FEDERAL TRADE COMMISSION

16 CFR Part 313

Privacy of Customer Financial Information—Security

AGENCY: Federal Trade Commission.

ACTION: Notice of extension of comment period.

SUMMARY: The Federal Trade Commission (''Commission'' or ''FTC'') has extended the time for submitting comments on developing the information safeguards rule that the Commission must issue under section 501(b) of the Gramm-Leach-Bliley Act (the ''G–L–B Act'' or ''Act'').

DATES: Comments must be received on or before October 24, 2000.

ADDRESSES: Written comments should be addressed to: Secretary, Federal Trade Commission, Room H–159, 600 Pennsylvania Avenue, NW., Washington, DC 20580. The Commission requests that commenters submit the original plus five copies, if feasible. Comments should also be submitted, if possible, in electronic form, on either a 5¼ or a 3½ computer disk, with a disk label stating the name of the commenter and the name version of the word processing program used to create the document. (Programs based on DOS or Windows are preferred. Files from other operating systems should be submitted in ASCII format.) Alternatively, the Commission will accept comments submitted to the following e-mail address: *GLB501Rule@ftc.gov.* Those commenters submitting comments by e-mail are advised to confirm receipt by consulting the postings on the Commission's website at www.ftc.gov. In addition, commenters submitting comments by e-mail are requested to indicate whether they are also providing their comments in other formats. Individuals needs not submit multiple copies or comments in electronic form. All submissions should be captioned ''G–L–B Act Privacy Safeguards Rule Comment.''

FOR FURTHER INFORMATION CONTACT: Laura Berger, Attorney, Division of Financial Practices, Federal Trade Commission, Washington, DC 20580, 202–326–3224.

SUPPLEMENTARY INFORMATION: On September 7, 2000, the FTC sought comment on developing the rule that Section 501(b) of the G–L–B Act requires it to establish for financial institutions subject to its jurisdiction. The Rule will establish standards pertaining to administrative, technical, and physical safeguards for nonpublic customer records and information. (''Safeguard Rule''). 65 FR 54186. As required by the G–L–B Act, the Safeguards Rule will seek to bolster the security and confidentiality of customer records and information, to protect against any anticipated threats or hazards to their security or integrity, and to protect against unauthorized access to or use of such records or information which could result in substantial harm or inconvenience to any customer. The comment period is currently scheduled to close on October 10, 2000.

The National Association for Attorneys General has asked that the comment period be extended to enable the Association to consult its members and complete a comment on the Safeguards Rule. The Commission is mindful of the need to develop a proposed Safeguards Rule expeditiously. However, the Commission also is aware that the issues raised are complex and believes that the additional comments that may result justify a short extension of the comment period.

Accordingly, the Commission has decided to extend the comment period to October 24, 2000.

By Direction of the Commission.

Donald S. Clark,

Secretary.

[FR Doc. 00–25660 Filed 10–5–00; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34–43401; File No. S7–18–00]

RIN 3235–AH94

Processing Requirements for Cancelled Security Certificates

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rulemaking.

SUMMARY: The Commission is publishing for comment proposed rules to improve the processing of securities certificates by transfer agents. Proposed Rule 17Ad–19 under the Securities Exchange Act of 1934 would require every transfer agent to establish and implement written procedures for the cancellation, storage, transportation, and destruction of securities certificates. The rule would also require transfer agents to: Mark each cancelled securities certificate with the word ''cancelled''; maintain a secure storage area for cancelled certificates; have specific procedures for the destruction of cancelled certificates, and maintain an electronic database of all of its cancelled certificates. Additionally, the Commission proposes to codify that Rules 17f–1 (the lost and stolen securities rule) and 17Ad–12 (the transfer agent safekeeping rule) apply to cancelled certificates.

DATES: Comments should be received on or before December 5, 2000.

ADDRESSES: Comments should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609. Comment letters should refer to File No. S7–18–00. All comment letters received will be made available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, NW., Washington, DC 20549–0102. Comments also may be submitted electronically at the following E-mail address: *rule_comments@sec.gov.* All comment letters should refer to File Number S7–18–00, this file number should be included on the subject line if E-mail is used. Comment letters will be available for inspection and copying in the public reference room at the same address. Electronically submitted comment letters will be posted on the Commission's Internet web site (http://www.sec.gov).

FOR FURTHER INFORMATION CONTACT: Jerry W. Carpenter, Assistant Director, or Thomas C. Etter, Jr., Special Counsel, at (202) 942–4187, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–1001.

SUPPLEMENTARY INFORMATION

I. Introduction

In this release, we propose rules to require transfer agents to establish written procedures for the cancellation, storage, transportation, and destruction of securities certificates. Additionally, we propose to require the tracking of securities in transit between reporting institutions; to set a time frame for making inquiries about possible lost, stolen, missing, or counterfeit securities certificates; and to define related terms in the transfer agent rules. The amendments would clarify that cancelled certificates fall within the Commission's Lost and Stolen Securities Program and that they must be safeguarded.[1]

[1] In a separate release, we have proposed to allow registered transfer agents to use electronic media and microfiche for recordkeeping purposes. By providing more flexibility for the storage of cancelled certificates, transfer agents could destroy certificates at the time they are cancelled thereby

These proposals promote several fundamental Commission goals: (1) Improving the safety and efficiency of securities processing and transfer; (2) reducing the physical movement of securities certificates; and (3) reducing the potential for fraudulent use of cancelled securities certificates. The proposals primarily relate to problems and costs associated with cancelled securities certificates. In particular, we address the problem that, until properly destroyed, cancelled securities certificates can resurface in the market place and can be used to defraud members of the public or financial institutions. Better procedures for processing and destroying cancelled certificates would reduce this potential for harm.

II. Background

When a security certificate is retired, such as when a bond is redeemed or ownership of stock is transferred, it is cancelled by the transfer agent. Cancellation normally involves both an accounting entry on the books of the transfer agent and an alteration of the certificate itself. Any registered cancelled certificate must then be stored for not less than six years under the record retention rules [2] of the Securities Exchange Act of 1934 (''Exchange Act'').[3] Thereafter, the certificate may be destroyed.[4] In recent years, many corporate bond issues have been called for redemption decades before their maturities.[5] These bond redemptions and an active stock market have generated vast amounts of cancelled securities certificates that must be shipped, stored, safeguarded, and tracked.

