issuance of deb guaranteed by its parent, Company A. Company B is a consolidated subsidiary of Company A.

Question 1:

Must Company B's registration statement always contain all of the financial statements specified by the applicable registration form?

Interpretive Response:

No, provided that certain conditions are met.

The disclosure provisions of the Securities Act generally mandate full disclosure for each issuer that is registering the sale of its securities. Because the registration of a guaranteed security involves the registration of two securities,[1] each by a separate issuer, the general requirement is for full financial statement disclosure by both the issuer of the guaranteed security and the guarantor of that security. The staff believes, however, that under certain circumstances full financial statement disclosure by the issuer of the guaranteed security may be unnecessary. The appropriate disclosure for the issuer of the guaranteed security will depend on the nature of that entity in relation to the guarantor and the nature of the guarantee. The staff is of the view that such factors can justify three levels of disclosure: no separate disclosure, summarized disclosure and full disclosure.

No Separate Disclosure. Where the issuer of the guaranteed security is wholly owned (as defined in Rule 1-02(z) of Regulation S-X) by the guarantor and essentially has no independent operations, and where the guarantee is full and unconditional, the staff generally will not require separate financial statements of the issuer of the guaranteed security because the consolidated financial statements of the guarantor parent are adequate for the protection of investors. Subsidiaries that typically fall into this category are foreign financing subsidiaries, export-import subsidiaries, and other entities that function essentially as special purpose divisions of the parent. In these cases, the investor's investment decision is based on the credit worthiness of the guarantor.

Summarized Disclosure. Where the issuer of the guaranteed security is wholly owned by the guarantor but has more than minimal independent operations of its own, and where the guarantee is full and unconditional, the staff generally will not require the issuer of the guaranteed security to present all the financial information specified by the applicable registration form if the registration statement contains summarized financial information regarding the subsidiary. Such information should include at least that described in the definition of "summarized financial information" in Rule 1-02(aa)(1) of Regulation S-X. The summarized financial information should be included in the footnotes to the audited consolidated financial statements of the guarantor parent, and should be as of the same dates and for the same periods as the consolidated financial statements.

Full Disclosure. Where the issuer of the guaranteed security is not wholly owned by the guarantor, or where the guarantee is not full and unconditional, the staff generally will require the issuer subsidiary to include all the financial statements required by the applicable registration form as well as the financial statements of the guarantor parent.

Question 2:

What financial statements of the issuer subsidiary must be included in reports filed pursuant to the Securities Exchange Act of 1934 (the "Exchange Act")?

Interpretive Response:

Generally, the staff will apply the same criteria used in determining the level of disclosure for the issuer of a guaranteed security under the Securities Act to govern questions regarding that issuer's reporting obligations under the Exchange Act. Thus, if the issuer of a guaranteed security falls into the first category above—that is, it is wholly owned, it essentially has no independent operations, and the guarantee is full and unconditional—separate financial information for the issuer will generally be unnecessary. If the issuer of the guaranteed security falls into the second category above—that is, it is wholly owned, it has more than minimal independent operations of its own, and the guarantee is full and unconditional—it generally will be sufficient to include summarized financial information about the issuer subsidiary in the notes to the parent guarantor's consolidated financial statements.[2] Finally, if the issuer of the guaranteed security is in the third category above—that is, it is not wholly owned by the guarantor or the guarantee is not full and unconditional—the issuer of the guaranteed security would have to satisfy all Exchange Act reporting obligations.

H. Financial Statement Requirements in Filings Involving the Guarantee of Securities by a Subsidiary

Facts:

Company A files a registration statement involving the issuance of debt guaranteed by its subsidiary, Company B.

Question 1:

Does Rule 3-10(a) of Regulation S-X require the inclusion in the registration statement of the financial statements of Company B?

Interpretive Response:

In the relatively infrequent situations where a registration statement covers the issuance by a parent of a security that is guaranteed by its subsidiary, the staff has concluded that, as a general rule, financial statements for both of the issuers would be material to the investment decision.[3]

[FR Doc. 83-16451 Filed 6-20-83, 8:45 am]

BILLING CODE 8010-01-M

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17 CFR Part 240

[Release No. 34-19860; File No. S7-946]

Maintenance of Accurate Securityholder Files and Safeguarding of Funds and Securities by Registered Transfer Agents

AGENCY: Securities and Exchange Commission.

ACTION: Adoption of rules.

SUMMARY: In order to further the national system for the clearance and settlement of securities transactions under Section 17A of the Securities Exchange Act of 1934 and to ensure the prompt and accurate clearance and

[1] *See* Section 2(1) of the Securities Act.

[2] Further, in situations where the parent guarantor of an issuer subsidiary in either the first or second category is a reporting company under the Exchange Act, upon application to the Commission such a subsidiary would be conditionally exempted pursuant to Section 12(h) of the Exchange Act from reporting obligations under such Act.

[3] Rule 3-10(a) of Regulation S-X recently was amended to reflect the requirement that a guarantor must provide financial statements when the guaranteed security is registered or being registered. *See,* Accounting Series Release No. 302 (November 6, 1981) [46 FR 56171], restated in part in section 213.05 of Financial Reporting Release No. 1 (April 15, 1983) [47 FR 21028].

Certain registrants have misinterpreted the last sentence of Rule 3-10(a) as requiring only the consolidated financial statements of the parent in situations where a consolidated subsidiary has guaranteed the parent's securities. Under this interpretation registrants have asserted that the guarantor subsidiary's financial statements are filed by virtue of inclusion in the parent's consolidated financial statements. Rather, the last sentence of Rule 3-10(a) clarifies the relationship of the requirements of that rule to those of Rule 3-09. For example, financial statements of an unconsolidated guarantor subsidiary filed pursuant to the requirements of Rule 3-09 on an individual basis or consolidated with its subsidiaries will satisfy the requirements of Rule 3-10(a). However, financial statements of such a guarantor subsidiary filed on a combined basis with other unconsolidated subsidiaries pursuant to Rule 3-09(c) will not satisfy the requirements of Rule 3-10(a).

settlement of those transactions, the Securities and Exchange Commission (the "Commission") is adopting rules that: (1) Require registered transfer agents to maintain certain information concerning securityholder records; (2) require registered transfer agents to maintain current and accurate securityholder records; (3) require registered transfer agents to post promptly all transfers, purchases and redemptions to those securityholder records and to notify their appropriate regulatory agency if they are unable to do so; (4) require registered transfer agents to exercise diligent and continuous attention in resolving record inaccuracies; (5) require registered transfer agents to disclose directly to the issuers for whom they perform transfer agent functions and to their appropriate regulatory agency information regarding record inaccuracies; (6) require registered transfer agents to buy-in certain record inaccuracies that result in a physical overissuance of securities; (7) prescribe a minimum level of communication between registered transfer agents contractually related to the same issuer; (8) set standards for the safeguarding of funds and securities in the custody or possession of registered transfer agents; (9) require certain registered transfer agents to obtain, on an annual basis, an internal accounting control report prepared by an independent public accountant; and (10) eliminate the requirement that transfer agents whose appropriate regulatory agency is either the Commission or the Office of the Comptroller of the Currency file notices regarding their status as exempt transfer agents under § 204.17Ad-4(b).

