

occurring sooner than the end of the fifth business day.

#### 5. Securities Shipments

We proposed to add to Rule 17f-1(c)(2)(ii) a requirement that transfer agents track shipments of securities certificates, including cancelled certificates, between reporting institutions. When such a shipment becomes unaccounted for (for example, when the delivering institution fails to receive notice of receipt of the shipment), the delivering institution would be required to investigate to determine the facts. If the certificates cannot be located, under the proposed amendment, the delivering institution would be required to report to LSSP that the certificates are missing, stolen, or lost within a reasonable time not exceeding ten business days after the shipment was sent.

We received five comments on this proposal.<sup>43</sup> The commenters said that the proposed time frame of ten business days was too short a period for transfer agents to verify the non-delivery, to investigate the cause, and to report such matters to LSSP. Alternative suggestions were 15, 20, and 30 business days. In response to these suggestions, and upon consideration of the time we believe is reasonably needed to verify and investigate such non-deliveries, we have increased the time frame to 20 business days.

EquiServe also commented that inasmuch as the overall purpose of the rule package is to address problems with retired or cancelled certificates, the securities shipment proposal in question should not apply to "live" certificates.<sup>44</sup> EquiServe noted that, as proposed, the rule would appear to apply to all shipments of securities certificates, both live certificates and retired certificates, but it noted that live certificates tend to be shipped (1) in small amounts and perhaps only as single certificates and (2) in protected ways, such as by certified mail, that reflect their asset value. It also commented that it would be expensive for transfer agents to monitor the receipt of each such small mailing. EquiServe stated that retired certificates, however, tend to be shipped in bulk, and since they have no investment value there is less economic incentive to record and track such certificates. Thus, EquiServe

suggests, the coverage of the rule proposal could be limited to retired certificates.

We agree with EquiServe's reasoning on this matter. The proposed rule appears unnecessary for live certificates, which generally are carefully safeguarded by the securities industry and where the rule would impose higher expenses due to the small shipments usually involved.<sup>45</sup> But we believe the proposal is necessary with respect to retired certificates where there is less financial incentive for the industry to safeguard the certificates and where shipments tend to be fewer and in bulk amounts so that the tracking expenses per certificate would be less. Accordingly, the proposed rule has been modified to apply only to shipments containing retired certificates.

#### C. Rule 17Ad-12: Safeguarding of Funds and Securities

Rule 17Ad-12 governs the safekeeping of funds and securities by transfer agents.

It requires that securities be handled in a manner that is reasonably free from the risk of destruction, theft, or other loss. We proposed an amendment to Rule 17Ad-12 to make clear that cancelled certificates come within the meaning and purpose of Rule 17Ad-12.<sup>46</sup> As we observed earlier, a cancelled certificate has no intrinsic value but, like a counterfeit certificate, it can be used to defraud. Accordingly, we have amended Rule 17Ad-12 as proposed to provide that the term "securities" used in that rule will have the same meaning as the term "securities certificate" defined in Rule 17f-1. As such, cancelled certificates will be expressly included in the coverage of Rule 17Ad-12, and transfer agents will be responsible for safeguarding cancelled certificates under their control.<sup>47</sup>

#### D. Other Comments

Discussed below are other comments we received in response to the Proposing Release.

##### 1. Exceptions for Certain Transfer Agents

Paragraph (b) of proposed Rule 17Ad-19 would have applied only to those transfer agents involved in the "keeping, handling, or processing of securities

certificates." We requested comment on whether the proposal should apply to all registered transfer agents (approximately 900) or only to the approximately 800 registered transfer agents that maintain securityholder records for one or more securities issues and are directly involved with the keeping, handling, or processing of securities certificates. Excluded from the larger group would be "named transfer agents" (transfer agents that contract their transfer agent functions to transfer agent "service Companies") and transfer agents that conduct a specialty business not involving securities certificates.<sup>48</sup> We received two comments.

CTA recommended that proposed Rule 17Ad-19 apply only to the transfer agents that maintain securityholder records, with an exception for issuers registered as transfer agents that act only for their own issues ("issuer-only transfer agents") with average monthly volumes of 100 transfer items or less. Secondly, Otter Tail, an issuer-only transfer agent, said it averages only 30 certificates per month and that maintaining retrievable records and witnessing the destruction of certificates would require more staff and equipment and would be unduly expensive.

As Rule 17Ad-19 is written, it is applicable only to transfer agents that are involved in the handling, processing, or storage of securities certificates.<sup>49</sup> Therefore, a number of transfer agents, such as named transfer agents, are not subject to the provisions of Rule 17Ad-19, which includes the requirement to prepare written procedures. Nevertheless, a transfer agent that outsources its transfer agent work, which consists of handling, processing, or storage of securities certificates, to another transfer agent (*i.e.*, a service company transfer agent) is legally responsible for ensuring that the provisions of Rule 17Ad-19 are followed with respect to the securities for which it is the named transfer agent. Therefore, both named transfer agents and service company transfer agents have responsibilities for complying with Rule 17Ad-19. Regarding the provisions of Rule 17Ad-19 dealing with the recordkeeping of the destruction of retired securities certificates, we do not believe that these requirements become burdensome simply because the number

<sup>43</sup> The five commenters were: CTA, EquiServe, ICI, PFPC, Inc., and U.S. Bank.

<sup>44</sup> We are using the term "retired certificate" in a slightly broader sense than the term "cancelled certificate." A certificate is "retired" at the time it is taken out of circulation, often by transfer or redemption, regardless of whether it has yet been cancelled.

<sup>45</sup> See Rule 17Ad-12, 17 CFR 240.17Ad-12.

<sup>46</sup> We have brought enforcement actions for violations of Rule 17Ad-12 that involved cancelled securities certificates. See, *e.g.*, SEC v. Citibank, N.A., *supra* at note 8.

<sup>47</sup> The only comment received concerning Rule 17Ad-12 concerned the new definition of "securities certificate" of Rule 17f1-(a)(6), which is being incorporated by reference into Rule 17Ad-12. See Section III.B.2.a above.

<sup>48</sup> For the definitions of "named transfer agent" and "service company" refer to 17 CFR 240.17Ad-9(j) and (k).

<sup>49</sup> The new language of "handling, processing, or storage of securities certificates" more appropriately describes the procedure in question than the previously proposed language of "keeping, handling, and processing of securities certificates."