

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-54288; File No. SR-NASDAQ-2006-008)

August 8, 2006

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Order Granting Approval of a Proposed Rule Change Requiring Securities be Eligible to Participate in a Direct Registration System

I. Introduction

On April 27, 2006, The NASDAQ Stock Market LLC (“Nasdaq”) filed with the Securities and Exchange Commission (“Commission”) proposed rule change SR-NASDAQ-2006-008 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”).¹ Notice of the proposal was published in the Federal Register on June 7, 2006.² Two comment letters were received.³ For the reasons discussed below, the Commission is granting approval of the proposed rule change.⁴

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

¹ 15 U.S.C. 78s(b)(1).

² Securities Exchange Act Release No. 53913 (May 31, 2006), 71 FR 33024 (June 7, 2006) [File No. SR-NASDAQ-2006-008].

³ 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).

⁴ Concurrent with the Commission’s approval of Nasdaq’s rule change, the Commission is also approving in separate orders similar rule changes proposed by the American Stock Exchange LLC (“Amex”) and the New York Stock Exchange LLC (“NYSE”). Securities Exchange Act Release Nos. 54290 (August 8, 2006) [File No. SR-Amex-2006-40] and 54289 (August 8, 2006) [File No. SR-NYSE-2006-29]. 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].

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”).⁵ 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, Nasdaq is proposing to add new Section (l) to its Rule 4350 to require that all listed securities be eligible to participate in DRS.⁶

⁵ 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).

⁶ The exact text of the Nasdaq proposed rule change is set forth in its filing, which can be found at http://www.complinet.com/nasdaq/display/display.html?rbid=1705&element_id=26.

While the rule change requires that issuers' securities be eligible for DRS, it does not require issuers to participate in DRS operated by DTC and would not mandate the elimination of physical certificates. As a result, subject to applicable state law and the company's governing documents, an investor could still elect to receive a certificate if the issuer chose to make certificates available.

Because currently the only DRS operated by a registered clearing agency is the DRS operated by DTC, in order for a security to be eligible to participate in DRS, an issuer will be required to use a transfer agent that meets DTC's DRS transfer agent requirements, including insurance and connectivity requirements. As a result, some transfer agents acting for Nasdaq issuers may have to make changes to comply with these requirements. Certain issuers may also have to make amendments to their governing documents, such as their by-laws, to be eligible to issue securities that are not represented by certificates. To allow sufficient time for any of these changes that need to take place, Nasdaq will implement the proposed rule change January 1, 2008, for the securities of issuers with securities already listed on Nasdaq or another listed marketplace at the time the rule change is approved. Companies listing for the first time should have greater flexibility to adopt any changes required to have their securities DRS eligible, and therefore, the rule change will be applicable to new listings beginning January 1, 2007. The requirement will not apply to non-equity securities that are held in book-entry-only form.

III. Comment Letters

The Commission received two comment letters in support of the proposed rule change.⁷ 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

⁷ 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.

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 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.⁸ 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.⁹ 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.¹⁰ 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

⁸ 15 U.S.C. 78f(b)(5).

⁹ 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).

¹⁰ Id.

settlement system and has given the Commission responsibility and authority to address these issues.¹¹

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 securities¹² and that require any security listed for trading must be depository eligible if possible.¹³ More recently the Commission has approved the implementation and expansion of DRS.¹⁴

¹¹ 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).

¹² 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).

¹³ 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).

¹⁴ 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-

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, Nasdaq's rule change, along with those of Amex and the NYSE, 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; 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

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].

companies must have a transfer agent which is a DRS Limited Participant.¹⁵ 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 proposed 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 Nasdaq'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 .

¹⁵ For a description of DTC's rules relating to DRS Limited Participants, see Securities Exchange Act Release Nos. 37931 and 41862. Supra note 5.

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-NASDAQ-2006-008) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.¹⁶

Nancy M. Morris
Secretary

¹⁶ 17 CFR 200.30-3(a)(12).