EFFECTIVE DATES: Sections 240.17Ad-12, 240.17Ad-4 (b) and (c): July 25, 1983; Sections 240.17Ad-9, 240.17Ad-10, 240.17Ad-11 and 240.17Ad-13: September 30, 1983.

FOR FURTHER INFORMATION CONTACT: Any of the following attorneys in the Office of Securities Processing Regulation: Dan W. Schneider, Jonathan Kallman, Ester Saverson, Jr., Heidi Steinberg Coppola, or Sandra A. Sciole at (202) 272-2775, Division of Market Regulation, Securities and Exchange Commission, Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION: On October 15, 1982, the Securities and Exchange Commission issued Securities Exchange Act Release No. 19142 (the "October Release",[1] proposing for comment, among other things, a series of rules for registered transfer agents establishing minimum standards for the prompt and accurate creation and maintenance of issuer securityholder records and for the safeguarding of funds and securities used in transfer agent activities. In addition, the Commission proposed amendments to Rule 17Ad-4 designed to reduce filing requirements for certain registered transfer agents that qualify for certain exemptions under existing Commission rules. Finally, the Commission solicited comment on the desirability of amending certain existing Rules that establish performance standards for certain registered transfer agents in respect of the "turnaround" of "routine" items presented for transfer and the desirability of proposing net worth and insurance requirements for registered transfer agents (other than federally regulated banks and transfer agents that perform transfer functions exclusively for their own securities).

In response to the October Release, the Commission received 53 letters of comment, including letters from the staff of the Board of Governors of the Federal Reserve System (the "BGFRS") and the Office of the Comptroller of the Currency (the "OCC").[2] As discussed below, a majority of commenters supported the concepts underlying proposed Rules 17Ad-9 through 17Ad-13. Although some commenters suggested changes that they believed would significantly enhance investor protection and would promote more prompt and accurate settlement of securities transactions, a majority of the commenters suggested refinements that would reduce compliance costs associated with the proposed rules. A small number questioned the need for any of the proposed rules, while others criticized only certain provisions as drafted that, in their view, would impose significant costs without substantial countervailing benefits.

The comments received were thoughtful and informative. Various transfer agent associations, including the Stock Transfer Association, numerous registered transfer agents, broker-dealers and one registered clearing agency have, through their comments, assisted the Commission in the formulation of appropriate limited rules. The Commission appreciates, in particular, the many comments respecting the proposed buy-in requirement, the comments of the American Institute of Certified Public Accountants respecting the proposed external accountant study and evaluation requirement, and the helpful overall comments of the federal bank regulatory agencies.[3] The Commission believes that the success of the comment process in this proceeding is evident in the rules as adopted today.

The Commission has determined to adopt Rules 17Ad-9 through 17Ad-13 modified, as discussed below, to accommodate many of the suggestions made by the commenters. Consistent with its intent as stated in the October Release, the Commission, in modifying the proposed rules, has sought to avoid creating new costs for any substantial segment of the transfer agent industry. Moreover, to the extent that new costs are imposed on some registered transfer agents, the Commission believes that those costs, on balance, are outweighed by the significant benefits associated with the modified rules.[4]

I. Rules 17Ad-9 through 13

A. Basis, Purpose and General Discussion

The Commission proposed Rules 17Ad-9 through 17Ad-13 as a result of its experience since 1975 in operating the transfer agent regulatory program pursuant to Section 17A of the Securities Exchange Act of 1934 (the "Act").[5] In the October Release, the Commission indicated its belief that the proposed new rules, in principle, appeared "necessary to investor protection and to * * * the uninterrupted and efficient operation of the national clearance and settlement system and the securities markets."[6] The Commission noted that whenever transfer agents fail to perform their activities promptly, acccurately and safely, the securities clearance and settlement process suffers, and financial intermediaries, including registered broker-dealers and registered clearing

[1] 47 FR 47269 (October 25, 1982).

[2] File No. S7-948 contains all these public comment letters.

[3] In accordance with Section 17A(d)(3)(A)(i) of the Act, the Commission has consulted with, and requested the views of, the federal bank regulatory agencies at least fifteen days prior to this announcement.

[4] In making this determination, the Commission has attempted to balance compliaince costs in this large and diverse service market against the value to the national clearance and settlement system, the securities industry, the securities markets and the investing public of better assured promptness and accuracy in transfer performance.

[5] 15 U.S.C. 78q-1 (1982).

[6] 47 FR 47269, 47269-270 (October 25, 1982). Section 17A of the Act, as added by the Securities Acts Amendments of 1975, directs the Commission to use its authority under the Exchange Act to facilitate the development of a national system for the prompt and accurate clearance and settlement of securities transactions, including securities transfers.

agencies, face significant financial exposure.[7]

Of the fifty-three letters of comment received by the Commission, approximately fourteen criticized the proposed rules as either unnecessary or inappropriate at this time. Several transfer agents asserted, for example, that most transfer agents, except in isolated cases, have experienced no substantial problems in connection with recordkeeping functions or the safeguarding of funds and securities used in transfer agent operations. Several of these commenters suggested that the Commission and the other Appropriate Regulatory Agencies (the "ARAs")[8] should focus their resources, through examinations in particular cases, on those transfer agents that are unable to perform their recordkeeping, transfer and related functions promptly and safely. Several others, including the American Bankers Association and at least one transfer agent trade association, noted that the proposed rules may be untimely because of industry preoccupation with recent federal tax law changes that require the withholding of federal taxes on dividend and interest payments to securityholders.

