

needed to be disposed. We expect these costs to be relatively minimal.¹⁴

We estimate that approximately 60 transfer agents will use a third party to escrow the required source code.¹⁵ Each transfer agent will evaluate the risk and cost effectiveness of its records management solution differently based upon the solution that is best for its business model, such as its business practices and volume, and that assures its ability to comply with Rule 17Ad-7. Moreover, we cannot predict the effect of future market competition and innovation on the technologies that transfer agents might employ for their recordkeeping.

In addition, there will be some cost associated with the escrow requirement amendment. However, the Commission the Commission considered these costs in the April 2001 adopting release and any new costs associated with the escrow amendment (*i.e.*, having a third party escrow the source code on the transfer agent's behalf) would likely be included in the software contract between the parties.

V. Consideration of Burden on Competition, and Promotion of Efficiency, Competition, and Capital Formation

Section 3(f) of the Act¹⁶ requires the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, to consider whether the action will promote efficiency, competition, and capital formation.

Section 23(a)(2) of the Act requires us to consider the anti-competitive effects of any rules that we adopt under the Act. This section prohibits us from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

In the Proposing Release, the Commission solicited comments on whether the amendments to Rule 17Ad-7 would have any effects on competition, efficiency and capital

formation. We received no comments in response to this solicitation.

The Commission believes the amendments should improve efficiency, competition, and capital formation. The amendments should promote efficiency by allowing registered transfer agents to benefit from advances in recordkeeping technology. The amendments should promote competition between the vendors who create and manufacture the new storage technologies and between the transfer agents who use the new methods. Vendors can compete with each other to develop systems that can allow transfer agents to manage their records on a more economical basis. The improvement in storage technologies would allow transfer agents to compete among one another in offering to companies a more cost-effective and efficient service. Finally, the amendments should not adversely affect capital formation because the amendments relate solely to post-issuance activity.

The Commission does not anticipate that the amendments will impose any burden on competition that is not necessary or appropriate in furtherance of the Act. The amended rule permits, but does not require, registered transfer agents to use electronic or micrographic media to retain their records in lieu of hard copies and a third party to place the required software code into escrow on behalf of a registered transfer agent. The amendments are intended to remove legal uncertainties facing transfer agents who decide to store records in an electronic or micrographic form. The Commission believes that by adopting these amendments, transfer agents will have greater certainty to assess which storage method will best suits their business needs.

VI. Final Regulatory Flexibility Analysis

This Final Regulatory Flexibility Analysis ("FRFA") has been prepared in accordance with the Regulatory Flexibility Act ("RFA").¹⁷ This analysis relates to amendments to Rule 17Ad-7(f) under the Securities Exchange Act of 1934 ("Act")¹⁸ to determine whether the rule amendments will have a significant economic impact on a substantial number of small entities. The amendments will allow registered transfer agents to take advantage of improvements in electronic recordkeeping technology by being able to store their records exclusively using electronic storage technology and by being able to have a third party place in

escrow the source code on behalf of the transfer agent.

A. Need for the Rule

Notwithstanding recent amendments to Rule 17Ad-7,¹⁹ there appeared to be some uncertainty whether (1) Rule 17Ad-7(f) allows transfer agents to rely exclusively on electronic or micrographic records for purposes of the Commission's transfer agent recordkeeping rules and to no longer maintain hard copy records, including cancelled certificates, and (2) a third party may deposit with an independent escrow agent a copy of all the documentation required under Rule 17Ad-7(f)(5)(ii) on behalf of the transfer agent for the purpose of complying with Rule 17Ad-7(f)(5)(ii).²⁰

In order to eliminate this uncertainty, the Commission is amending Rule 17Ad-7(f) to clarify that records, including cancelled securities certificates, required to be maintained pursuant to Rule 17Ad-6 may be retained electronically or micrographically and may serve as a substitute for hard copy records required to be maintained pursuant to Rule 17Ad-6. Accordingly, this substitution provision allows, but would not mandate, the destruction of hard copy records, including securities certificates, after electronic or micrographic records have been created in conformity with Rule 17Ad-7(f).²¹

The amendments make it clear that transfer agents may use electronically and micrographically retained records to comply with the Commission's transfer agent recordkeeping requirements. We note that the Commission did not take a position on whether transfer agents should store

¹⁹ *Supra* note 2.

²⁰ Under Rule 17Ad-7(f)(5)(ii), transfer agents that choose to use electronic storage media to store the required records must, among other things, "place in escrow with an independent third party and keep current a copy of the physical and logical format of the electronic storage or micrographic media, the field format of all different information types written on the electronic storage media and source code and the appropriate documentation and information necessary to access records and indexes. * * *

²¹ While Rule 17Ad-7 would permit destruction of paper records for purposes of our recordkeeping requirements, a transfer agent may have an obligation to preserve paper records under other applicable laws or rules. The Commission proposed new Rule 17Ad-19 that would require transfer agents to establish and implement written procedures for the cancellation, storage, transportation, and destruction of securities certificates. Securities Exchange Act Release No. 43401 (Oct. 2, 2000); 65 FR 59766 (Oct. 6, 2000). In addition, while Rule 17Ad-7 would permit the destruction of paper records for purposes of our recordkeeping requirements, a transfer agent may have an obligation to preserve such paper records under other applicable law or rules.

¹⁴ In the adopting release to Rule 17Ad-7(f), we estimated that approximately 500 transfer agents were likely to use electronic or micrographic storage systems. During the year-and-a-half since Rule 17Ad-7(f) has been effective, however, five transfer agents have taken advantage of the record storage alternatives provided by the rule.

¹⁵ Although this estimate represents less than 10% of the number of currently-registered transfer agents, we expect that many of the largest bank, corporate, and independent transfer agents, which represent over 90% of the entire transfer agent industry volume, will eventually convert their records-management systems to electronic-based solutions.

¹⁶ 15 U.S.C. 78c(f).

¹⁷ 5 U.S.C. 603.

¹⁸ 15 U.S.C. 78a *et seq.*