Certificate processing can involve significant warehousing costs and risks. The following examples illustrate some of these risks.

In a 1992 case, approximately $111 billion face amount of cancelled bond certificates disappeared after being delivered from a transfer agent's warehouse to a certificate destruction vendor. The certificates, representing many well-known public companies, later began to resurface worldwide. A number of banks and brokers as well as individuals were defrauded through sales of the cancelled certificates for cash or through use of the cancelled certificates as loan collateral. The bulk of these cancelled certificates still remain unaccounted for and continue to resurface in the marketplace.[6]

In a similar 1994 case, approximately $6 billion face amount of cancelled bond certificates disappeared after being delivered from a transfer agent's record center to two certificate destruction vendors. The cancelled certificates, which represented well-known companies, later began to circulate worldwide. Again, the bulk of these cancelled certificates remain unaccounted for and continue to resurface in the marketplace.[7]

In another instance, cancelled certificates were stolen from a transfer agent's shipping bags while in transit. The transfer agent regularly shipped cancelled certificates from the West Coast to a New York bank for processing. The transfer agent, however, did not record the contents of its shipments and, in effect, relied on its processing agent to do its bookkeeping. When the shipping bags were stolen, neither the transfer agent nor its processing agent realized that the certificates were missing. A number of the certificates resurfaced more than a month after the theft in off-market sales.[8]

Other instances have involved bulk thefts of cancelled certificates from warehouses. In some cases, the records of the certificate numbers also were stolen because they were stored with the certificates. Even in cases where certificate records for stolen securities were available, they generally were of limited value in identifying the stolen securities because the records were manual, rather than electronic, and they were organized chronologically by cancellation dates rather than by certificate numbers. As a result, the necessary information was not easily retrievable from the records.

In many cases, the stolen certificates reentered the marketplace either through sales or as collateral for loans, resulting in substantial fraud on public investors, public companies, creditors, broker-dealers, and transfer agents. Not only do situations such as these present potential liability for the transfer agents responsible, but they consume the resources of regulatory and criminal law enforcement agencies.

A common transfer agent practice contributed to this problem. In physically cancelling certificates, many transfer agents marked the certificates only with pin-hole sized perforations. These tiny perforations were used to avoid defacing the certificates and impairing their usefulness as records. The pinholes, however, which usually formed the cancellation date and the initials of the transfer agent, often were barely noticeable. In some cases, they have been mistaken for notary or authentication markings. Even more problematic was the practice by some transfer agents of not marking certificates at all to indicate that the certificates had been cancelled.

Although neither the text nor the legislative history of Sections 17(f) and

reducing costs and the potential for theft and misuse. Securities Exchange Act Release No. 41442 (May 25, 1999), 64 FR 29608.

[2] 17 CFR 240.17Ad–6(c) and 240.17Ad–7(d). The term ''registered '' as used in 17 CFR 240.17Ad.6(c) with reference to cancelled certificates means certificates registered in the name of an owner, as distinct from bearer certificates which were in wide circulation when this rule was promulgated in 1997.

[3] 48 Stat. 881 (1934), 15 U.S.C. 78a *et seq.*

[4] It has been suggested that the Commission mandate the destruction of cancelled certificates within thirty days of their cancellation. While current practices are changing and some transfer agents may select alternative means to satisfy the recordkeeping requirements for cancelled certificates (*see supra* note 5), many transfer agents satisfy these recordkeeping requirements by maintaining the physical certificates themselves. In this regard, issuers and transfer agents are often called upon by courts and investors to produce records that validate transfer instructions, transfer authorizations, and for other evidence best available from cancelled certificates or acceptable images or copies thereof. Accordingly, we do not believe that a uniform destruction requirement is necessary or appropriate at this time. Commenters are invited to address this issue.

[5] Among the reasons for these bond redemptions has been the decline in long-term interest rates since the early 1980s.

[6] In 1992, the commission brought an action against a transfer agent for its failure to report stolen certificates pursuant to Rule 17f–1, 17 CFR 240.17f–1, and for its failure to safeguard securities in its possession pursuant to Rule 17Ad–12, 17 CFR 240.17Ad–12. The transfer agent agreed to pay a civil penalty of $750,000 and to cease and desist from future violations of sections 17(f)(1) and 17A of the Exchange Act and Rules 17f–1 and 17Ad–12 thereunder. *See SEC* v. *Citibank, N.A.,* Civil Action No. 92–2833 (USDC, DC, 1992). Securities Exchange Act Release No. 31612 (December 17, 1992), 53 SEC Docket 224.

[7] In 1994, the Commission and the Comptroller of the Currency brought a joint action against a transfer agent for its failure to report stolen cancelled certificates pursuant to Rule 17f–1 and its failure to safeguard securities in its possession pursuant to Rule 17Ad–12. The transfer agent agreed to pay a civil penalty of $100,000 and to cease and desist from future violation of sections 17(f)(1) and 17A of the Exchange Act and Rules 17f–1 and 17Ad–12 thereunder. As remedial measures, the transfer agent also agreed to make cancelled certificates with the word ''cancelled'' and to adopt other safeguards. *See The Chase Manhattan Bank,* Administrative Proceeding No. 3–8518. Securities Exchange Act Release No. 34784 (October 4, 1994), 57 SEC Docket 2195.

[8] In 1994, the Commission and the Office of the Comptroller of the Currency brought a joint enforcement action against a transfer agent and found that the transfer agent had violated section 17(f)(1) of the Exchange Act and Rule 17f–1 thereunder for failing to report the missing securities to the Commission's Lost and Stolen Securities Program. The transfer agent agreed to cease and desist from any further violations of section 17(f)(1) and Rule 17f–1 thereunder and agreed to pay a $75,000 civil penalty. *See Seattle-First National Bank,* Securities Exchange Act Release No. 34293 (July 1, 1994), 57 SEC Docket 146.

