

their records using electronically or micrographically instead of in paper.

In addition, we are amending paragraph (f)(5)(ii) of Rule 17Ad-7 to clarify that a transfer agent may fulfill its software escrow obligation by having a third party 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.<sup>22</sup>

Amendments to Rule 17Ad-7 are adopted under the Commission's authority set forth in Sections 17, 17A, and 23 of the Act.

#### *B. Significant Issues Raised by Public Comment*

We received three comment letters in response to the Proposing Release.<sup>23</sup> Integrated Fund Services ("IFS") argued that the general requirement that an escrow agent be independent of both the transfer agent and the third party software provider is overly burdensome to transfer agents and software developers and that sufficient legal and regulatory remedies exist that provide the Commission access to the software should the transfer agent fail to do so. IFS believes that these factors discourage transfer agents from using electronic records management systems.

The Records Management Division of the Nebraska Secretary of State contended that (1) electronic documents are not as widely accepted as evidence in state and federal judicial proceedings compared to paper and microfilm records, (2) in addition to the software, the hardware, including printers and ink cartridges, necessary to retrieve and reproduce hard copy images of the records should also be kept in escrow, (3) paper and microfilm are easier to access than electronic records, and (4) paper and microfilm records should be subject to the same performance requirements as electronic records, specifically that they should be indexed, kept in duplicate, and kept safe and secure (e.g. from heat and sunlight).

While we will consider these two commenters' observations and suggestions as we continue to assess the effectiveness of the transfer agent recordkeeping rules, such comments do not address the issues presented in the

Proposing Release, which was to clarify that (1) electronic records may be maintained in lieu of paper records and (2) a third party may escrow the required software on behalf of a transfer agent. Their comments relate more to the issues raised when we adopted amendments to Rule 17Ad-7 that allowed transfer agents to use electronic storage media to maintain their records.

EquiServe supported the proposed amendments. EquiServe stated that the proposed amendment will resolve an ambiguity, especially with respect to cancelled certificates, whether hard copy records need to be maintained if they are also stored electronically pursuant to the requirements set forth in Rule 17Ad-7. In addition, EquiServe agreed with the need to make clear that third parties may escrow the source code on behalf of transfer agents.

Accordingly, we are adopting the proposed amendments to Rule 17Ad-7(f) entirely as proposed.

#### *C. Small Entities Subject to the Rule*

The rule amendments should not affect registered transfer agents that are small entities. Rule 0-10(h) under the Act defines the term "small business" or "small organization" to include any transfer agent that: (1) Received less than 500 items for transfer and less than 500 items for processing during the preceding six months (or in the time that it has been in business, if shorter); (2) transferred items only of issuers that would be deemed "small business" or "small organizations" as defined in Rule 0-10 under the Exchange Act; (3) maintained master shareholder files that in the aggregate contained less than 1,000 shareholder accounts or was the named transfer agent for less than 1,000 shareholder accounts at all times during the preceding fiscal year (or in the time that it has been in business, if shorter); and (4) is not affiliated with any person (other than a natural person) that is not a small business or small organization under Rule 0-10.<sup>24</sup> We estimate that 180 registered transfer agents qualify as small entities and would be subject to the amendment to Rule 17Ad-7(f).

#### *D. Projected Reporting, Recordkeeping, and Other Compliance Requirements*

The amendments do not impose any new reporting, recordkeeping, or other compliance costs or requirements on any particular person or entity. First, the amendments do not in any way change the manner that transfer agents are currently maintaining their records today. Second, compliance with this provision is purely voluntary depending

on whether registered transfer agents choose to exclusively use electronic or micrographic media to store the required records. While transfer agents that elect to exclusively use micrographic media or electronic storage media may incur some costs in destroying or otherwise disposing hard copy records. However, the Commission believes that this cost is minimal. Finally, while there will be some cost imposed by the proposed escrow requirement provision, these costs were contemplated by the Commission in the 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.

Accordingly, we believe that amendments to Rule 17Ad-7(f) should not have a significant economic impact on a substantial number of small entities.

#### *E. Agency Action To Minimize Effect on Small Entities*

The Regulatory Flexibility Act directs the Commission to consider significant alternatives that would accomplish the stated objective while minimizing any significant adverse impact on small entities. In connection with the adopted amendments, the Commission considered the following alternatives: (a) The establishment of differing compliance or reporting requirements or timetables that take into account the resources of small entities; (b) the clarification, consolidation, or simplification of compliance and reporting requirements under the rule for small entities; (c) the use of performance standards rather than design standards; and (d) an exemption from coverage of the proposed amendment or any part thereof for small entities.

The adopted amendments are designed to enable 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. The Commission believes that different compliance or reporting requirements for small entities are not necessary because the amendments do not establish any new reporting, recordkeeping, or compliance requirements for small entities. In addition, the Commission has concluded that it is not feasible to further clarify, consolidate, or simplify the proposed amendments for small

<sup>22</sup> One situation that necessitates this clarifying amendment is when a software provider licenses its electronic records storage system software to a transfer agent but does not grant a license for the source code. As a result, the transfer agent does not have access to the source code.

<sup>23</sup> Letters from Jeffrey G. Rutowski, Vice President, Integrated Fund Services (June 30, 2003); Cathy Danahy, Assistant Director, Nebraska Secretary of State's Office, Records Management Division (July 14, 2003); and Charles V. Rossi, Division President, EquiServe, Inc. (July 29, 2003).

<sup>24</sup> 17 CFR 240.0-10(h).