

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-54290; File No. SR-Amex-2006-40]

### Self-Regulatory Organizations; American Stock Exchange LLC; Order Granting Approval of a Proposed Rule Change Relating to Direct Registration System Eligibility Requirements

August 8, 2006.

#### I. Introduction

On April 28, 2006, the American Stock Exchange LLC (“Amex”) filed with the Securities and Exchange Commission (“Commission”) proposed rule change SR-Amex-2006-40 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”).<sup>1</sup> Notice of the proposal was published in the *Federal Register* on June 7, 2006.<sup>2</sup> Two comment letters were received.<sup>3</sup> For the reasons discussed below, the Commission is granting approval of the proposed rule change.<sup>4</sup>

#### II. Description

The Direct Registration System (“DRS”) allows an investor to establish either through the issuer’s transfer agent or through the investor’s broker-dealer a book-entry position on the books of the issuer and to electronically transfer her position between the transfer agent and the broker-dealer of her choice through a facility currently administered by The Depository Trust Company (“DTC”).<sup>5</sup>

DRS, therefore, enables an investor to have securities registered in her name without having a securities certificate issued to her and to electronically transfer her securities to her broker-dealer in order to effect a transaction without the risk and delays associated with the use of securities certificates.

Investors holding their securities in DRS retain the rights associated with securities certificates, including such rights as control of ownership and voting rights, without having the responsibility of holding and safeguarding securities certificates. In addition, in corporate actions such as reverse stock splits and mergers, cancellation of old shares and issuance of new shares are handled electronically with no securities certificates to be returned to or received from the transfer agent.

In order to reduce the number of transactions in securities for which settlement is effected by the physical delivery of securities certificates and thereby reduce the risks, costs, and delays associated with the physical delivery of securities certificates, Amex is amending its listing requirements to add new Rule 778 to its Rules and new Section 135 to its Company Guide.<sup>6</sup> These provisions will require certain listed companies to make their securities eligible for a DRS operated by a securities depository.<sup>7</sup> Specifically, Amex’s rule change will require (i) all securities (other than the securities identified below) initially listing on Amex on or after January 1, 2007, to be eligible for a DRS and (ii) all securities (other than the securities identified below) listed on Amex on and after January 1, 2008, to be eligible for a DRS. The initial listing requirement set forth in (i) above will not apply to securities of issuers that already have securities listed on the Amex, securities of issuers that immediately prior to such initial Amex listing had securities listed on another national securities exchange, derivative products,<sup>8</sup> or securities (other than stocks) which are book-entry-only. The ongoing listing requirement set

forth in (ii) above will not apply to derivative products or securities (other than stocks) which are book-entry-only.

#### III. Comment Letters

The Commission received two comment letters in support of the proposed rule change.<sup>9</sup> The SIA Operations Committee (“SIA”), an industry organization representing broker-dealers, stated that the effect of the proposed rule change will be to reduce significantly the number of transactions in securities for which settlement is effected by the physical delivery of securities certificates thereby reducing costs, risks, and delays associated with physical settlement. The SIA also contended that by increasing the number of DRS-eligible securities, the proposed rule change is an important step in reducing the number physical certificates, a goal the SIA has long supported in its efforts to promote immobilization and dematerialization.

Computershare, a registered transfer agent, stated that the proposed rule change will help immobilize and eventually dematerialize certificates in the U.S. market, which it believes will result in benefits such as cost savings, increased efficiency, more accurate and timely trade settlements, and reduced risk of loss for investors. Computershare noted however that some challenges remain to be overcome in the broker-dealer community before these benefits can be realized. For example, Computershare contended, among other things, that broker-dealers are not sufficiently educating their employees or their customers about the inherent risks associated with owning certificates or the benefits of owning in DRS. In addition, Computershare stated that certain current industry processing practices also need to be changed. Specifically, it believes that the industry should “default to DRS,” a process whereby customers of broker-dealers would obtain only a statement of their positions held on the issuer’s records rather than a certificate unless the customer contacted the issuer’s transfer agent directly to obtain a certificate. Computershare urged the Commission to review and modify current regulation to address these issues.

#### IV. Discussion

Section 6(b)(5) of the Act requires, among other things, that the rules of an

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> Securities Exchange Act Release No. 53911 (May 31, 2006), 71 FR 33009 (June 7, 2006) [File No. SR-Amex-2006-40].

<sup>3</sup> Letters from Noland Cheng, Chairman, SIA Operations Committee, Securities Industry Association (June 27, 2006) and Paul Conn, President, Global Capital Markets, Computershare Limited, and Charlie Rossi, Executive Vice President, Computershare Investor Services (July 28, 2006).