17A of the Exchange Act[9] expressly discusses cancelled certificates, these provisions provide the Commission with ample authority and responsibility to protect investors and securities industry participants from the dangers associated with the fraudulent use of cancelled certificates. Section 17(f)(1),[10] in fact, is designed to curtail the profitability of and the unlawful trafficking in lost and stolen securities certificates.[11] Moreover, section 17A, among other things, requires adequate safeguarding of funds and securities within a transfer agent's custody or control or for which it is responsible.[12] The Commission has broad discretion in carrying out this mandate.[13]

We believe that most situations where cancelled securities certificates resurfaced in the market place have resulted from a lack of good internal control systems for the processing, storage, transportation, or destruction of the certificates. The rules that we propose today are intended to provide for more efficient and secure certificate processing, particularly of cancelled certificates. Moreover, the proposed amendments would promote several fundamental Commission mandates: (1) Improving the safety and efficiency of securities transfers; (2) reducing the physical movement of securities certificates; and (3) reducing the potential for fraudulent use of cancelled securities certificates.[14]

III. Proposed Rules

A. Proposed Rule 17Ad–19: Processing of Cancelled Certificates

The processing of cancelled certificates is largely governed by trade practices. For example, in 1994, the Securities Transfer Association (''STA''), the largest transfer agent trade association, adopted guidelines for its members which, among other things, call for marking cancelled certificates with the word ''cancelled'' and for greater security measures in certificate storage and destruction.[15] Because cancellation is the critical first step in the processing of retired securities certificates, we believe that rulemaking is necessary to strengthen and standardize this process.[16]

Proposed Rule 17Ad–19[17] would require each transfer agent to: (1) Have a written statement setting forth its procedures for the cancellation, storage, transportation, and destruction of securities certificates; (2) clearly apply to the face of each cancelled certificate the word ''cancelled'' unless the transfer agent's procedures will cause the certificate to be destroyed in accordance with other Commission rules within 72 hours of its cancellation; (3) transport cancelled certificates in a secure manner with a record of the certificates in transit; (4) witness and document the destruction of certificates; and (5) keep a retrievable electronic record of each cancelled certificate with identifying data.[18] The rule would authorize the Commission to provide exemptions from these provisions in appropriate cases upon written request or upon its own motion, such as where a transfer agent lacks any automated capability or where a transfer agent uses electronic storage media to image certificates and then immediately destroys the certificates pursuant to Exchange Act rules.[19] Under Rule 17Ad–7(i), as amended, transfer agents would have to maintain records to demonstrate compliance with these requirements of Rule 17Ad–19 for not less than three years, the first year in an easily accessible place.[20]

We believe that if the word ''cancelled'' were clearly imprinted onto or perforated into each cancelled certificate, it would help protect the public and industry participants from certain forms of securities fraud. Therefore, we have included such a requirement in the proposed rule. We welcome comments on whether we should prescribe standards for this requirement, such as the size of the word ''cancelled'' and where it should be placed on a certificate.

B. Rule 17f–1: Lost and Stolen Securities Program

1. Background

Section 17(f)(1) of the Exchange Act requires the Commission to operate a Lost and Stolen Securities Program (''LSSP'' or ''Program''). Congress directed the establishment of the Program in 1975 to curtail trafficking in lost, stolen, missing, and counterfeit securities certificates.

Rule 17f–1 under the Exchange Act governs LSSP. The Program consists mainly of a data base for securities that are reported lost, stolen, missing, or counterfeit. Operationally, the Program has two essential parts: ''reports'' and ''inquiries.'' Most financial institutions (including banks, brokers, and transfer agents) are required to participate in the Program and must ''report'' any certificates that they discover to be lost, stolen, missing, or counterfeit.[21] Financial institutions also must ''inquire'' about any securities certificate valued at $10,000 or more that comes into their possession or keeping.[22] Additionally, these financial institutions may, on a permissive basis, report or inquire about other certificates.[23] The Program was designed with the belief that economic realities would cause financial institutions to inquire in a timely manner in connection with any securities certificates in substantial amounts that came into their possession.[24]

The Program is operated under contract with the Commission by the Securities Information Center, located in Boston, Massachusetts. As of December 31, 1999, the Program's data base contained reported securities with a value of approximately $385 billion. Subscribing institutions participating in

[9] 48 Stat. 881 (1934), 15 U.S.C. 78q(f) and 78q–1.

[10] 15 U.S.C. 78q(f)(1).

[11] *See* Lost and Stolen Securities Program, Hearings before the Permanent Subcommittee on Investigations of the Senate Committee on Government Operations, 93d Cong., 1st Ses. (1973), 2d Sess. (1974). S.249, which became the Securities Acts Amendments of 1975, was amended on the floor of the Senate to add legislation concerning lost, stolen, missing, and counterfeit securities. 121 Cong. Rec. 6186 (April 17, 1975). *See also* Conference Report to Accompany S.249, 94th Cong., 1st Sess. 103–104 (1975).

[12] *See* Securities Acts Amendments of 1975, Comm. on Banking, Housing and Urban Affairs, Sen. Rep. No. 75 to Accompany S. 249, 56–58 (1975).

[13] ''The Commission is empowered with broad rulemaking authority over all aspects of a transfer agent's activities as a transfer agent.'' Id. at 56–57. For example, cancelled securities certificates already are expressly covered by the Exchange Act's recordkeeping rules that apply to transfer agents. Rule 17Ad–6(c), 17 CFR 240.17Ad–6(c).

[14] *See,* generally, Exchange Act, section 17A(a), (e), and (f).

[15] Rules of the STA, Section 1.26 (Recommended Procedures for Cancelled Securities).

[16] STA has over 400 members, the majority of whom are registered transfer agents. For STA's website, *see* www.stai.org. There is no self-regulatory organization for transfer agents.

[17] 17 CFR 240.17Ad–19.

