Securities Industry Association
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July 28, 2004

Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: File No. S7-24-04; Issuer Restrictions or Prohibitions on Ownership by Securities Intermediaries

Dear Mr. Katz:

The Securities Industry Association ("SIA")[1] Operations Committee appreciates the opportunity to comment on Securities and Exchange Commission ("SEC" or "Commission") proposed Rule 17Ad-20 under the Securities Exchange Act of 1934 ("Exchange Act").[2] The Rule generally would prohibit registered transfer agents from transferring any equity security for a publicly-traded company if such security is subject to any restriction or prohibition on transfer to or from a securities intermediary, such as a clearing agency, bank, or broker-dealer. The Operations Committee strongly supports the proposal and urges the Commission to act quickly to adopt this new Rule.

[1] The Securities Industry Association, established in 1972 through the merger of the Association of Stock Exchange Firms and the Investment Banker's Association, brings together the shared interests of nearly 600 securities firms to accomplish common goals. SIA member firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. According to the Bureau of Labor Statistics, the U.S. securities industry employs 780,000 individuals. Industry personnel manage the accounts of nearly 93 million investors directly and indirectly through corporate, thrift, and pension plans. In 2003, the industry generated an estimated $209 billion in domestic revenue and $278 billion in global revenues. (More information about SIA is available on its home page: www.sia.com.)

[2] Securities and Exchange Commission Release No. 49809 (June 4, 2004), 69 FR 32784.

On a number of occasions over the last several years, the Operations Committee has expressed concern to the Commission when issuers of equity securities imposed restrictions on transfers to intermediaries in order to curtail naked short selling in their ssecurities.[3] The issues typically have been non-Nasdaq issues trading in the over-the-counter market, where there are no listing standards that mandate depository eligibility.[4] The issuers believe that requiring securities to be registered in the name of the beneficial owner and precluding ownership by securities intermediaries forces broker-dealers to deliver securities certificates on each transaction, and eliminates the ability of naked short sellers to maintain a naked short position. Although we appreciate issuers' desire to curb abusive short selling in their stock, we believe that such abuses should be addressed through regulation, and not by issuer-imposed restrictions that will be detrimental to the national clearance and settlement system.[5] In fact, as discussed below, we believe recently adopted rules relating to short sales adequately address the practices that have prompted issuers to attach ownership restrictions.

I. Restrictions on Ownership Are an Impediment to Prompt and Accurate Clearance and Settlement

The Operations Committee strongly agrees with the Commission that issuer efforts to restrict ownership of publicly-traded securities by securities intermediaries is inconsistent with Section 17A of the Exchange Act, which directs the Commission to use its authority to end the physical movement of security certificates in connection with settlement of transactions among brokers and dealers.[6] Pursuant to this directive, the

[3] Short sales, when done in compliance with applicable rules, benefit the markets by providing liquidity and pricing efficiency. Although short selling serves useful market purposes, it also may be used to illegally manipulate stock prices. For example, naked short selling generally refers to situations where a seller sells a security without owning or borrowing the security and does not deliver the security on settlement date. Naked short selling can have a number of negative effects, particularly when the failure to deliver persists for an extended period of time and results in a significantly large unfulfilled delivery obligation at the clearing agency. *See* Securities Exchange Act Release No. 48709 (October 28, 2003), 68 FR 62972 (proposing Regulation SHO relating to short sales).

[4] Securities that trade on exchanges and in the Nasdaq Stock Market are subject to rules requiring depository-eligibility, and members' use of depositories to settle securities transactions is mandated. *See* Securities Exchange Act Release No. 32455 (June 11, 1993), 58 FR 33699 and Securities Exchange Act Release No. 35798 (June 1, 1995), 60 FR 30909.

[5] When a number of issuers sought to withdraw securities issued by them from the Depository Trust Company ("DTC") to impose ownership restrictions, DTC proposed, and the Commission approved, a rule change clarifying that DTC's rules and procedures provide only for participants (*i.e.*, broker-dealers and banks) to submit withdrawal instructions for securities on deposit at DTC, and do not require DTC to comply with withdrawal requests from issuers. Securities Exchange Act Release No. 47978 (June 4, 2003), 68 FR 35037.