<sup>4</sup> Concurrent with the Commission’s approval of NYSE’s rule change, the Commission is also approving in separate orders similar rule changes proposed by the New York Stock Exchange LLC (“NYSE”) and The NASDAQ Stock Market LLC (“Nasdaq”). Securities Exchange Act Release Nos. 54289 (August 8, 2006) [File No. SR-NYSE-2006-29] and 54288 (August 8, 2006) [File No. SR-NASDAQ-2006-008]. The Commission has also published notice of a similar rule change proposed by NYSE Arca, Inc. Securities Exchange Act Release No. 54126 (July 11, 2006), 71 FR 40768 (July 18, 2006) [File No. SR-NYSEArca-2006-31].

<sup>5</sup> Currently, the only registered clearing agency operating a DRS is DTC. For a detailed description of DRS and the DRS facilities administered by DTC, see Securities Exchange Act Release Nos. 37931 (November 7, 1996), 61 FR 58600 (November 15, 1996), [File No. SR-DTC-96-15] (order granting approval to establish DRS) and 41862 (September 10, 1999), 64 FR 51162 (September 21, 1999), [File No. SR-DTC-99-16] (order approving implementation of the Profile Modification System).

<sup>6</sup> The exact text of the Amex proposed rule change is set forth in its filing, which can be found at <http://www.amex.com>.

<sup>7</sup> The term “securities depository” is defined as a securities depository registered as a clearing agency under Section 17A(b)(2) of the Act. See note 5.

<sup>8</sup> As defined in Article 1, Section 3(d) of Amex’s Constitution, the term “derivative products” includes in addition to standardized options, other securities which are issued by The Options Clearing Corporation or another limited purpose entity or trust and which are based solely on the performance of an index or portfolio of other publicly traded securities. The term “derivative products” does not include warrants of any type or closed-end management investment companies.

<sup>9</sup> *Supra* note 3. The SIA and Computershare’s comment letters were written in support of the three similar proposed rule changes filed by Amex, Nasdaq, and NYSE. *Supra* note 4. The NYSE Arca’s proposed rule change was noticed by the Commission subsequent to the date the commenters submitted their comment letters.

exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.<sup>10</sup> For the reasons described below, the Commission finds that the rule change is consistent with Section 6(b)(5) of the Act.

The use of securities certificates has long been identified as an inefficient and risk-laden mechanism by which to hold and transfer ownership.<sup>11</sup> Because securities certificates require manual processing, their use can result in significant delays and expenses in processing securities transactions and present the risk of certificates being lost, stolen, or forged. Many of these costs and risks are ultimately borne by investors.<sup>12</sup> Congress has recognized the problems and dangers that the use of certificates presents to the safe and efficient operation of the U.S. clearance and settlement system and has given the Commission responsibility and authority to address these issues.<sup>13</sup>

Consistent with its Congressional directives, in its efforts to improve efficiencies and decrease risks associated with processing securities transactions, the Commission has long advocated a reduction in the use of certificates in the trading environment by immobilizing or dematerializing securities and has encouraged the use of alternatives to holding securities in certificated form. Among other things, the Commission has approved the rule filings of self-regulatory organizations that require their members to use the facilities of a securities depository for the book-entry settlement of all transactions in depository-eligible securities<sup>14</sup> and that require any

security listed for trading must be depository eligible if possible.<sup>15</sup> More recently the Commission has approved the implementation and expansion of DRS.<sup>16</sup>

While the U.S. markets have made great progress in immobilization and dematerialization for institutional and broker-to-broker transactions, many industry representatives believe that the small percentage of securities held in certificated form (mostly by retail customers of broker-dealers) impose unnecessary risk and disproportionately large expense to the industry and to investors. In an attempt to address this issue, Amex's rule change, along with those of the NYSE and Nasdaq, should help expand the use of DRS. As a result, risks, costs, and processing inefficiencies associated with the physical delivery of securities certificates should be reduced, and the perfection of the national market system should be promoted. Additionally, those investors holding securities in listed securities covered by the rule change that decide to hold their securities in DRS should realize the benefits of more accurate, quicker, and more cost-efficient transfers; faster distribution of sale proceeds; reduced number of lost or stolen certificates and a reduction in the associated certificate replacement costs;

York Stock Exchange, National Association of Securities Dealers, American Stock Exchange, Midwest Stock Exchange, Boston Stock Exchange, Pacific Stock Exchange, and Philadelphia Stock Exchange to use the facilities of a securities depository for the book-entry settlement of all transactions in depository-eligible securities with another financial intermediary).

<sup>15</sup> Securities Exchange Act Release No. 35798 (June 1, 1995), 60 FR 30909 (June 12, 1995), [File Nos. SR-Amex-95-17; SR-BSE-95-09; SR-CHX-95-12; SR-NASD-95-24; SR-NYSE-95-19; SR-PSE-95-14; SR-PHLX-95-34] (order approving rules setting forth depository eligibility requirements for issuers seeking to have their shares listed on the exchange).

