

transfer at DTC.⁴⁴ DTC contends that attempts by issuers to control their publicly traded securities are improper and may constitute conversion. DTC states that by purporting to exercise the rights of the shareholders, issuers are interfering with the legal and beneficial rights of DTC and its participants with respect to securities deposited at DTC and with DTC's obligations under section 17A of the Act.

DTC disagreed with the commenters' contention that it had an obligation to take action to resolve the issues associated with naked short selling because those issues arise in the context of trading and not in the book-entry transfer of securities. DTC pointed out that if beneficial owners believe that their interests are best protected by not having their shares subject to book-entry transfer at DTC, then they can instruct their broker-dealer to execute a withdrawal-by-transfer, which will remove the securities from DTC and transfer them to the shareholder in certificated form.

Finally, DTC contested certain commenters' assertion that issuers cause their shares to become eligible at DTC and therefore have the right to withdraw from DTC eligibility. DTC states that most shares are made eligible at the request of participants and not issuers. But regardless of how the shares are made eligible, DTC believes it continues to own and hold the shares for the convenience and at the request of its participants. DTC believes that if it were to exit shares upon demand of an issuer, there is no mechanism to ensure that the shares entrusted to DTC by its participants would be returned to their rightful owners. This, DTC contended, would be inconsistent with its obligations under section 17A.

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 and to remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions.⁴⁵ For the reasons described below, the Commission finds that the rule change is consistent with section 17A of the Act.

Pursuant to 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.⁴⁶ Inefficient clearance and settlement procedures, Congress found, impose unnecessary costs on investors and those acting on their behalf.⁴⁷ Congress vested with the Commission the authority and responsibility to regulate, coordinate, and direct the operations of all persons involved in processing securities transactions toward the goal of establishing a national system for the prompt and accurate clearance and settlement of transactions in securities ("National Clearance and Settlement System") in an effort to increase efficiency and reduce risk.⁴⁸ 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.⁴⁹

As a registered clearing agency, DTC has adopted rules under section 19(b) of the Act to act as a depository that operates a centralized system for the handling of securities certificates through book-entry movements.⁵⁰ Generally, those rules, including adoptions, deletions, or changes to DTC's constitution, articles of incorporation, bylaws, rules, or stated policies, practices, and interpretations, must be filed with the Commission and must be approved by the Commission if the Commission finds the rule change consistent with the Act.⁵¹ Furthermore, DTC can only act in accordance with its rules. DTC has adopted rules that permit deposits of securities into DTC by participants⁵² and rules that permit

withdrawals from DTC by participants and pledgees.⁵³ However, DTC has not adopted rules that permit issuers to withdraw securities from DTC. Accordingly, a procedure allowing issuers to withdraw securities from DTC would have to be filed and approved by the Commission. DTC has not filed such a rule change.

In accordance with its rules, DTC accepts deposits of securities from its participants (*i.e.*, broker-dealers and banks), credits those securities to the depositing participants' accounts, and effects book-entry movements of those securities.⁵⁴ The securities deposited with DTC are registered in DTC's nominee name, Cede & Co. (making DTC's nominee the registered owner of the securities) and are held in fungible bulk. Each participant or pledgee having an interest in securities of a given issue credited to its account has a pro rata interest in the securities of that issue held by DTC. Among other services it provides, DTC provides facilities for payment by participants to other participants in connection with book-entry deliveries of securities, collects and pays dividends and interest to participants for securities, and provides facilities for the settlement of institutional trades. By centralizing and automating securities settlement, by reducing the movement of publicly traded securities in the U.S. markets, and by facilitating the prompt and accurate settlement of securities transactions, DTC serves a critical function in the National Clearance and Settlement System.

DTC's rules also accommodate withdrawal requests from participants or under certain conditions, from pledgees.⁵⁵ Securities credited to a participant's or pledgee's account may be withdrawn in certificated form (if the issue is not dematerialized).⁵⁶ DTC's rules, both prior to and after the approval of the clarification which is the subject of this rule filing, obligates and allows DTC to take instructions only from its participants.

Some commenters opposing DTC's proposed rule change contend that issuers should have a choice as to whether their securities are made

debt and most municipal securities) enter into a contract with DTC whereby the issuer deposits their securities into DTC and DTC then credits the securities to the accounts of participants. *See also* note 55 *infra* and accompanying text.

⁵³ *See e.g.* Rules 2, 6, and 9 of DTC's Rules.

⁵⁴ *See e.g.* Rule 6 of DTC's Rules. All deposits, whether made by a participant or, in the case of book-entry-only securities, by an issuer must be credited to a participant's account at DTC.

⁵⁵ *See e.g.* Rules 2, 6, and 9 of DTC's Rules.

⁵⁶ *See e.g.* Rule 6 of DTC's Rules, By-Laws and Organization of Certificate.

⁴⁴ DTC also noted that none of the securities where the issuer is attempting to restrict the transferability of its shares bear any legend, conspicuous or otherwise, noting the restrictions.

⁴⁵ 15 U.S.C. 78q-1(b)(3)(F).

⁴⁶ 15 U.S.C. 78q-1(a)(1)(A).

⁴⁷ 15 U.S.C. 78q-1(a)(1)(B).

⁴⁸ 15 U.S.C. 78q-1(a)(1)(A)(i). Congress expressly envisioned the Commission's authority to extend to every facet of the securities handling process involving securities transaction 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).

⁴⁹ Exchange Act Release No. 20221 (September 23, 1983), 48 FR 45167 (October 3, 1983).

⁵⁰ As a registered clearing agency, DTC is a self-regulatory organization and as such, must file with the Commission any proposed rule or rule change pursuant to section 19 of the Act. 15 U.S.C. 78s(b).

⁵¹ Section 3(a)(27) of the Act defines the term "rules of a clearing agency." The Commission's role in the approval of such rules is described in section 17A and section 19(b) of the Act. 15 U.S.C. 78q-1 and 15 U.S.C. 78s.

⁵² DTC has informed the Commission that issuers of book-entry-only securities (*i.e.*, some corporate