The majority of commenters, however, either concurred generally in the proposed rules and supported the regulatory and operational objectives underlying the proposed rules, or focused their discussion on particular provisions that they believed would introduce unnecessary costs. Commenters generally supporting all the proposed rules included one transfer agent trade association, five registered transfer agents, one registered securities depository and two registered broker-dealers. For example, in its comment letter, the Depository Trust Company ("DTC"), a registered securities depository, stated that it "supports the Commission's efforts to ensure prompt, accurate, and efficient transfer services for shareowners and those acting on their behalf." DTC continued, stating that:

> Generally speaking the proposed record-keeping rules strengthen that effort and provide greater safeguards against abuse. We do not think they are overly burdensome in that well-run transfer agents probably maintain their records in as complete a fashion as contemplated by the proposed rules or almost so. Those that do not may find more stringent record-keeping will have long term benefits to their issuer clients and the issuer's shareholders.

Similarly, American Stock Transfer, Inc., a registered transfer agent, indicated its support for the proposed rule changes:

> The concept of developing a better, unified set of transfer agent rules based on up-to-date processing procedures is extremely exciting and ultimately beneficial to the entire investment community.

After reviewing the record in this rulemaking proceeding, the Commission continues to believe that, because transfer agents occupy a crucial role in making the nation's securities markets safe and efficient, it is important that transfer agents observe reasonable, uniform minimum performance standards.[9] Moreover, in view of recent and anticipated accelerating trading volume, and in view of the increasing dependence of most financial institutions on efficient, safe and economical clearance and settlement systems, it is paramount that all registered transfer agents routinely operate in ways that ensure promptness and accuracy in transfer agent activities.

With respect to the scope of the rules as proposed in the October Release, the Investment Company Institute (the "ICI") and several transfer agents for mutual funds urged the Commission to exempt from the proposed rules registered transfer agents that perform transfer agent functions for redeemable securities issued by companies registered under the Investment Company Act of 1940. These commenters asserted that these transfer agents and their activities are already subject to regulation, through requirements under the Investment Company Act. In addition, these commenters noted that most of these securities issued by companies registered under that Act are issued and transferred in uncertificated form and argued, drawing a parallel to the Commission's "Turnaround Rules"[10] and the general exemption granted with respect to those rules,[11] that proposed Rules 17Ad-9 through 17Ad-13 appeared to be designed essentially for transfer and processing of certificated securities.

The Commission believes, however, that exemptions respecting uncertificated securities, although appropriate in regulations governing transfer agent processing and turnaround of certificates and certificate-related items presented for transfer, are inappropriate in regulations regarding registered transfer agents' accurate creation and maintenance of issuer securityholder records and safeguarding of funds and securities in their operations. Indeed, in the absence of certificates reflecting the rights of securityholders, the integrity of an issuer's securityholder records is critically dependent on the controls and safeguards relating to its transfer agent's operations. Moreover, since critical records are maintained by mutual fund transfer agents on behalf of many investment company issuers, these transfer agents have direct responsibility for the integrity of issuer securityholder records and the adequacy of related transfer agent controls. Responsibilities derived from the issuer's obligations to securityholders under applicable law, including the Investment Company Act,[12] while important, cannot be controlling. Thus, the Commission declines at this time to adopt the exemption requested by ICI.

B. Rule 17Ad-9-Definitions

Proposed Rule 17Ad-9 would define the principal terms used throughout proposed Rules 17Ad-10 through 13, including the terms "certificate detail," "debit," "credit," "master securityholder file" and "record difference." The definitions drew significant comment.

Proposed paragraph (a) of the rule would define the term "certificate detail" to include certain minimum identifying information about securities

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[7] More specifically, the Commission cited examples of substandard transfer agent performance in the areas of recordkeeping and safeguarding, which presented significant potential adverse operational and financial problems for the issuer community and the investing securities industry, the securities markets, the public. *See* 47 FR at 47270, notes 5-7.

[8] *See* Section 3(a)(34)(B) of the Act, 15 U.S.C. 78c(a)(34)(B), which defines "ARA."

[9] The Commission believes that these minimum standards are critical to: (i) Providing the Commission with needed additional legal authority to address seriously deficient transfer agent performance; (ii) reducing the potential for transfer agent failure, which inevitably imposes substantial potential liabilities and costs on issuers, securities firms and securityholders; and (iii) improving generally transfer agent performance and thereby reducing the broker-dealers' costs associated with fails to settle and extended transfer delays.

[10] *See* Rules 17Ad-1 through 17Ad-7 (17 CFR 240.17Ad-1 through 17Ad-7).

[11] *See* Rule 17Ad-4(a), 17 CFR 240.17Ad-4(a) (1982).

[12] By directing the Commission to promote the prompt and accurate clearance, settlement, and transfer of securities, and granting the Commission broad rulemaking authority with respect to transfer agent activities, Section 17A of the Exchange Act recognizes both the crucial securities processing role of transfer agents and the basic responsibility placed on transfer agents to monitor and control all transfer agent activities.

Although certain investment companies obtain an external review of transfer agents' systems of internal accounting control in connection with preparing Form N-1R, the criteria associated with that review are substantially different from the criteria set forth in Rule 17Ad-13. Nonetheless, to the extent that the same accountants conduct both Form N-1R evaluations and Rule 17Ad-13 evaluations and the required scopes of those reviews and tests overlap, the expense of preparing reports required by Rule 17Ad-13 should be significantly reduced.

which transfer agent experience has shown to be important to the maintenance of acccurate securityholder records and to the efficient and effective research of inaccuracies in the master securityholder file. "Certificate detail" would include, at a minimum: the certificate number; the number of shares of equity securities or the principal dollar amount of debt securities represented by the certificate; the securityholder's registration (registered owner's name) and address; the date the certificate was issued; the cancellation date of the certificate; and, in the case of redeemable securities of investment companies, an appropriate description of the transaction for each debit and credit being posted (*e.g.*, "purchase," "redemption," or "transfer").

One commenter suggested that, notwithstanding the proposed requirement that transfer agents maintain certain minimum certificate detail, issuers should be permitted, in their discretion, to waive certain of these items that comprise certificate detail. The Commission believes, however, that it is important for all registered transfer agents to maintain certain standard information about securities, particularly since the component parts of the national system for the clearance and settlement of securities transactions are becoming increasingly integrated.[13] Indeed, requiring standard minimum certificate detail is likely to be essential to effective development of "book-entry transfer" of securities ownership.[14]

In response to comments from the Investment Company Institute and several registered transfer agents, the Commission is modifying the definition of "certificate detail" to clarify that that term applies to information about both certificated and uncertificated securities and related account detail. The Commission is also amending paragraph (a)(7) to clarify that, with respect to open-end mutual fund shares, a transfer agent may designate a transaction as a transfer, purchase or redemption by using any appropriate notation or reference in the master securityholder file.