<sup>16</sup> In 1996, the NYSE modified its listing criteria to permit listed companies to issue securities in book entry form provided that the issue is included in DRS. Securities Exchange Act Release No. 37937 (November 8, 1996), 61 FR 58728 (November 18, 1996), [File No. SR-NYSE-96-29]. Similarly, the NASD modified its rule to require that if an issuer establishes a direct registration program, it must participate in an electronic link with a securities depository in order to facilitate the electronic transfer of the issue. Securities Exchange Act Release No. 39369 (November 26, 1997), 62 FR 64034 (December 3, 1997), [File No. SR-97-51]. On July 30, 2002, the Commission approved a rule change proposed by the NYSE to amend Section 501.01 of the NYSE Listed Company Manual to allow a listed company to issue securities in a dematerialized or completely immobilized form and therefore not send stock certificates to record holders provided the company's stock is issued pursuant to a dividend reinvestment program, stock purchase plan, or is included in DRS. Securities Exchange Act Release No. 46282 (July 30, 2002), 67 FR 50972 (August 6, 2002), [File No. SR-NYSE-2001-33].

and consistency of owning in book-entry across asset classes.

The Commission realizes that some issuers and transfer agents may bear expenses related to complying with the rule change. In order to make a security DRS-eligible, issuers of listed companies must have a transfer agent which is a DRS Limited Participant.<sup>17</sup> In order to make an issue DRS-eligible, issuers may need to amend their corporate governing documents to permit the issuance of book-entry shares. The Commission believes, however, that the long-term benefits of increased efficiencies and reduced risks afforded by DRS outweigh the costs that some issuers and transfer agents may incur. Furthermore, the time frames built into the proposal should allow issuers sufficient time to make any necessary changes to comply with the rule change.

While the propose rule change should significantly reduce the number of transactions in securities for which settlement is effected by the physical delivery of securities certificates, the proposed rule change will not eliminate the ability of investors to obtain securities certificates after the settlement of securities transactions provided the issuer has chosen to issue certificates. Such investors can continue to contact the issuer's transfer agent, either directly or through their broker-dealer, to obtain a securities certificate.

Accordingly, for the reasons stated above the Commission finds that the rule change is consistent with Amex's obligation under Section 6(b) of the Act to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

## V. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act and in particular with the requirements of Section 6(b)(5) of the Act and the rules and regulations thereunder.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-Amex-2006-40) be and hereby is approved.

<sup>17</sup> For a description of DTC's rules relating to DRS Limited Participants, see Securities Exchange Act Release Nos. 37931 and 41862. *Supra* note 5.

<sup>18</sup> 17 CFR 200.30-3(a)(12).

<sup>10</sup> 15 U.S.C. 78f(b)(5).

<sup>11</sup> Securities Exchange Act Release No. 49405 (March 11, 2004), 69 FR 12922 (March 18, 2004), [File No. S7-13-04] (Securities Transaction Settlement Concept Release).

<sup>12</sup> *Id.*

<sup>13</sup> 15 U.S.C. 78q-1(a)(2)(A). Congress expressly envisioned the Commission's authority to extend to all aspects of the securities handling process involving securities transactions within the United States, including activities by clearing agencies, depositories, corporate issuers, and transfer agents. See S. Rep. No. 75, 94th Cong., 1st Sess. at 55 (1975).

<sup>14</sup> Securities Exchange Act Release No. 32455 (June 11, 1993), 58 FR 33679 (June 18, 1993) (order approving rules requiring members, member organizations, and affiliated members of the New

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>18</sup>

Nancy M. Morris,  
Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-54291; File No. SR-BSE-2006-30]

### Self-Regulatory Organizations; Boston Stock Exchange, Inc.; Notice of Filing of Proposed Rule Change Relating to the Implementation of the Second Phase of the Boston Equities Exchange ("BeX") Trading System

August 8, 2006.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on August 3, 2006, the Boston Stock Exchange ("BSE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the BSE. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

In previous rule filings, BSE proposed to establish the governance framework for a new electronic trading facility, as that term is defined in Section 3(a)(2) of the Act,<sup>3</sup> which is to be called BeX,<sup>4</sup> and to propose rules that pertain to the first phase of BeX.<sup>5</sup> The first phase of the BeX trading system involves a fully automated electronic book for the display and execution of orders in securities listed otherwise than on The

Nasdaq Stock Market for which the BSE obtains unlisted trading privileges ("UTP") after June 30, 2006.