[18] Required certificate detail would be: CUSIP number, certificate number including prefix or suffix, denomination, registration, issue date, and cancellation date. *Cf.,* Exchange Act Rules 17Ad–9(a) and 17f–1(c)(6), 17 CFR 240.17Ad–9(a) and 240.17f–1(c)(6).

[19] *See* Securities Exchange Act Rule 0–12, 17 CFR 240.0–12 regarding existing exemption provisions.

[20] This recordkeeping requirement for Rule 17Ad–19 would have no effect on the recordkeeping requirements of Rule 17Ad–6(c) which applies to certificates themselves.

[21] Rule 17f–1(c) and (d), 17 CFR 240.17f–1(c) and (d).

[22] *See* Rule 17f–1(d)(iv), 17 CFR 240.17f–1(d)(iv). The inquiry requirement applies to any securities certificate received as part of a transaction whose aggregate value (face value in the case of debt or market value in the case of stocks) exceeds $10,000. Required inquiries under existing Rule 17f–1(d) would not be changed by this rule proposal.

[23] *E.g.,* inquiries on securities certificates valued at less than $10,000. *See* Paragraph (e) of Exchange Act Rule 17f–1, 17 CFR 240.17f–1(e).

[24] *See* ''Inquiry Requirements,'' Securities Exchange Act Release No. 13832 (August 5, 1977), 42 FR 41022.

the Program totalled 25,569, consisting of 13,982 banks, 10,664 securities organizations,[25] and 923 non-bank transfer agents. During 1999, reports were made on 1,438,305 certificates (an average of 5,708 certificates per business day); inquiries were made on 7,993,148 certificates (an average of 31,719 certificates per business day); and matches or ''hits'' resulting from inquiries were made on 301,420 certificates, which had a value of approximately $6.9 billion.[26] The hits essentially warned the inquirers that reports had been filed with the Program against the certificates inquired about. This meant that the certificates had been reported as lost, stolen, missing, or counterfeit, and that they were not eligible for transfer.

2. Rule 17f–1 Definitions

a. ''*Securities Certificate*''. We propose to amend Rule 17f–1(a) to add a definition of ''securities certificate'' to clarify that the scope of Rule 17f–1 covers a certificate from the time it is printed by the issuer or the issuer's agents until the time it is destroyed. Accordingly, it would cover: certificates that have been printed but never issued, certificates that have been issued and remain outstanding, certificates that are held by the issuer as treasury securities or held by the issuer or its agents in any other capacity, and certificates that have been cancelled.

b. ''*Missing'' Securities Certificates.* The term ''missing'' is used in section 17(f)(1) of the Exchange Act and in Rule 17f–1 thereunder, but it is not defined.[27] The term missing has been used to describe certificates that cannot be located, such as certificates that are not found during a count or audit, but that are thought to be misfiled rather than lost or stolen.[28]

There are other circumstances, however, where a transfer agent believes it knows what happened to a cancelled certificate but cannot be certain. For example, if cancelled certificates are stored by a transfer agent in a warehouse that is destroyed by a fire, the transfer agent may believe but cannot necessarily be confident (*i.e.,* to the point of providing a guarantee) that all of the stored certificates were destroyed.[29] In such a situation, a risk exists that some of the certificates will resurface in the marketplace. These certificates might be described as lost but also could be described as missing.

The Commission believes it would be in the public interest to define the term ''missing'' for purposes of Rule 17f–1 to mean: (1) Any certificate that cannot be located but which is not believed to be lost or stolen; and (2) any certificate that the transfer agent believes was destroyed, but was not destroyed according to the certificate destruction procedures required by proposed Rule 17Ad–19(c). Transfer agents would be required to report these types of missing certificates to LSSP. Then, if the certificates resurfaced, there would be a high degree of likelihood that they would be identified through LSSP.

3. Rule 17f–1: LSSP Reporting

Rule 17f–1 governs the operations of LSSP, including that Program's data base for securities certificates that are lost, stolen, missing, or counterfeit. The Commission has brought enforcement actions for violations of Rules 17f–1 where cancelled securities certificates that were lost or stolen were not reported to LSSP.[30] Nevertheless, there appears to be uncertainty about whether this rule applies to cancelled certificates.[31]

In our view, cancelled certificates come within the meaning and purpose of Rules 17f–1. Like counterfeit certificates, cancelled certificates have no intrinsic value, but they can be used to defraud the public.[32] Therefore, in the interest of safety and soundness in certificate processing, we propose to amend Rule 17f–1 by adding to the rule subparagraph (a)(6) which would define ''securities certificates'' as expressly including cancelled certificates.

4. Rule 17f–1(d)(3): LSSP Inquiries

In Rule 17f–1, paragraph (c) governs ''reports'' about lost, stolen, missing, and counterfeit securities, and paragraph (d) governs ''inquiries'' about lost, stolen, missing, and counterfeit securities. While the rule currently specifies time frames for making reports, it specifies no time frames for making inquiries. Proposed Rule 17f–1(d)(3) would address time frames for inquiries under LSSP.[33]

In 1976, when the rule was adopted, the absence of a time frame for making inquiries was meant to accommodate various business practices and to avoid commercial disruptions.[34] However, since the 1970s business conditions have changed substantially, in large part due to improvements in automation and communications. Inquiries by financial institutions to LSSP have become quite routine and systematic; a standard for inquiries can no longer be viewed as potentially disruptive to commerce. Second, we note that the lack of any time limit for making required inquiries has made compliance with the rule difficult to monitor.[35] Accordingly, we propose to add paragraph (d)(3) to Rule 17f–1 providing that inquiries must be made by the end of the fifth business day after a certificate comes into the possession or keeping of a reporting institution, provided that such inquiries shall be made before the certificate is

[27] While parallel terms (lost, stolen, and counterfeit) also are not defined by the statute or the rule, we believe that their meanings are clear from the context.

[28] *See, e.g.,* Rule 17f–1(c)(2)(ii) concerning certificates considered ''missing'' as the result of a securities count or verification during, for example, an internal audit.

[29] On March 19, 1997, a major warehouse fire apparently destroyed a large number of cancelled securities certificates held in storage by a transfer agent, and the fire reportedly was caused by arson. *See* ''A Burning Question: How Safe Are Your Records,'' *Business Week,* June 23, 1997, at page 130E4.