[6] 15 U.S.C. 78q-1 *et seq.*

Commission in 1983 approved the registration of several clearing agencies in order to facilitate the immobilization of securities in a registered entity and the settlement of transactions by book-entry movement. The proposed Rule is designed to prohibit restrictions that, in effect, require securities to be certificated and transactions in the securities to be manually cleared, settled, and transferred on a transaction-by-transaction basis, which is contrary to the objectives of Section 17A.

If securities intermediaries are precluded from having securities registered in their name, the use of physical certificates is likely to increase. The high costs and risks associated with processing physical certificates are well-documented.[7] More importantly, physical certificates adversely affect the clearance and settlement process and undermine the industry's long term efforts to streamline securities processing and achieve straight-through processing in the United States.

It is for precisely this reason that self-regulatory organization ("SRO") rules generally require members to use a securities depository for book-entry settlement of all transactions in depository-eligible securities, and require that securities be made depository eligible as part of the market's listing requirements. Consequently, the only companies that will be affected by the proposed Rule are those currently not trading on a national securities exchange or Nasdaq. The Operations Committee has been a staunch supporter over the years of initiatives that serve to increase efficiency and reduce risk in the clearance and settlement process, and we applaud the Commission's effort to level the playing field for all issuers.

II. Issuer Concerns Are Adequately Addressed by Recent Regulatory Initiative

The Commission recently reexamined short sale regulation in light of significant developments in the markets including, among other things, instances of abusive short selling. As a result of this reexamination, the Commission has adopted rules addressing the concerns that issuers have raised about short selling in their securities. Specifically, the Commission has established a uniform rule that specifies the procedures that all short sellers must follow to locate securities for borrowing, and that requires delivery of securities where there is evidence of significant settlement failures.[8] The Operations Committee believes these requirements will enable the Commission to prevent short sale abuses while promoting the prompt and accurate clearance and settlement of securities transactions.

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[7] *See* Securities Exchange Act Release No. 49405 (March 11, 2004), 69 FR 12922 (Concept Release on Securities Transaction Settlement); *see also* Letter to Jonathan G. Katz, Secretary, SEC, from Jeffrey C. Bernstein, Chairman, SIA STP Steering Committee, dated June 16, 2004.

[8] *See* http://www.sec.gov/news/press/2004-87.htm.

Subject to limited exceptions for bona fide market making, new Rule 203 under the Exchange Act will prohibit a broker-dealer from executing a short sale order for its own account or the account of another person, unless the broker-dealer, or the person for whose account the short sale is executed (1) borrowed the security, or entered into an arrangement for the borrowing of the security, or (2) had reasonable grounds to believe that it could borrow the security so that it would be capable of delivering the securities on the date delivery is due. The "locate" must be made and annotated in writing prior to effecting any short sale.

As an additional safeguard against some of the problems associated with naked short selling, Rule 203 imposes other additional requirements on designated "threshold securities." Rule 203 defines a threshold security to mean an equity security for which there is an aggregate "fail to deliver" position for five consecutive settlement days at a registered clearing agency of 10,000 shares or more and that is equal to at least 0.5% of the issue's total shares outstanding. Where a clearing agency participant has a "fail to deliver" position in threshold securities that persists for ten consecutive days after settlement, the participant must take action to close out the position. Until the position is closed out, the participant, and any broker-dealer for which it clears transactions, may not effect further short sales in the particular threshold security without borrowing or entering into a bona fide arrangement to borrow the security.

We believe these new requirements will substantially curtail naked short selling far more effectively than efforts to impose restrictions on ownership would, without the severe inefficiencies in the clearance and settlement process that such ownership restrictions would create. Given the availability of this much more effective regulatory approach, we believe proposed Rule 17Ad-20 is necessary to prohibit ownership restrictions and to protect the operation of the national clearance and settlement system.

III. Conclusion

The Operations Committee strongly supports proposed Rule 17Ad-20. We applaud the Commission for acting to address issuer-imposed restrictions that harm the national clearance and settlement system, and for addressing through new regulations the problems of naked short selling and extended "fails to deliver" positions.

We thank you for the opportunity to comment. If we can provide additional information, or if you would like to discuss our views further, please contact the undersigned or Richard Bommer, Director of Operations, at 212.608.1500.

Sincerely,

Ernest A. Pittarelli
Chairman

SIA Operations Committee

CC: Annette L. Nazareth, Director, Division of Market Regulation ("MR")
Robert L.D. Colby, Deputy Director, MR
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