In response to commenters who suggested that certain items of information, not previously proposed, become "required certificate detail," the Commission has added paragraph (a)(8) to the proposed definition. That paragraph would require a transfer agent that includes in its records non-minimum items of information about securities or securityholders to maintain that information if that information is reasonably necessary to the transfer agent's record difference resolution process. Such information could include certificate number prefixes and suffixes, as well as taxpayer identification numbers, to the extent the transfer agent depends on either of these items of information in identifying or researching record differences.[15]

Paragraph (b) of Rule 17Ad–9, as proposed in the October Release, would define "master securityholder file" as "the official list of individual securityholder accounts." That file is the record recognized by the issuer as the official listing of persons or entities that are the record owners of the issuer's securities.[16] Because of the legal and operational importance of this listing, Rule 17Ad–10 requires that postings of certificate detail to the master securityholder file remain on the list until a debit to a securityholder account in the master securityholder file is appropriate.

The Investment Company Institute and several registered transfer agents suggested a change in the definition of "master securityholder file" to allow a mutual fund transfer agent to use a number of interrelated files in lieu of one "master securityholder file." They explained that current industry practice with respect to uncertificated securities is to maintain a group of three or more computer files, commonly linked by the securityholder's account number. Taken together, these files contain the required "certificate detail," as well as other useful account information.

In response to these comments, the Commission is modifying the definition of "master securityholder file" to allow the master securityholder file to consist of multiple, but linked, automated files for uncertificated securities of open-end investment companies registered under the Investment Company Act of 1940. The Commission is not extending this modification to other securities issues because the Commission understands that, with respect to those issues, current industry practice is to post certificate detail to a single master securityholder file. Furthermore, the Commission recognizes, as do most transfer agents, that maintaining a single record containing all critical certificate and account detail simplifies performance of transfer agent functions, contributes to efficient transfer agent operations, and promotes the accuracy of securityholder records.

In the October Release, paragraphs (e) and (f) defined "credit" as "an addition of certificate detail to the master securityholder file because of the purchase or transfer of a security," and "debit" as "a cancellation of certificate detail from the master securityholder file because of the transfer or redemption of a security." The American Bankers Association and other commenters suggested that this definition of "credit" does not account for the issuance of a replacement certificate for a lost security or the issuance of a new certificate in a different denomination than the old certificate. Similarly, these commenters also suggested that the definition of "debit" does not account for the cancellation of a certificate that is lost or the cancellation of a certificate that has been reissued in a different denomination.[17]

In response to these comments, the Commission is modifying the definitions of "credit" and "debit" to broaden their scope as recommended and is adding the term "issued" to paragraph (a) of

[13] Significantly, in an effort to increase immoblization and to improve efficiency in handling securities certificates, registered transfer agents, in conjunction with registered securities depositories, have developed transfer agent custodian programs. Under one such program, DTC's FAST Program, transfer agents maintain custody of an "omnibus" balance security certificate representing the positions that DTC holds for its participants in that issue. See Securities Exchange Act Release No. 19678 (April 15, 1983) 48 FR 17604 (April 25, 1983) and DTC Participant Operating Procedures, Section D.

[14] Book-entry systems for the transfer, purchase and redemption of shares are now used extensively by registered investment companies and their transfer agents. In the future, book-entry systems well be used in connection with corporate or other securities issues when applicable commercial, corporate and other state laws are amended to accommodate uncertificated securities.

[15] Several commenters suggested that the certificate number prefix or suffix and the taxpayer identification number should be included in the required minimum certificate detail. According to some commenters, a transfer agent that handles many issues or that has multiple co-transfer agents might have to suspend activity on all matching-numbered certificates if the prefix or suffix is not immediately known. One commenter suggested that taxpayer identification numbers would greatly enhance the master securityholder file by allowing "identification and proper accounting" among common name accounts. The Commission believes that the decision to include these items of information as certificate detail is better left to the discretion of each registered transfer agent in light of its record format, particularly since the taxpayer identification number is supplied voluntarily to the transfer agent by the securityholder.

[16] As noted in the October Release, the master securityholder file is intended to be synonymous with the record referred to in state corporate law as the "stockholder ledger" or "stockholder register."

[17] One commenter cited another hypothetical "debit" not included in the proposed definition. Occasionally an issuer will issue a new class of securities to replace an outstanding class without calling in the old class and, therefore, without cancelling the outstanding physical certificates. The Commission believes that, in such circumstances, posting debits to the master securityholder file would not be appropriate since certificates reflecting the old issue have not been cancelled.

Rule 17Ad–10. Thus, "credit" and "debit," as defined in this Rule, and the prompt posting requirement of Rule 17Ad–10(a) now refer to any change in certificate detail reflected on the master securityholder file.

As a related matter, some commenters noted that the proposed definition of "debit" appears to require that all certificate detail be purged from the master securityholder file in the event of a debit, but that in practice some certificate detail, *e.g.*, securityholder registration and address, should not be deleted from the file whenever there are other certificates outstanding in the particular securityholder account.[18] For this reason, the Commission is adding the word "appropriate" to the definitions of "credit" and "debit" to clarify that only appropriate elements of certificate detail need to be added to, or cancelled from, the master securityholder file in connection with each credit or debit.

The term "record difference" was defined in Rule 17Ad–9(g) of the October Release relative to two situations: first, when "the total number of shares or total principal dollar amount of securities in the master securityholder file does not equal the number of shares or principal dollar amount in the control book"; and second, when "the security transferred or redeemed contains certificate detail different from the certificate detail currently on the master securityholder file, which difference cannot be immediately resolved."

The Stock Transfer Association, Inc. ("STA") and other commenters sought clarification of the definition of "record difference" because of its importance to the buy-in requirement in proposed Rule 17Ad–10.[19] Since those commenters opposed any buy-in requirement for the second type record difference, (*i.e.*, aged record differences that do not reflect an actual physical overissuance of securities), those commenters suggested that the term "record difference" describe only situations involving actual physical overissuances.