The proposed rules set forth below are being filed in connection with the implementation of the second phase of the BeX trading system. As of January 1, 2007, there will no longer be any specialist participation in any transactions on the BSE or otherwise. Additionally, in connection with satisfying the requirements of Regulation NMS, the BSE is proposing eight new order types; rules to prevent locked or crossed quotations; a new order routing system; and an order protection rule. The text of the proposed rule change is available on Exchange's Web site (<https://www.bostonstock.com>), at the Exchange's Office of the Secretary, and at the Commission's Public Reference Room.

The text of the proposed rule change also appears below. Proposed new language is italicized; deleted language is in [brackets].<sup>6</sup>

#### Rules of the Boston Stock Exchange Chapter XXXVII—Boston Equities Exchange ("BeX") Trading System

The Boston Equities Exchange ("BeX") trading system is a fully-automated facility of the Exchange, which allows eligible orders in eligible securities to electronically match and execute against one another.

##### Section 1. BeX Eligible Securities

(a) Eligible Securities. All securities eligible for trading on the Exchange [that are listed otherwise than on The Nasdaq Stock Market for which the BSE obtains unlisted trading privileges ("UTP") after June 30, 2006] shall be eligible for trading through BeX. Any specialist request to remove a security from BeX shall be considered by the appropriate Board Committee.

##### Section 2. Eligible Orders

Subsections (a) through (b)—no change.

(c) Eligible order types:

(i) Orders eligible for execution in BeX may be designated as one of the following existing BSE order types as defined in Chapter I, Section 3 except that any reference in the existing BSE Rules to the execution of Orders as soon as "represented at the specialist's post" shall for purposes of this Section be understood to mean "entered in BeX":

- (A) At the Opening or At the Opening Only Order.
- (B) Day Order.
- (C) Do Not Increase (DNI).
- (D) Do Not Reduce (DNR).
- (E) Fill or Kill.
- (F) Good 'Till Cancel Order.
- (G) Immediate or Cancel.
- (H) Limit, Limited Order or Limited Price Order.
- (I) At the Close.
- (J) Market Order.
- (K) Stop Limit Order.
- (L) Stop Order.

With the exception of Fill or Kill and Immediate or Cancel Orders, a customer may append to an Order an instruction that the Order be routed to the market(s) displaying the National Best Bid or Offer if the Order would trade through the National Best Bid or Offer if executed on the BeX. *Absent such an instruction, the order will be cancelled.*

(ii) Orders eligible for execution in BeX may also be designated as one of the following additional order types:

(A) "Cross": An order to buy and sell the same security at a specific price better than the best bid and offer displayed in BeX and equal to or better than the National Best Bid and Offer. A Cross Order may represent interest of one or more BSE Members.

(B) "Cross with Size": A Cross Order to buy and sell at least 5,000 shares of the same security with a market value of at least \$100,000.00 (i) at a price equal to or better than the best bid or offer displayed in BeX and the National Best Bid or Offer and (ii) where the size of the order is larger than the *largest order* [aggregate size of all interest] displayed in BeX at that price.; and (iii) where neither side of the order is for the account of the BSE Member sending the order to BeX.]

(C) "Good 'Till Date (GTD)": An order to buy or sell that, if not executed, expires at the end of date specified in the order.

(D) "Good 'Till Time (GTT)": An order to buy or sell that, if not executed, expires at the time specified in the order.

(E) "Limit or Close": A limit order to buy or sell that if not executed prior to the Market on Close cutoff time of 3:40 p.m., pursuant to Chapter II, Section 22, will automatically convert to an At the Close Order for inclusion in the closing process and if not so executed, at the close, will be cancelled.

(F) "Mid-Point Cross": A two-sided order with both a buy and sell component combined that executes at the midpoint of the National Best Bid or Offer. A Mid-point Cross Order will be rejected when a locked or crossed

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Under the Act, the "term 'facility' when used with respect to an exchange includes its premises, tangible or intangible property whether on the premises or not, any right to the use of such premises or property or any service thereof for the purpose of effecting or reporting a transaction on an exchange (including, among other things, any system of communication to or from the exchange, by ticker or otherwise, maintained by or with the consent of the exchange), and any right of the exchange to the use of any property or service." See 15 U.S.C. 78c(a)(2).

<sup>4</sup> See Securities Exchange Act Release No. 54035 (June 22, 2006), 71 FR 37135 (June 29, 2006) (SR-BSE-2006-20) ("BeX Governance Filing").

<sup>5</sup> See Securities Exchange Act Release No. 54034 (June 22, 2006), 71 FR 37140 (June 29, 2006) (SR-BSE-2006-22) ("BeX Facility Filing").

<sup>6</sup> For clarity, the rule text below treats the rule text proposed in the BeX Facility Filing as existing rule text even though that filing has not been approved by the Commission.