exchange Act Release No. 35798 (June 1, 1995), 60 FR 30909 (June 12, 1995) (order approving rules setting forth depository eligibility requirements for issuers seeking to have their shares listed on the exchange).

<sup>39</sup> Securities Exchange Act Release Nos. 13342 (March 8, 1977) [File No. SR-DTC-76-3]; 14997 (July 26, 1978) [File No. SR-DTC-78-11]; 21401 (October 16, 1984) [File No. SR-DTC-84-8]; 31941 (March 3, 1993) [SR-DTC-92-15]; and 46956 (December 6, 2002) [File No. SR-DTC-2002-15].

<sup>40</sup> See supra note 10.

<sup>31</sup> The Commission notes that the Regulatory Flexibility Act of 1980 is not applicable to proposed rule changes filed by self-regulatory organizations pursuant to Section 19(b) of the Exchange Act.

<sup>32</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>33</sup> 15 U.S.C. 78q-1(a)(1)(A).

<sup>34</sup> 15 U.S.C. 78q-1(a)(1)(B).

19(b) of the Exchange Act. Most of these filings have been and will continue to be filed with the Commission, published for public comment, and subject to the review and approval by the Commission. This process should provide transfer agents, as well as others affected by DTC's rules, adequate procedural safeguards.

Some commenters contend that by allowing DTC the authority to determine which transfer agents may become a FAST transfer agent or DRS Limited Participant, DTC is also granted by extension the authority to determine which transfer agents may continue to operate a transfer agent business. The Commission does not agree. Many transfer agents act as transfer agent for publicly traded securities and are not FAST agents or DRS Limited Participants. But if a transfer agent chooses to act as transfer agent for an issuer of securities that requires it to become a FAST agent or DRS Limited Participant, then DTC has an interest and statutory responsibility to ensure that the securities held on its behalf at the transfer agent are safeguarded and that the settlement of transactions in those securities, which includes safe and efficient transfers in ownership, occurs in a prompt and accurate manner.

With regards to specific operational requirements required by DTC's rule, such as insurance requirements, physical security standards, audit requirements, and system modifications to support or enhance DRS functionality, the Commission believes that the amended rule contains standards that are appropriate and reasonably designed to achieve DTC's goal of protecting the securities held by transfer agents on DTC's behalf and on behalf of DTC's participants and the participants' customers. The Commission does not find it compelling to contend that just because DTC and other registered holders have not sustained economic losses, DTC's insurance requirements are overly broad or unjustified. The point of the rule's insurance requirement is to protect against losses before losses occur. Furthermore, if a transfer agent can demonstrate that its existing coverage or capitalization provide similar protections as the insurance required DTC, DTC has the discretion to grant a waiver from any or all of the requirement. This flexibility should provide DTC the ability to properly address situations where the required coverage is too onerous or ineffective for the type, amount, or dollar value of DTC's securities held by the transfer agent.

The Commission also finds little merit in the contention that the audit reports required by the rule are unwarranted or unnecessarily costly. The Commission believes that requiring transfer agents to provide to DTC the Annual Study of Evaluation of Internal Accounting Controls, conducted pursuant to Rule 17Ad-13, and a SAS-70 audit report, if the agent has already obtained such a report for other purposes, are reasonable in light of DTC's statutory obligations to ensure the safeguarding of its securities. These audit reports provide DTC with additional information about the adequacy of the transfer agent's operational capabilities and internal controls for the transfer of record ownership and the safeguarding of related securities and funds. This is not only relevant but material information to DTC. In addition, because DTC's rule requires that transfer agents provide DTC with documents that have already been produced by the transfer agent for other purposes and should be in the transfer agent's possession, the Commission believes that there should be little or no additional expense and relatively little extra burden on transfer agents in providing these documents to DTC.

Similarly, commenters' concerns about requiring transfer agents to provide DTC with a copy of the two most recent compliance or deficiency correspondences from the Commission and all notices of alleged material deficiencies documented by the Commission appear to be misplaced. While the Commission appreciates the sensitive nature of transfer agent examination reports and the need to ensure the confidentiality of all information contained in those reports, the Commission believes nonetheless that DTC's request for these documents is reasonable. Information contained in those reports should allow DTC to better manage any potential risks associated with the transfer agent's ability to transfer securities, maintain ownership records, or operate its business in a safe manner.

Even though some commenters objected to DTC's provision requiring transfer agents to send DTC a file indicating a transaction advice has been sent to investors for each DRS withdrawal-by-transfers, the Commission believes DTC has a valid interest in requiring notice that investors have obtained a transaction advice from transfer agents. The file required to be sent to DTC will provide confirmation that the transaction advice has been sent to the investor so that DTC can close out its pending transfer position or file (sometimes referred to as

an open transfer record). If that position is not closed, then DTC's records will show that the transfer remains open and it will become an outstanding aged transfer. To avoid this, DTC is requiring transfer agents to send a notice that the transfer has been completed by sending the investor a transaction advice. This process is similar to that of the current process when a transfer agent notifies DTC that a certificate has been mailed to the investor.

Finally, the Commission believes that commenters' concerns regarding the rule's clarification of DTC's standard of care provision are unfounded. The purpose of the rule change is to clarify that DTC shall not be liable to participants for acts or omissions of any third party (including without limitation any depository, custodian, sub-custodian, clearing or settlement system, transfer agent, registrar, data communication service or delivery service). DTC's Rule 6 applies to DTC's relationship with its participants, not FAST agents. Therefore, this particular provision does not have any impact on FAST Agents that are not also participants. The provision does not shift liability from DTC to FAST Agents or absolve DTC from liability to FAST Agents.

## V. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change, as amended, 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, as amended, (File No. SR-DTC-2006-16) be and hereby is approved.<sup>41</sup>

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.<sup>42</sup>

**Elizabeth M. Murphy,**  
*Secretary.*

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<sup>41</sup> In approving the proposed rule change, the Commission considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>42</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).