The Commission has determined to adopt the definition of "record difference" as proposed in the October Release. Retaining that definition will enable the Commission to continue to require, in Rule 17Ad–10, that recordkeeping transfer agents use diligent and continuous attention in resolving record differences that may not involve actual physical overissuances and, in Rule 17Ad–11, that recordkeeping transfer agents report to issuers and ARAs respecting both types of record differences. Nevertheless, as discussed below,[20] the Commission is responding to the commenters' basic concern by narrowing the buy-in requirement respecting aged record differences in Rule 17Ad–10.

Paragraphs (c) and (d) as proposed would define the terms "subsidiary file" and "control book." Paragraphs (h), (i), (j), and (k) of the rule define several types of transfer agents. The Commission received no substantive comments concerning these paragraphs and has determined to adopt them without modification.

Finally, in response to requests for clarification from several commenters, the Commission is adding paragraph (l), concerning the term "file," to the definitions. That new definition clarifies that a registered transfer agent's files can consist of either automated or manual records.

C. Rule 17Ad–10—Accurate Creation and Maintenance of Securityholder Files

Paragraph (a). Proposed Rule 17Ad–10(a) would require each recordkeeping transfer agent to post promptly certificate detail to its master securityholder file after a security is transferred, purchased or redeemed. This rule also would require a recordkeeping transfer agent to post any unreconciled portion of the debit and related certificate detail to a subsidiary file and maintain it there until resolved.[21] Furthermore, the transfer agent would be required to use diligent and continuous attention to research these discrepancies. Upon resolution, the item must be promptly posted in accordance with the Rule.

The Commission proposed three specific categories of transfer agents and corresponding time frames within which posting would generally have to occur to be deemed "prompt."[22] For recordkeeping transfer agents that are exempt transfer agents under Rule 17Ad–14(b)[23] and that do not perform transfer agent functions for issuers of redeemable securities of registered investment companies, posting would be deemed prompt if certificate detail is posted within one month after the related security has been transferred. For non-exempt recordkeeping transfer agents that perform transfer agent functions for issues with sustained low transfer volume, the prompt posting requirement would be satisfied if certificate detail is posted within five business days after transfer of the related security. For non-exempt recordkeeping transfer agents that perform transfer agent functions for issues with sustained high transfer volume, posting would be deemed prompt if certificate detail is posted within three business days following the transfer of the related security. The Commission intended the same time frames to apply to the posting of co-transfer agent journals, except that the posting period would commence upon receipt of the journals by the recordkeeping transfer agent.

The Commission received thirty-four comment letters opposing the proposed "prompt" posting time frames. Five commenters objected to the proposal as unnecessary in light of current transfer

[18] The October Release also cited at least two reasons why certificate detail might continue to appear on the master securityholder file but nevertheless might relate to certificates that have been cancelled, *i.e.*, situations in which certificate detail may be retained on the files despite a credit or debit. First, many registered transfer agents retain information about former securityholders to comply with requirements of the Internal Revenue Service that certain information be reported annually. Accordingly, transfer agents generally do not purge their files more often than once a year. Second, some registered transfer agents retain certificate detail on the files as long as possible to facilitate research of potential record differences.

[19] The STA, for example, emphasized that there are two entirely separate types of record differences. The first is created by an unpostable debit, which is usually the result of a prior file error. These errors, while not routine, are not rare and generally represent clerical entry or past system conversion errors. This type of record difference results when equal debits and credits are presented and transferred, but are not equally posted to the master securityholder file, and does not represent a difference between the shares or debt amount authorized and outstanding (as reflected in the control book) and the actual shares or debt amount issued.

The second type of record difference, the first type referred to in proposed paragraph (g), is, according to the STA, the only true out-of-balance condition. The condition exists whenever, for example, the shares issued and outstanding in the hands of the public exceed the shares authorized and reflected as outstanding in the control book. This error is most commonly created when shares are transferred over stop orders or when one class or series of securities is issued against another class or series.

[20] *See* discussion in text at notes 28–31, *infra*.

[21] A registered transfer agency may reject securities presented for transfer or redemption if appropriate under the Uniform Commercial Code. If rejection is inappropriate, however, the transfer agent must process the item in compliance with the Turnaround Rules.

[22] As stated in the October Release, the prompt posting rules are minimum standards that do not mandate the use of any particular type of recordkeeping system. In addition, a recordkeeping transfer agent may post to its master securityholder file debits and credits prior to, or contemporaneously with, but in no case later than promptly after, the transfer, pruchase or redemption of an item to which the debits and credits relate.

[23] This rule exempts from certain of the Turnaround Rules, transfer agents that receive during any six consecutive months fewer than 500 items for transfer and fewer than 500 items for processing. *See* 17 CFR 240.17Ad–4(b) (1982).

agent efficiency. Twenty-six commenters favored either: (i) Less restrictive time frames for high and low volume issues,[24] or (ii) a uniform time frame.[25] One transfer agent and two broker-dealers, however, favored more restrictive time frames. Seven issuer transfer agents opposed the proposed time frames to the extent that the proposal would require them to abandon "batch" posting. That technique, which entails daily posting to a front-end subsidiary file and less frequent "batch" updating to the master securityholder file, minimizes costs by enabling issuers to allocate efficiently their computer facilities to various activities. Finally, ten commenters sought clarification concerning the time frame for posting certificate detail from co-agent transfer journals and recommended that any posting requirement for recordkeeping transfer agents using co-transfer agents account for delays caused by mailing transfer journals. These commenters urged, in addition, that the posting time frames should not commence until the recordkeeping transfer agent receives the appropriate transfer records from the co-transfer agent.

