

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-55481; File No. SR-CHX-2006-33]

### Self-Regulatory Organizations; Chicago Stock Exchange, Inc.; Order Granting Approval of a Proposed Rule Change Amending Rules To Require Listed Companies To Make Securities Eligible for the Direct Registration System

March 15, 2007.

#### I. Introduction

On October 30, 2006, the Chicago Stock Exchange, Inc. ("CHX") filed with the Securities and Exchange Commission ("Commission") proposed rule change SR-CHX-2006-33 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 December 7, 2006.<sup>2</sup> No comment letters were received. For the reasons discussed below, the Commission is granting approval of the proposed rule change.<sup>3</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>4</sup>

DRS, therefore, enables an investor to have securities registered in her name on the books of the issuer 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, expenses, 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.

To reduce the number of transactions in securities for which settlement is effected by the physical delivery of securities certificates to and reduce the risks, costs, and delays associated with the physical processing of securities certificates, the CHX is amending its listing standards by adding paragraph (h) to Rule 1<sup>5</sup> that would require certain issuers to make their securities eligible for DRS. As amended, the new rule would require that any security initially listing on CHX on or after January 1, 2007, must be eligible for a DRS that is operated by a securities depository.<sup>6</sup> This requirement, however, would not extend to i) securities of companies which already have securities listed on CHX, ii) securities of companies which immediately prior to such listing had securities listed on another national securities exchange, iii) derivative products, or iv) securities (other than stocks) which are book-entry only. Under the rule, on and after January 1, 2008, all securities listed on CHX must be eligible for a DRS that is operated by a securities depository.<sup>7</sup>

CHX understands that issuers and transfer agents may incur initial costs when making an issue DRS-eligible. As an initial matter, the issuer must have a transfer agent that is a DRS Limited

Participant.<sup>8</sup> Transfer agents will need to meet certain DTC criteria, such as insurance and connectivity requirements in order to become DRS Limited Participants and an issuer's corporate documents, such as its bylaws or corporate charters, may need to be amended to permit the issuance of book-entry shares. CHX believes that the proposed deadlines as set forth above would allow issuers and transfer agents an appropriate amount of time to meet applicable requirements.

#### III. Discussion

Section 6(b)(5) of the Act requires, among other things, that the rules of an 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>9</sup> For the reasons described below, the Commission finds that CHX's 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>10</sup> Because securities certificates require manual processing, their use can result in significant delays and expenses in processing securities transactions and presents the risk of certificates being lost or stolen. Many of these costs and risks are ultimately borne by investors.<sup>11</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 the responsibility and the authority to address these issues.<sup>12</sup>

<sup>8</sup> DTC's rules require that a transfer agent (including an issuer acting as its own transfer agent) acting for a company issuing securities in DRS must be a DRS Limited Participant. Securities Exchange Act Release No. 37931 (November 7, 1996), 61 FR 58600 (November 15, 1996), [File No. SR-DTC-96-15].

<sup>9</sup> 15 U.S.C. 78f(b)(5).

<sup>10</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>11</sup> *Id.*

<sup>12</sup> 5 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 of securities transactions within the United States, including activities by clearing agencies, depositories, corporate issuers, and transfer agents.

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

<sup>2</sup> Securities Exchange Act Release No. 54833 (November 29, 2006), 71 FR 71004 (December 7, 2006) [File No. SR-CHX-2006-33].

<sup>3</sup> Concurrent with this order, the Commission is approving similar rule changes submitted by the Boston Stock Exchange, Inc., and Philadelphia Stock Exchange, Inc. Securities Exchange Act Release Nos. 54832 (November 29, 2006), 71 FR 71000 (December 7, 2006) [File No. SR-BSE-2006-46] and 54834 (November 29, 2006), 71 FR 71013 (December 7, 2006) [File No. SR-Phlx-2006-69]. The Commission has also granted approval to similar rule changes submitted by the New York Stock Exchange LLC ("NYSE"), American Stock Exchange LLC ("Amex"), The NASDAQ Stock Market LLC ("Nasdaq"), and the NYSE Arca, Inc. ("NYSE Arca"). Securities Exchange Act Release Nos. 54289 (August 8, 2006), 71 FR 47278 (August 16, 2006) [File No. SR-NYSE-2006-29]; 54290 (August 8, 2006), 71 FR 47262 (August 16, 2006) [File No. SR-Amex-2006-40]; 54288 (August 8, 2006), 71 FR 47276 (August 16, 2006) [File No. SR-NASDAQ-2006-08]; 54410 (September 7, 2006), 71 FR 54316 (September 14, 2006) [File No. SR-NYSE Arca-2006-31].