[30] *See, e.g, SEC* v. *Citibank, N.A., supra* note 9.

[29] On March 19, 1997, a major warehouse fire apparently destroyed a large number of cancelled securities certificates held in storage by a transfer agent, and the fire reportedly was caused by arson. *See* ''A Burning Question: How Safe Are Your Records,'' *Business Week,* June 23, 1997, at page 130E4.

[30] *See, e.g, SEC* v. *Citibank, N.A., supra* note 9.

[31] For example, one court has found that because ''cancelled securities'' are not expressly included in Rule 17f–1, they are not subject to the reporting requirements of that rule. *A.G. Edwards & Sons, Inc.* v. *Centocor, Inc.,* Civil Action No. 91–6133 (E.D. PA, 1992).

[32] In *United States* v. *Jackson,* 576 F.2d. 749, 757 (8th Cir. 1978), the court recognized that stolen blank stock certificates have no intrinsic value as investments but that they have a ''thieves' market value'' as demonstrated by an FBI undercover operation, which was part of the case, where the certificates were purchased at 40% of their apparent market value.

[33] For description of ''inquiries,'' *see supra* notes 23–28 and accompanying text.

[34] When enacting the underlying statute, Congress stated that the Commission should carefully weigh the benefits of mandating inquiries against the costs and effects on efficient business practices. Conference Report on S. 249, Securities Acts Amendments of 1975, 94th Cong., 1st Sess. 104 (1975). In 1976, the Commission observed that the system for inquiries should avoid undue disruptions to commercial transactions and chose not to set time limits for inquiries. *See* Securities Exchange Act Release No. 12030 (January 20, 1976), 41 FR 04834. In 1979, when the Commission asked for comments from the industry, reporting institutions said they favored a policy of leaving to their own business judgment the time frames for valuing and inquiring of LSSP about securities that came into their possession. The Commission accepted that position. *See* ''inquiry Time Frames,'' Securities Exchange Act Release No. 15683 (March 29, 1979), 44 FR 20614

[35] The Seventh Circuit Court of Appeals observed that the addition of a precise time frame for making required inquiries would improve the operation of the rule. *First National Bank of Cicero* v. *Lewco Securities Corp.,* 860 F.2d 1407, 1416, n. 14 (7th Cir. 1988). The court also said that whether an institution meets the test of ''good faith'' required for bona fide purchaser status with respect to securities certificates may depend on whether it has met the inquiry requirements of Rule 17f–1. *Id.* at 1413–1415. *See also* Yadley and Ilkson, ''Bona Fide Purchasers of Lost and Stolen Securities: Meeting the 'Good Faith;' and 'Notice' Requirements,'' 5 George Mason U.L. Rev. 101, 127–133 (1982).

sold, used as collateral, or sent to another reporting institution.

5. Rule 17f–1(c)(2): Securities Shipments

We are proposing to add to Rule 17f–1(c)(2)(i) language that would require transfer agents to track shipments of securities certificates, including cancelled certificates, between reporting institutions.[36] When such a shipment becomes unaccounted for (for example, where the delivering institution fails to receive notice of its receipt), the delivering institution would be required to timely investigate and take reasonable steps to determine the facts. If the certificates cannot be located, the delivering institution must report to LSSP that the certificates are missing, stolen, or lost and must do so within a reasonable time not exceeding ten business days after the shipment was sent.

C. Rule 17Ad–12: Safeguarding of Funds and Securities

Rule 17Ad–12 governs the safekeeping of funds and securities by transfer agents. It requires that securities be handled in a manner that is reasonably free from the risk of destruction, theft, or other loss. The proposed amendment to Rule 17Ad–12 is intended to generally improve safety and soundness in certificate processing and, specifically, to clarify that cancelled certificates come within the meaning and purpose of Rule 17Ad–12. As we observed earlier, a cancelled certificate has no intrinsic value, but like a counterfeit certificate, it can be used to defraud the public. Moreover, we have brought enforcement actions for violations of Rule 17Ad–12 that involved cancelled securities certificates.[37] Therefore, we propose to amend Rule 17Ad–12 to state that it applies to ''securities certificates,'' a term that we have proposed to define to include cancelled certificates.[38]

IV. Request for Public Comment

Any person wishing to submit comments on the above proposals or related matters is invited to do so. We specifically solicit comments on whether the proposed procedures for the cancellation, storage, and destruction of securities certificates would help prevent the theft and fraudulent resale or collateralization of cancelled securities. If the proposed rules do not appear to do so, commenters are requested to suggest other provisions that would ensure the safekeeping of cancelled securities and avoid the risks that cancelled certificates currently pose to the marketplace.

We also are requesting cost data for implementation of the proposals requiring procedures for the cancellation, storage, transportation, and destruction of securities certificates. We are soliciting comments on the proposed time frame for inquiries under Rule 17f–1 and about any undue burdens to commerce that might result from the proposed rules.

We welcome comments on whether proposed Rule 17Ad–19 should apply to all of approximately 1,050 registered transfer agents or only to the approximately 825 registered transfer agents that maintain security holder records for one or more securities issues. The difference of approximately 225 includes ''named transfer agents,'' which refer their transfer agent business to transfer agent service companies,[39] and includes other transfer agents that conduct a specialty business or are inactive.

Members of the securities industry have advised the Commission about a practice of using hand stamps on securities certificates that state ''cancelled in error'' or similar language to avoid the expense of destroying certificates that are marked ''cancelled'' by mistake. They have recommended that the Commission prohibit this practice and require that certificates that are mistakenly marked ''cancelled'' be destroyed. Do you believe we should adopt such a rule? We welcome any comments on this matter.

We welcome comments on how much ''certificate data'' should be retained and indexed for cancelled certificates, destroyed certificates, and certificates that are in transit.[40] Finally, for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, the Commission is also requesting information regarding the potential impact of the proposed rule on the economy on an annual basis. Commentators should provide empirical data to support their views.