As a general matter, the Commission believes that timely updating of the master securityholder file is essential since delayed posting or the failure to post may promote the proliferation of record inaccuracies that would impede the accurate payment of dividends and interest and the processing of proxy solicitations. In response to the comments, however, the Commission has determined not to predicate posting time frames on the volume of items presented for transfer within each security issue, but instead, has decided to set a uniform five day prompt posting standard for registered, non-exempt transfer agents to correspond more accurately to the prevailing industry standard as reflected in the comments. The Commission nonetheless urges all transfer agents to post with a view toward assuring maintenance of accurate securityholder records and encourages all registered transfer agents that now post on a same-day or next-day basis to continue that exemplary practice.[26] In addition, the Commission is extending the time frame for issuer transfer agents that batch post. Because of the limited number of issues transferred by issuers and the absence of any evidence of problems resulting from the use of batching systems, the Commission believes that this flexibility is consistent with the objectives of the Rule. The Commission also has clarified transfer agents' posting obligations with respect to co-transfer agent journals. Thus, as adopted, Rule 17Ad–10(a) defines the term "prompt" to mean:

the following number of days after issuance, purchase, transfer, or redemption of a security:

(i) With respect to recordkeeping transfer agents that are exempt transfer agents under § 240.17Ad–4(b), 30 calendar days;

(ii) With respect to recordkeeping transfer agents that: (i) Perform transfer agent functions solely for their own or their affiliated companies' securities issues, and (ii) employ batch processing systems, ten business days; and

(iii) with respect to all other recordkeeping transfer agents, five business days;

Provided, however, That all securities transferred prior to record date but posted subsequent thereto, shall be posted "as of" the record date. With respect to posting *certificate detail from transfer journals* received by the recordkeeping transfer agent from a co-transfer agent, the time frames set forth in [the above paragraph] shall commence upon receipt of those journals by the recordkeeping transfer agent.

The definition of "prompt" now contains a proviso concerning posting "as of record date." Various commenters emphasized the importance of maintaining the master securityholder file *in ways that reflect securities* transferred prior to record date and that are thereby subject to record date protection. The phrase "as of the record date" is intended to afford recordkeeping transfer agents flexibility in posting debits and credits resulting from securities transferred immediately prior to record date and to enable those transfer agents to continue the customary practice of "leaving open" the master securityholder file to post those debits and credits whenever heavy transfer volume immediately prior to record date delayed posting those debits and credits by a day or two.

The Commission believes the standards, as adopted, will be easier for registered transfer agents and ARAs to administer. In addition, although the Commission generally has relaxed the prompt posting standard, the Commission believes that the modified rules appropriately identify the performance standards minimally necessary to assure the maintenance of accurate securityholder records and correspond better to the needs and practices of responsible issuer, bank, and other registered transfer agents.

The Commission is also adding "or issued" to the list of situations that may give rise to the need to post certificate detail to the master securityholder file. Thus, for example, Rule 17Ad–10(a) will apply to the posting of certificate detail related to the initial issuance of securities or to the issuance of replacement certificates.

Numerous commenters sought clarification concerning retroactive application of the requirement in Rule 17Ad–10(a) to maintain accurate securityholder files. More specifically, commenters questioned whether paragraph (a) would be interpreted to require registered transfer agents to reconstruct the master securityholder file for missing certificate detail respecting debits and credits posted prior to the effective date of this section.[27]

[24] Most of the commenters noted that only the three day prompt posting standard would impose too severe a burden on their current processing systems. Two commenters opposed the three day prompt posting standard because the higher volume issues require more time for posting to the master securityholder file, not less, as the Commission's proposal implied.

Fifteen commenters suggested implementation of less restrictive time frames, and ten suggested that the cost of compliance might hinder transfer agents' adherence to the three or five day prompt posting standard. Several of those commenting transfer agents stated that they could comply with a five day prompt posting standard with little additional financial or operational burden. Several others, mostly issuer transfer agents, viewed a two week or thirty day prompt posting standard as more appropriate. Still others did not state what their capabilities were, but expressed the view that the costs of compliance with a three day time frame would be excessive. Two commenters indicated that the costs of compliance with the Rule, as proposed, may be so excessive as to force certain transfer agents out of business. Both of these transfer agents, as well as the STA, however, noted that most registered transfer agents generally should be able to adhere to a five day prompt posting standard.

[25] Five commenters suggested a uniform five day prompt posting standard; three suggested a uniform three day standard; one suggested a uniform four day standard; and three commenters endorsed a uniform approach without suggesting any specific time frame. Several endorsed a uniform prompt posting standard because uniformity would avoid confusion and potential competitive injury. In addition, they stated that it would promote easy administration by transfer agents and their ARAs.

[26] In the October Release, the Commission also proposed to establish a 30 day posting time frame for registered transfer agents that handle insubstantial transfer volume, so that such transfer agents could post periodically. Some commenters objected to that exemption, asserting that transfer delays emanate with greater frequency from such transfer agents. The Commission, however, has determined not to change that proposal for two reasons. First, the introduction of a 30 day posting standard, while less strict than the general five-day standard, nonetheless introduces a uniform and reasonably strict discipline for exempt transfer agents. Second, the Commission is proposing today, in a separate release, that exempt transfer agents who handle depository-eligible securities turnaround routine items within five business days of their receipt. That proposal, if adopted, would create significant discipline with respect to those transfer functions that most directly affect presentors.

[27] One commenter suggested that the Commission should require "the previous records to be pulled to set up the certificate detail from the manual records previously maintained."

In response to those inquiries, the Commission is adding new paragraph (h). That paragraph clarifies that registered transfer agents will not be required to reconstruct the master securityholder file to add certificate detail for securities transferred prior to the effective date of Rule 17Ad–10. Paragraph (h), however, provides that subsequent to the effective date, successor recordkeeping transfer agents that establish a new master securityholder file for a particular issue, or recordkeeping transfer agents converting from manual to automated recordkeeping systems, must carry over certificate detail existing on the master securityholder file.

Paragraph (b): The buy-in requirement. Proposed Rule 17Ad–10(b) would require every registered recordkeeping transfer agent to maintain accurate master securityholder files and any necessary related subsidiary files. If a record difference exists and the recordkeeping transfer agent cannot resolve the difference within 6 months, the proposed rule would require the transfer agent to purchase in the open market ("buy-in") an amount of securities sufficient to reduce the record difference. The transfer agent would also be required, by this Rule, to devote continuous and diligent attention to resolving any record differences.

In the October Release, the Commission indicated its initial belief that the "buy-in" provision, if adopted, would deter transfer agents from permitting record differences to accrue and, in that respect, would tend to reduce financial exposure to the transfer agent, issuer and securityholders. In addition, the Commission stated that the maintenance of a complete and accurate master securityholder file would assure securityholders that they are identified as such by the issuer and, as a result, will receive all corporate distributions and communications.

Most of the comments the Commission received regarding this provision endorsed the buy-in requirement, at least in limited circumstances, as a means of assuring accurate master securityholder files.[28] Several commenters, however, indicated that a buy-in requirement may be unnecessary,[29] and many commenters objected to the Commission's broad proposal to require buy-ins for all record differences. For example, as noted previously, the STA emphasized the existence of two distinct categories of record differences and suggested that a buy-in be required only for a true out-of-balance condition, wherein the shares issued and outstanding exceed the shares authorized and outstanding and reflected in the control book. (Most often, such an actual physical overissuance occurs when shares are transferred over stop orders or when one class or series of securities is issued against another class or series.) Six commenters also sought clarification that the buy-in provision would not require a recordkeeping transfer agent to buy-in record differences caused by a registered co-transfer agent or a predecessor transfer agent.