<sup>4</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>5</sup> The exact text of the CHX proposed rule change is set forth in its filing, which can be found at [http://www.chx.com/rules/proposed\\_rules.htm](http://www.chx.com/rules/proposed_rules.htm).

<sup>6</sup> Under the proposed rule, a "securities depository" would mean a securities depository registered as a clearing agency under Section 17A(b)(2) of the Act.

<sup>7</sup> Securities (other than stock) that are book-entry-only and derivative products would continue to be excluded from the DRS requirement.

Consistent with its Congressional directives and 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 immobilization or dematerialization of 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>13</sup> and that require any security listed for trading must be depository eligible if possible.<sup>14</sup> More recently the Commission has approved the implementation and expansion of DRS.<sup>15</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 (held mostly by retail

See S. Rep. No. 75, 94th Cong., 1st Sess. at 55 (1975).

<sup>13</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 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>14</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>15</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 NYSE 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 or a stock purchase plan or is included in a DRS. Securities Exchange Act Release No. 46282 (July 30, 2002), 67 FR 50972 (August 6, 2002), [File No. SR-NYSE-2001-33].

investors) impose unnecessary risk and disproportionately large expense to the industry and to investors. In an attempt to help address this issue, CHX's rule change, along with those of the NYSE, Amex, Nasdaq, NYSE Arca, BSE, and Phlx, should help expand the use of DRS. As a result, risks, costs, and processing inefficiencies associated with the use of securities certificates should be reduced, and impediments to the perfection of the national market system should be removed. Additionally, those investors holding securities in listed securities certificates 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; 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 an issue DRS-eligible, issuers of listed companies must have a transfer agent which is a DRS Limited Participants and 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 costs and 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 and their transfer agents sufficient time to make any necessary changes to comply with the rule change.

While the rule change should significantly reduce the number of transactions in securities for which settlement is effected by the physical delivery of securities certificates, it will not eliminate the ability of investors to obtain securities certificates 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 CHX'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.<sup>16</sup>

#### IV. 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-CHX-2006-33) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>17</sup>

**Florence E. Harmon,**  
*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-55482; File No. SR-Phlx-2006-69]

### Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Order Granting Approval of a Proposed Rule Change Amending Rules Relating to the Direct Registration System

March 15, 2007.

#### I. Introduction

On October 31, 2006, the Philadelphia Stock Exchange, Inc. ("Phlx") filed with the Securities and Exchange Commission ("Commission") and on November 14, 2006, amended proposed rule change SR-Phlx-2006-69 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 December 7, 2006.<sup>2</sup> No comment letters were received. For the reasons discussed below, the Commission is granting approval of the proposed rule change.<sup>3</sup>

<sup>16</sup> In approving the proposed rule change, the Commission considered the proposal's impact on the efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

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

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

<sup>2</sup> Securities Exchange Act Release No. 54834 (November 29, 2006), 71 FR 71013 (December 7, 2006) [File No. SR-Phlx-2006-69].

<sup>3</sup> Concurrent with this order, the Commission is approving similar rule changes submitted by the Boston Stock Exchange, Inc., and Chicago Stock Exchange, Inc. Securities Exchange Act Release Nos. 54832 (November 29, 2006), 71 FR 71000 (December 7, 2006) [File No. SR-BSE-2006-46] and 54833 (November 29, 2006), 71 FR 71004 (December 7, 2006) [File No. SR-CHX-2006-33].