V. Costs and Benefits of Proposed Amendments

The Commission is considering the costs and benefits of proposed Rule 17Ad–19 and the proposed amendments to Rules 17f–1 and 17Ad–12. The Commission has identified certain costs and benefits relating to the proposals, which are discussed below, and we encourage commenters to discuss any additional costs or benefits. In particular, we request comment on the potential costs for any necessary modifications to information gathering, management, and record-keeping systems or procedures, as well as any potential benefits resulting from the proposals for issuers, transfer agents, banks, brokers, regulators, or others. Commenters should provide analysis and data to support their views on the cost and benefits associated with the proposals.

A. Benefits

The proposals should provide specific benefits to U.S. investors, issuers, transfer agents, and other financial intermediaries. These benefits are not readily quantifiable in terms of dollar value. Nevertheless, the proposals are designed to reduce the fraudulent use of securities certificates, particularly cancelled certificates, by requiring improved safeguarding and recordkeeping by transfer agents. In recent years, the fraudulent resale and fraudulent collateralization of cancelled certificates (certificates with no investment value) have cost private individuals and financial institutions many millions of dollars. Such costs could be substantially reduced or even eliminated by adequate safeguarding and recordkeeping of these certificates by transfer agents. Moreover, the proposals should provide the added benefit of increasing compliance with securities certificate recordkeeping and safeguarding rules (by, among other things, clarifying that cancelled certificates are subject to these rules), while decreasing instances of fraud on investors.

The Commission does not have data to quantify the value of the benefits described above. We are seeking comment on how we may quantify these benefits and any other benefits, not already identified, that may result from the adoption of the proposed amendments.

B. Costs

The proposals require transfer agents to have written procedures for the cancellation, storage, transportation, and destruction of securities certificates; to mark cancelled securities certificates as ''cancelled''; to witness and document the destruction of certificates; and to keep a retrievable electronic record of each cancelled certificate. The preparation of these written procedures

[36] The term ''reporting institution'' would have the meaning set forth in 17 CFR 240.17f–1(a)(1).

[37] *See, e.g., SEC* v. *Citibank, N.A., supra* at note 9.

[38] *See, supra,* Section III.B.2.a. for discussion of definition of securities certificate.

[39] *See* Rule 17Ad–9(j) and (k), 17 CFR 240.17Ad–9(j) and (k).

[40] For the term ''certificate data,'' *see supra* note 20.

requested by the new rules would be a cost to transfer agents.

Regarding the proposed use of the word ''cancelled'' on cancelled certificates, we understand that, with the encouragement of the Securities Transfer Association's published guidelines,[41] most transfer agents already are marking their cancelled certificates with the word ''cancelled'' to designate their cancelled status.[42] We believe that the proposed requirement to use the word ''cancelled'' would to a large extent codify good business practices with little additional cost to the industry.

The proposed requirements to witness and record the destruction of certificates and to keep retrievable electronic records of the cancelled certificate would mean additional costs to many transfer agents. However, existing Exchange Act rules already require transfer agents to maintain ''appropriate certificate detail,'' and this includes records of cancelled certificates,[43] and these requirements would apply only on a going forward basis, *i.e.*, transfer agents will not have to create electronic records for old cancelled certificates. Moreover, the proposed recordkeeping requirements, to a substantial degree, would clarify requirements and encode recordkeeping practices already in place, and we are unable to quantify the extent of such incremental costs. We would welcome the submission of detailed information on the subject.

VI. Effects on Competition, Efficiency, and Capital Formation

In adopting rules under the Exchange Act, section 23(a)(2) requires the Commission to consider the impact any rule would have on competition. Further, the law requires that the Commission not adopt any rule that would impose a burden on competition not necessary or appropriate in furtherance of the Exchange Act. Section 3(f) of the Exchange Act requires the Commission, when engaged in rulemaking, and when considering the public interest, to consider whether the action would promote efficiency, competition, and capital formation.

The proposed amendments should improve market efficiency by reducing a source of fraud and its associated costs and inefficiencies (*i.e.,* the fraudulent introduction of cancelled and worthless securities into the marketplace). In addition, the proposed amendments should have no material anticompetitive effects because they would apply equally to all transfer agents and should have no material effect on capital formation.

To evaluate more fully the effects on competition of the proposed amendments, we are requesting commenters to provide their views and specific empirical data as to any effects their adoption would have on competition. We also request comments on what effect the proposals, if adopted, would have on efficiency and capital formation.

VII. Summary of Regulatory Flexibility Analysis

The Commission has prepared an Initial Regulatory Flexibility Analysis (''IRFA''), in accordance with the provisions of the Regulatory Flexibility Act,[44] regarding proposed Rule 17Ad–19 and the amendments to Rules 17f–1 and 17Ad–12 under the Exchange Act. The IRFA states that the purpose of the proposal is to establish uniform procedures for the cancellation, storage, and destruction of securities certificates.

The IRFA sets forth the statutory authority for the proposal. The IRFA also discusses the effect of the proposal on transfer agents that are small entities pursuant to Rule 0–10 under the Exchange Act.[45] A transfer agent is a small entity if it: (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) 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 (3) is not affiliated with any person (other than a natural person) that is not a small business or small organization under Rule 0–10. Approximately 470 registered transfer agents qualify as ''small entities'' for purposes of the RFA and would be subject to the requirements of proposed Rule 17Ad–19.

Proposed Rule 17Ad–19 would require all transfer agents to establish and implement written procedures for the cancellation, storage, transportation, and destruction of securities certificates. Such written procedures and the implementation thereof shall be subject to examination by the transfer agent's appropriate regulatory agency. Additionally, amendments to Rules 17f–1 and 17Ad–12 would clarify that these two rules apply broadly to securities certificates, including cancelled securities certificates.

The IRFA states that the Commission considered whether viable alternatives to the proposed rulemaking exist that accomplish the stated objectives of applicable statutes that minimize any significant economic impact of proposed rules on small entities. More specifically, the Commission considered the following alternatives: (1) The establishment of different procedures that take into account the resources available to small entities; (2) the clarification, consolidation, or simplification of compliance and reporting requirements under the proposed rules insofar as they affect small entities; (3) the use of performance rather than design standards; and (4) an exemption from coverage of the rule, or any part thereof, for small entities.