In response to these comments, the Commission is narrowing the scope of the proposed buy-in requirement to cover actual physical overissuances[30] created by transfers or issuances subsequent to the effective date of the Rule, rather than all record differences. While the Rule continues to require good-faith efforts by registered transfer agents to resolve all record differences, the Commission recognizes that, where no actual overissuance has occurred, a strict buy-in requirement could impose costs on transfer agents which substantially exceed the potential financial exposure. In addition, to avoid any confusion, the Commission is removing the buy-in requirement from paragraph (b), as proposed, and is placing the buy-in obligation, together with all relevant considerations, in a separate paragraph (g). Furthermore, in light of the comments received, the Commission has determined to modify the requirement that only recordkeeping transfer agents are responsible for buy-ins; instead, the provision will require that transfer agents responsible for the actual physical overissuances, including co-transfer agents, effect the "buy-ins."[31]

With respect to actual physical overissuances, therefore, new Rule 17Ad–10(g) will require:

> [a] registered transfer agent, in the event of any actual physical overissuance that such transfer agent caused and of which it has knowledge, shall within thirty days of the discovery of such overissuance, buy-in securities equal to the number of shares overissued in the case of equity securities or the principal dollar amount overissued in the case of debt securities. This paragraph requires a buy-in by the transfer agent that erroneously issued the certificate(s) giving rise to the physical overissuance.

Based upon the Commission's experience and the observations made by commenters during this rulemaking proceeding, there appear to be only three common instances of physical overissuance that necessitate a buy-in: (1) The transfer of a certificate over a stop order on the transfer agent's records; (2) the issuance of a certificate ("new certificate") in a dollar or share amount that exceeds the authorized dollar or share amount of the certificate against which the new certificate was issued; and (3) the erroneous issuance of a certificate on cancellation of a certificate of a different security issue class or series (*e.g.*, common for preferred).

Paragraphs (c) and (d). Proposed paragraphs (c) and (d) of Rule 17Ad–10 would require, respectively, that every registered co-transfer agent: (1) Promptly dispatch or mail to the recordkeeping transfer agent a record of certificate detail for every certificate cancelled and every certificate issued; and (2) promptly respond to all inquiries from the recordkeeping transfer agent regarding that record of certificate detail. As proposed in the October Release, the Commission would define "prompt," for both paragraphs, to require a co-transfer agent to perform its

[28] One commenter suggested that the Commission require all record differences to be bought in within one year of the Rule's effective date so that all recordkeeping transfer agents would have complete and accurate files.

[29] For example, seven commenters objected to the buy-in provision because some transfer agents currently have procedures for reconciling record differences. Some commenters cited internal procedures that entail periodic reports to the issuer and to its internal audit department or independent accountant. Other commenters believe the buy-in provision is unnecessary since ARAs currently monitor transfer agent records and procedures. Several other commenters stated that a federal buy-in requirement may be unnecessary since state law already imposes an obligation to purchase securities in the open market or through original issue on behalf of securityholders in order to satisfy any legitimate shareholder claims.

[30] Often the error giving rise to the physical overissuance occurs upon issuance or cancellation of a security certificate. If a co-transfer agent arrangement exists for a particular security issue, it is often the case that the co-transfer agent is responsible for the issuance and cancellation of the actual certificate. In instances such as this, the Commission believes it should be the responsibility of the co-transfer agent to reconcile the error, by buying-in the overissuance when appropriate under new Rule 17Ad–10(g).

[31] Issuers and their transfer agents may be required to buy-in securities that reflect an "overissue" under state law (*see* § 8–104 of the Uniform Commercial Code). This obligation reflects, essentially, a remedy granted to persons directly and adversely affected by the "overissue." Although the Commission is establishing a federal buy-in requirement for actual physical overissuances by registered transfer agents, Rule 17Ad–10(g) is not intended to affect rights or remedies granted to securityholders under § 8–104 of the Uniform Commercial Code or under any other applicable state law. Rule 17Ad–10(g) would require registered transfer agents to buy-in an amount of authorized securities equal to the number of unauthorized equity shares or principal dollar amount of unauthorized debt securities and hold those authorized shares or securities against the transfer agents' potential liability to bona fide purchasers of the unauthorized securities.

obligations by the end of the next business day after the triggering event.[32]

The Commission received five comments stating that the definition of "prompt," for the purposes of these paragraphs, is too strict.[33] Commenters also suggested that proposed time frames be specified in the Rule, rather than in the release. In response, the Commission is relaxing somewhat the time frame for dispatch of certificate detail to the recordkeeping transfer agent to allow co-transfer agents to mail or dispatch certificate detail within two business days after transfer of certificates and is incorporating that time frame in Rule 17Ad–10(c). The Commission believes that this change will reduce the burden associated with the proposed rule by enabling co-transfer agents to dispatch certificate detail every other day, rather than daily. While a two-day time frame is stricter than suggested by the commenters, the Commission believes it important to assure that recordkeeping transfer agents receive transfer journals near the date of transfer, so that the master securityholder file can be maintained from the issuer on a timely basis. Moreover, because dispatch of those journals commonly occurs after work associated with transfer is completed, the Commission believes that a two-day time frame will not be unduly burdensome. Indeed, some commenters that perform cotransfer agent functions, as well as the STA, expressed approval of the strict time frame originally proposed. Furthermore, because of the critical need to post promptly debits and credits around record date, Rule 17Ad–10(c), as modified, requires co-transfer agents to dispatch on a daily basis certificate detail concerning transfers that occur within five business days of record date. This will enable recordkeeping transfer agents to post appropriate credits and debits promptly at the time such posting is most important and should, to some extent, relieve posting backlogs near record date.

Also, in response to commenters' suggestions that the rules provide co-transfer agents with suitable time to research aged transfer records whenever they receive inquiries from recordkeeping transfer agents, the Commission is extending the minimum response time required by Rule 17Ad–10(d) to require a response within five business days of the inquiry. This time frame parallels the requirements of Rule 17Ad–5.

