

certificates.<sup>11</sup> Section 17(f)(1), in fact, is designed to curtail the profitability of and the unlawful trafficking in lost and stolen securities certificates.<sup>12</sup> Section 17(a)(3) of the Act expressly provides the Commission with rulemaking authority over transfer agent recordkeeping matters.<sup>13</sup> In Section 17A(a), Congress directs the Commission to carry out certain objectives including the safeguarding of securities and funds that are related to securities transfers and the elimination of inefficient securities processing that imposes unnecessary costs on investors.<sup>14</sup> The Commission has broad discretion in carrying out these mandates.<sup>15</sup> We believe that most situations where cancelled securities certificates resurfaced in the marketplace have resulted from a lack of good internal control systems for the processing, storage, transportation, or destruction of the certificates. The rules that we adopt today are intended to provide for more efficient and secure certificate processing, particularly of cancelled certificates.

### III. Final Rules

#### A. Rule 17Ad-19: Processing of Cancelled Certificates

Currently, the processing of cancelled certificates is largely governed by industry practices. For example, in 1994, the Securities Transfer Association ("STA"), the largest transfer agent trade association,<sup>16</sup> adopted guidelines for its members which, among other things, called for marking cancelled certificates with the word "cancelled" and for greater security measures in certificate storage and destruction.<sup>17</sup> However, these guidelines are not mandatory, and not all transfer agents follow them. Therefore, because cancellation is the critical first step in the processing of retired securities certificates, we believe that rulemaking is necessary to strengthen and standardize this process.

#### 1. Discussion of Text

Rule 17Ad-19 requires each transfer agent to have and implement written

procedures for the cancellation, storage, transportation, destruction, or other disposition of securities certificates. At a minimum, the written procedures must provide: (1) For controlled access to any cancelled certificate facility; (2) that the transfer agent clearly apply to the face of each cancelled certificate the word "cancelled" unless the transfer agent's procedures will cause the certificate to be destroyed in accordance with other Commission rules within three business days of its cancellation; (3) that the transfer agent keep a readily retrievable record of each cancelled certificate with identifying data consisting of CUSIP number, certificate number including prefix or suffix, denomination, registration, issue date, and cancellation date; (4) that the transportation of cancelled certificates be made in a secure manner with a record of the certificates in transit kept separately; (5) that the transfer agent keep a readily retrievable record of each destroyed certificate or certificate otherwise disposed of;<sup>18</sup> and (6) that authorized personnel of the transfer agent, supervise, witness and document the destruction of certificates.

We are modifying proposed Rule 17Ad-19 to require that transfer agents maintain records not only of the certificates that they or their agents destroy but also of those certificates that they dispose of by any other means and which may, for example, become the property of collectors or dealers in collectibles. In this regard, we note that cancelled certificates, after a period in transfer agent storage, are generally destroyed by the transfer agent or destroyed by some other party acting at the direction of the transfer agent or the issuer. However, a small amount of cancelled certificates may find their way from transfer agents to collectors or perhaps to other places currently unknown to us. Accordingly, to make the rule as complete as possible, we are inserting in paragraph (b) the words "or other disposition" into the phrase "destruction of securities certificates." The term "otherwise disposed of" requires that a record be maintained of how (as by sale or gift) and to whom (with name and address) the certificates were disposed of and the date of disposition. In the text of Rule 17Ad-19,

minor changes have been made to paragraphs (a)(2) and (a)(4) for clarification and specificity. Rule 17Ad-19 also includes procedures for the Commission to provide conditional or unconditional exemptions from any of these provisions of the rule in appropriate cases upon written request or upon its own motion. A related amendment to Rule 17Ad-7(i) requires transfer agents to maintain records to demonstrate compliance with the requirements of Rule 17Ad-19 for not less than three years, the first year in an easily accessible place.<sup>19</sup>

#### 2. Comment Letters

Many comments received in reply to the Proposing Release addressed particular aspects of proposed Rule 17Ad-19.

Three commenters,<sup>20</sup> objected to the proposed requirement that certificates must be "cancelled" unless existing procedures would cause their destruction "within 72 hours of their cancellation." They each recommended that "72 hours" be changed to "three business days" to avoid problems with weekends and holidays. We agreed that this change would achieve our goal, while avoiding problems with weekends and holidays and, therefore, we made this modification.

ChaseMellon asked for clarification whether the provision in the rule concerning certificates in transit would apply to shipments between a transfer agent's own offices and affiliates or only to shipments between unaffiliated reporting institutions, vendors, and others. The transportation provision of the rule is intended to apply only to shipments between a reporting institution and unaffiliated parties. We have modified the rule to reflect this point.<sup>21</sup>

ChaseMellon asked whether having written procedures that are consistent with STA's recommended guidelines would constitute compliance with Rule 17Ad-19. Because some requirements of Rule 17Ad-19 may differ from those of the STA's guidelines, transfer agents must be sure they are in compliance with the requirements of Rule 17Ad-19. ChaseMellon also requested clarification whether the records required by Rule

<sup>11</sup> 15 U.S.C. 78q(f) and 78q-1.

<sup>12</sup> Section 17(f)(1), 15 U.S.C. 78q(f)(1).

<sup>13</sup> 15 U.S.C. 78q(a)(3).

<sup>14</sup> 15 U.S.C. 78q-1(a). See Securities Acts Amendments of 1975, Comm. on Banking, Housing and Urban Affairs, Sen. Rep. No. 75 to Accompany S.249, 56-58 (1975).

<sup>15</sup> "The Commission is empowered with broad rulemaking authority over all aspects of a transfer agent's activities as a transfer agent." *Id.* at 57.

<sup>16</sup> STA has over 400 members, the majority of whom are registered transfer agents. For STA's Web site, see [www.stai.org](http://www.stai.org).

<sup>17</sup> Rules of the STA, Section 1.26 (Recommended Procedures for Cancelled Securities).

<sup>18</sup> Required certificate detail is: CUSIP number, certificate number including prefix or suffix, denomination, registration, issue date, and cancellation date. See 17 CFR 240.17Ad-9(a) and 240.17f-1(c)(6). The term "certificate otherwise disposed of" is intended to include the small minority of certificates that are not destroyed by transfer agents or other agents and may, for example, become the property of collectors or of dealers in collectibles.

<sup>19</sup> 17 CFR 240.17Ad-7(i).

<sup>20</sup> EquiServe, ICI, and PFPC, Inc. PFPC, Inc. is a member of the PFPC Financial Services Group, Inc.

<sup>21</sup> This provision is intended to address shipments between unaffiliated financial institutions. We believe that less risk of this type of loss exists in intrafirm shipments where the same firm controls both the sending and receiving offices. We note, however, that a transfer agent's general obligation to safeguard funds and securities applies to intrafirm shipments. See Exchange Act Rule 17Ad-12, 15 CFR 240.17Ad-12.