As explained further in the IRFA, the Commission has considered significant alternatives to the proposed rules that would adequately address the problem posed by cancelled securities certificates. The Commission believes that the establishment of different requirements for small entities is neither necessary nor practical because the proposal is designed to provide general standards that would protect the public and members of the financial community from certain types of securities fraud, and the proposal would include an exemption procedure that would be available to small entities on a case by case basis. Moreover, the IRFA concludes that the Commission believes that the proposal, if adopted, would not adversely affect small entities. Finally, the IRFA addresses each of the other requirements set forth under 5 U.S.C. 603.

The Commission encourages the submission of written comments with respect to any aspect of the IRFA. Those comments should specify costs of compliance with the proposed rule, and suggest alternatives that would accomplish the objective of proposed Rule 17Ad–19. A copy of the IRFA may be obtained by contacting Thomas C. Etter, Jr., Division of Market Regulation, Securities and Exchange Commission, 450 5th Street, NW., Washington, DC 20549–1001, telephone no. (202) 942–4895.

[41] *See supra*, note 18.

[42] We believe that most transfer agents are properly marking their retired certificates with the word ''cancelled,'' as STA has recommended. However, because doing so is not a Commission requirement, it is not a part of the Commission's examination module for transfer agents. Thus, our data on the subject is anecdotal, rather than systematic.

[43] *See* Securities Exchange Act Rules 17Ad–6(c) and 17Ad–9(a); 17 CFR 17Ad–6(c) and 17Ad–9(a).

[44] 5 U.S.C. 603.

[45] 17 CFR 240.0–10.

VIII. Paperwork Reduction Act

Certain provisions of the proposed amendments contain ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995 (''PRA''),[46] and the Commission has submitted them to the Office of Management and Budget (''OMB'') for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The title for the collection of information is: ''Record Retention Requirements for Registered Transfer Agents.'' The OMB control number for the current collection of information is 3235–0136. The collection requirements are necessary to ensure the integrity of transfer agents' records and the safeguarding of securities certificates.

Proposed Rule 17Ad–19 contains collection of information requirements that are intended to ensure the integrity and completeness of transfer agents' records regarding physical securities certificates, in particular cancelled securities certificates. Rule 17Ad–19 would require each registered transfer agent to: (1) Have a written statement setting forth its procedures for the cancellation, storage, transportation, and destruction of securities certificates; (2) mark each cancelled certificate with the word ''cancelled'' on the face of the certificate; (3) witness and document the destruction of certificates; and (4) keep a retrievable electronic record of each cancelled certificate with identifying certificate data. The proposed amendments to Rules 17f–1 and 17Ad–12 would involve no additional paperwork requirements.

Proposed Rule 17Ad–19 would incorporate the three year record retention requirement of Rule 17Ad–7(i), but the proposed amendments to Rules 17f–1 and 17Ad–12 would add not any retention periods for recordkeeping requirements. The maintenance of written procedures by transfer agents under Rule 17Ad–19 would be mandatory. The written procedures would be confidential and not available to the public, although they would be subject to examination by the Commission or other appropriate regulatory agencies. We note that an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

Approximately 1,100 transfer agents are registered with the Commission. The Commission estimates that the average amount of time per transfer agent needed to comply with the collection of information requirements of proposed Rule 17Ad–19 would be 40 hours per transfer agent for developing the written procedures. The Commission further estimates that the average amount of time per transfer agent per year to comply with the collection of information associated with recording and tracking cancelled securities certificates would be 50 hours per transfer agent per year, a figure that would vary greatly depending on the size of an entity and the volume of its business. Thus, assuming 1,100 registered transfer agents, the start-up collection of information requirements would require about 44,000 hours (40 × 1,100), and the annual collection of information requirements would be about 55,000 hours (50 × 1,100). Thus, the combined total during the first year would be about 99,000 hours.

Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments to:

(1) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information shall have practical utility;

(2) Evaluate the accuracy of the agency's estimate of the burden of the proposed collections of information;

(3) Enhance the quality, utility, and clarity of the information to be collected;

(4) Minimize the burden of the collections of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Person desiring to submit comments on the collection of information requirements should direct them to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609, with reference to File No. S7–18–00. Requests for materials submitted to OMB by the Commission with regard to this collection of information should be in writing, should refer to File No. S7–18–00, and be submitted to the Securities and Exchange Commission, Office of Filings and Information. OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication, so a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication.

IX. Statutory Basis and Text of Proposed Amendments

Statutory Basis

Pursuant to the Securities Exchange Act of 1934 and particularly Sections 17(a), 17A(d), and 23(a) thereof, 15 U.S.C. 78q–1(d) and 78w(a), the Commission proposes to adopt § 240.17Ad–19 of Title 17 of the Code of Federal Regulation in the manner set forth below.

List of Subjects in 17 CFR Part 240

Reporting and recordkeeping requirements; Securities.

Text of Proposed Rules

In accordance with the foregoing, the Commission proposes to amend Part 240 of Chapter II of Title 17 of the Code of Federal Regulations as follows:

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for Part 240 continues to read in part as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78f, 78i, 78j, 78j–1, 78k, 78k–1, 78*l*, 78m, 78n, 78o, 78p, 78q, 78s, 78u–5, 78w, 78x, 78*ll*(d), 78mm, 79q, 79t, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4 and 80b–11, unless otherwise noted.

* * * * *

2. Section 240.17f–1 is amended by:

a. Adding paragraphs (a)(6), (a)(7) and (a)(8);

b. Revising the phrase ''lost in transit'' to read ''lost, missing, or stolen while in transit'' in paragraph (c)(2)(i);

c. Redesignating paragraphs (c)(2)(ii) and (c)(2)(iii) as paragraphs (c)(2)(iii) and (c)(2)(iv);

d. Adding new paragraph (c)(2)(ii); and

e. Adding paragraph (d)(3) to read as follows:

§ 240.17f–1 Requirements for reporting and inquiry with respect to missing, lost, counterfeit or stolen securities.

