

Client Advisory | June 2009

## Cost of Holding Stock Certificates to Increase Sharply on July 1

### Incentive for Issuers to Switch to Book-Entry Registration of Stock Ownership

An imminent change in the processing of stock transfers will cost investors \$500 to request physical stock certificates, in addition to other transaction fees. Investor Relations should be prepared for shareholder feedback. If an issuer is not already participating in the Direct Registration System (DRS) – a book-entry system in which share ownership is represented by statements of holdings – it should consider doing so.



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This advisory describes the change first, then the background.

#### The Change

In January 2009, Depository Trust Company (DTC) began implementing a change to the “Withdrawal-by-transfer” (WT) procedures.<sup>1</sup> A WT occurs when a broker holding an investor’s shares in street name transfers the shares out to record ownership (i.e., into the investor’s name on the books of the issuer’s transfer agent). This could occur either if an investor who has held the shares in his brokerage account decides to withdraw them and become a record holder or if an investor buys shares through a broker but elects to hold them of record, not in an account with that broker. Once transferred, the shares may be represented by either a certificate or an account statement if the issuer participates in DRS.

In January, DTC stopped authorizing the issuance of physical certificates upon a WT for issuers that participate in DRS. Effective July 1, DTC will also stop authorizing the issuance of certificates upon a WT for issuers that do not participate in DRS. However, by definition, record holders of a non-participating issuer may *only* receive certificates. Accordingly, the investor can still obtain a certificate through the “Rush WT” process, but DTC will charge \$500 for the privilege.

This charge would not apply to issuance of a physical certificate in a transaction that need not be processed through DTC. E.g., where the investor already has a certificate and wishes to sell it in a private sale or give it, or a portion of the certificated shares, to someone else. Those transactions would be handled solely by the transfer agent, subject to any fees it charges. But any request to obtain a certificate as a result of a transaction that goes through a broker will probably be affected.

#### The Direct Registration System

DRS occupies an intermediate space between certificated shares and an exclusively book-entry system implemented by the issuer (“dematerialization”).<sup>2</sup> DTC manages many aspects of stock transfers, including DRS, for transfer agents. DRS is used by investors who want to both (i) be shareholders of record rather than hold their shares in street name and (ii) receive statements of book entry ownership rather than hold physical certificates. It is not irrevocable. Once in DRS, an investor who wishes to switch out again can either move the shares to street name ownership or (unless the issuer dematerializes completely) obtain a physical certificate.

The costs of handling physical certificates are astronomical. The advantages

of DRS to issuers and investors include reduced processing costs, more convenient transactions, quicker notice of corporate actions, avoiding the substantial indemnity bond and other costs to replace lost certificates, and less chance of fraud. DTC advertises that over 5,300 issuers offer the DRS alternative to their shareholders and over 400 have completely eliminated paper certificates.

### How to Respond

Participating in DRS requires the following steps:

- eliminating any by-law requirement that all shares be represented by certificates

(which all exchange-traded issuers should already have done),

- an authorizing board vote (e.g., under §158 of the Delaware General Corporation Law or §6.26 of the Massachusetts Business Corporation Act),
- the transfer agent's set-up process, and
- educating shareholders.

It is inexpensive and relatively painless. Transfer agents will provide information about participating.

Whether or not your company switches to DRS, your IR department should have a heads up about the July 1 change so that they can be prepared to deal with shareholder feedback.

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*Effective July 1, DTC will require \$500 to authorize the issuance of certificates upon a WT for issuers that do not participate in DRS.*

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<sup>1</sup> Notices implementing this change are:

- 12/1/08 SEC Notice approving DTC rule change - <http://www.sec.gov/rules/sro/dtc/2008/34-59033.pdf>
- DTCC (December 2008) notice -- Eff. 1/1/09, applies to DRS-participating issues - [http://www.dtcc.com/news/newsletters/dtcc/2008/dec/paper\\_certificates.php](http://www.dtcc.com/news/newsletters/dtcc/2008/dec/paper_certificates.php)
- DTCC (April 2009) notice -- Eff. 7/1/09, applies to non-participating issues - <http://www.dtcc.com/news/newsletters/dtcc/2009/apr/dematerialization.php>

<sup>2</sup> Street name ownership has historically involved fractional beneficial ownership (recorded in broker's accounts) of large denomination certificates that have been "immobilized" in a depository, the depository being the record owner of the whole.

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