(a) * * *

(6) The term *securities certificate* means any physical instrument that represents or purports to represent ownership in a security that was printed by or on behalf of the issuer thereof and shall include any such instrument that is or was:

(i) Printed but not issued;

(ii) Issued and outstanding including treasury securities;

(iii) Cancelled, which for this purpose means either or both of the procedures set forth in § 240.17Ad–19(a)(1); or

[46] 44 U.S.C. 3501 *et seq.*

(iv) Counterfeit or reasonably believed to be counterfeit.

(7) The term *issuer* shall include an issuer's:

(i) Transfer agent(s), paying agent(s), tender agent(s), and person(s) providing similar services; and

(ii) Corporate predecessor(s) and successor(s).

(8) The term *missing* shall include any securities certificate that:

(i) Cannot be located or accounted for, but is not believed to be lost or stolen; or

(ii) A transfer agent claims or believes was destroyed in any manner other than by the transfer agent's own certificate destruction procedures as provided in §§ 240.17Ad–19(b) and (c).

* * * * *

(c) * * *

(2) * * *

(ii) Where a shipment of securities certificates is in transit between any transfer agents, banks, brokers, dealers, or other reporting institutions, relationship between such entities, and the delivering institution fails to receive notice of receipt or non-receipt of the certificates, the delivering institution shall act to determine the facts. In the event of non-delivery where the certificates are not recovered by the delivering institution, the delivering institution shall report the certificates as lost, stolen, or missing to the Commission or its designee within a reasonable time under the circumstances but in any event within ten business days from the date of shipment.

* * * * *

(d) * * *

(3) A reporting institution shall make required inquiries by the end of the fifth business day after a securities certificate comes into its possession or keeping, provided that such inquiries shall be made before the certificate is sold, used as collateral, or sent to another reporting institution.

* * * * *

3. Section 240.17Ad–7, paragraph (i), is amended by revising the phrase ''§ 240.17Ad–17(c)'' to read ''§§ 240.17Ad–17(c) and 240.17Ad–19(c)''.

4. Amend § 240.17Ad–12, paragraph (a)(1), by revising the phrase ''risk of destruction, theft or other loss;'' to read ''risk of theft, loss or destruction (other than by a transfer agent's certificate destruction procedures pursuant to § 240.17Ad–19);'' and adding paragraph (b) to read as follows:

§ 240.17Ad–12 Safeguarding of funds and securities.

* * * * *

(b) For purposes of this section, the term securities shall include the term *securities certificate* as defined in § 240.17f–1(a)(6).

5. Section 240.17Ad–19 is added to read as follows:

§ 240.17Ad–19 Requirements for cancellation, storage, and destruction of securities certificates.

(a) *Definitions.* For purposes of this section:

(1) The terms *cancelled* or *cancellation* means the process in which a securities certificate:

(i) Is physically marked to clearly indicate that it no longer represents a claim against the issuer; and

(ii) Is voided on the records of the transfer agent.

(2) The term *cancelled certificate facility* means any location where securities certificates are cancelled, stored, or destroyed.

(3) The term *certificate number* means a unique identification or serial number that is assigned and affixed by an issuer or transfer agent to each securities certificate.

(4) The term *controlled access* means the practice of permitting the entry of only authorized personnel to areas where cancelled securities certificates are processed, stored, or destroyed.

(5) The term *CUSIP number* means the unique identification number that is assigned to each securities issue. The same CUSIP number appears on the face of each securities certificate of the same securities issue.

(6) The term *destruction* means the physical ruination of a securities certificate by a transfer agent as part of the certificate destruction procedures that make the reconstruction of the certificate impossible.

(7) The term *securities certificate* has the same meaning that it has in § 240.17f–1(a)(6).

(b) *Required procedures for the cancellation, storage, transportation, and destruction of securities certificates.*

Every transfer agent involved in the keeping, handling, or processing of securities certificates shall establish and implement written procedures that describe the transfer agent's procedures for the cancellation, storage, transportation, and destruction of such securities certificates. This requirement applies to any agent that the transfer agent uses to perform any of these activities.

(c) *Written procedures.* The written procedures required by paragraph (b) of this section at a minimum, shall:

(1) Provide controlled access to any cancelled certificate facility;

(2) Unless existing procedures will cause the destruction of cancelled certificates within 72 hours of their cancellation, provide that each cancelled certificate is clearly marked with the word ''CANCELLED'' by stamp or perforation on the face of the certificate;

(3) Require a retrievable electronic record containing the CUSIP number, certificate number with any prefix or suffix, denomination, registration, issue date, and cancellation date of each cancelled certificate within the transfer agent's possession or control;

(4) Require, pursuant to a certificate destruction procedure, a retrievable electronic record of each destroyed securities certificate; the records must contain for each destroyed certificate the CUSIP number, certificate number with any prefix or suffix, denomination, registration, issue date, and cancellation date;

(5) Require that the physical transportation of cancelled certificates be made in a secure manner and that the transfer agent maintain a record of the CUSIP number and certificate number of each certificate in transit;

(6) Require, pursuant to a certificate destruction procedure, that authorized personnel of the transfer agent or its designee supervise and witness the intentional destruction of any cancelled certificate and retain copies of all records relating to certificates which were destroyed; and

(7) Provide for the reporting to the Lost and Stolen Securities Program in a timely and complete manner, pursuant to § 240.17f–1, any cancelled certificate that is lost, stolen, missing, or counterfeit.

(d) *Recordkeeping.* Every transfer agent subject to this section shall maintain records which demonstrate compliance with the requirements set forth in this section and which describe the transfer agent's methodology for complying with this section.

(e) *Exemptive authority.* Upon written application or upon its own motion, the Commission may grant an exemption from the provisions of this section, either unconditionally or on specific terms and conditions, to any transfer agent or any class of transfer agents and to any securities certificate or any class of securities certificates.

By the Commission.

Dated: October 2, 2000.

Margaret H. McFarland,

Deputy Secretary.

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