Finally, to facilitate compliance with the reporting provisions of Rule 17Ad–11, the Commission is requiring co-transfer agents to mail recordkeeping transfer agents, within three business days of the end of each month, a record of all buy-ins executed by the co-transfer agent during the preceding month. Because this requirement concerns a special communication between co-transfer agents that the proposed rules necessarily contemplated but did not specifically mention, the Commission is adding appropriate language to paragraph (c).

Paragraph (e). Paragraph (e) of Proposed Rule 17Ad–10 would require every registered recordkeeping transfer agent to "maintain and keep current an accurate control book for each issue of securities." The control book (along with the master securityholder file) is a basic source used by transfer agents to determine the nature and extent of record differences. This Rule would require that a change in the control book not be made "except upon written authorization from a duly authorized agent of the issuer." As understood by the only commenter to address this paragraph, the Commission intends the phrase "written authorization" in this paragraph to include a blanket written authorization to make necessary changes in the control book and accordingly is adopting paragraph (e) as proposed.

Paragraph (f). Proposed Rule 17Ad–10(f) would require recordkeeping transfer agents to retain, for a period of six years, a copy of all certificate detail purged from the master securityholder file. This requirement was proposed to facilitate the resolution of record differences by recordkeeping transfer agents.

The Commission received several comments addressing the appropriate length of time for which purged certificate detail should be retained. The STA suggested that purged certificate detail need be retained only for three years.[34] Two commenters, however, suggested indefinite retention of purged certificate detail. One of these stated that it recently reconciled an account imbalance only after searching through securityholder records dating back more than twenty years.

The Commission continues to believe that a six year record maintenance requirement is desirable to facilitate the resolution of record differences and therefore, is adopting paragraph (f) as proposed. Although not required by this paragraph, the Commission encourages registered transfer agents that retain purged certificate detail for periods of time in excess of six years to continue that exemplary practice.

Three commenters questioned who should be required to maintain purged certificate detail in the event a transfer agent terminates its engagement with an issuer, and suggested that, under these circumstances, the issuer would be the appropriate party. In addition, the STA noted that the obligation should be passed on to the successor transfer agent, if and when such an appointment is made. In response, the Commission has modified paragraph (f) to permit recordkeeping transfer agents to give records to the issuer or an outside service bureau, to be maintained or preserved in accordance with Rules 17Ad–7(f) or 17Ad–7(g), provided the conditions in those rules are satisfied.

D. Rule 17Ad–11—Reporting Requirements

Rule 17Ad–11 governs reports regarding aged record differences, buy-ins and instances of failure to post certificate detail to securityholder files. The Commission believes that the reporting requirements would further two objectives. First, the reports would provide issuers with information necessary to make informed decisions about whether the transfer agent is performing its recordkeeping functions in a satisfactory manner, and whether the amount of aged record differences is sufficiently serious to require disclosure to securityholders. In this manner, the reports should enhance the ability of issuers to monitor transfer agent performance, thereby reducing the need for direct government intervention.

Second, the reports provide regulatory authorities with timely information concerning the source and extent of aged record differences and buy-ins and the identity of registed transfer agents who are experiencing serious difficulties in posting their records.[35] Armed with

[32] In the case of paragraph (c), the triggering event is the accomplishment of transfer of a security; in the case of paragraph (d), the triggering event is receipt of an inquiry from a recordkeeping transfer agent.

[33] With regard to paragraph (c), three commenters stated that a three day standard should be adopted. With regard to paragraph (d), one commenter suggested a five day standard. The fifth commenter suggested, with regard to both paragraphs (c) and (d), that there be either no time limit or a percentage requirement analogous to that established for the turnaround of routine items presented for transfer, pursuant to § 240.17Ad–2.

[34] The STA stated that this would be consistent with other Commission record retention requirements for registered transfer agents and that most, if not all, record differences come to light and are resolved well within three years.

[35] These reports, particularly in conjuction with transfer agent reports already required under Rule 17Ad–2 (c) and (d), should provide regulatory authorities with information regarding those

such reports, regulatory authorities should be able to focus their limited resources more effectively on those transfer agents whose performance may represent potential harm to investors or a threat to the smooth operation of the national system for clearance and settlement of securities transactions. For these reasons, the Commission has determined to adopt Rule 17Ad–11 with the modifications discussed below.

Reports to Issuers.[36] As proposed in the October Release, paragraph (a) of Rule 17Ad–11 would require registered recordkeeping transfer agents (except those that perform transfer agent functions solely for their own securities) to report to the chief executive officer of the affected issuer, within ten business days following the end of each month, regarding aged record differences in each issue for which it acts as recordkeeping transfer agent when either: (i) The aggregate principal dollar amount of debt securities or the aggregate market value[37] of equity securities for all record differences in that issue that have existed for more than 30 calendar days (7 calendar days in the case of redeemable securities issued by a registered openend investment company) exceeds $50,000[38] or (ii) the total number of shares of equity securities comprising record differences in that issue that have existed for more than 30 calendar days (7 calendar days in the case of redeemable securities issued by a registered open-end investment company) exceeds 10,000 shares and $10,000. Each report would set forth, for each issue of securities, the amount of the record difference, the reasons for the record difference and the steps being taken to resolve the record difference.

In response to suggestions from eigtht commenters, the Commission is changing the requirement of proposed paragraph (a)(3) that registered recordkeeping transfer agents (except those that perform transfer agent functions solely for their own securities) send reports under this section to the chief executive officer of the affected issuer. While the proposed rule was intended to produce reports that had an impact on the issuer, the commenters recommended that reports to the corporate official that performs corporate secretarial functions would be most likely to stimulate responsive corporate action. Accordingly, the Commission is requiring, in amended paragraph (b)(3), that reports of aged record differences be sent by the registered transfer agent to the official performing corporate secretary functions for a corporate issuer and to the chief financial officer of the issuer in the case of municipal securities.

Although three commenters suggested requiring reports only where there is a true overissuance and not where aged record differences result from mere clerical errors, the rule, as adopted, will continue to require reports concerning all aged record differences. The Commission believes that such information, if timely and complete, can provide an early warning to issuers that a registered transfer agent may be performing its recordkeeping functions in an unsatisfactory manner or in a manner that could harm the issuer's securityholders and financial intermediaries. For these reasons, the Commission is also retaining the requirement of monthly reports to issuers as proposed in the October Release, despite some comments suggesting less frequent reports. Moreover, since aged record difference reports to ARAs will only be required quarterly and only when aggregate aged record differences exceed federal interest thresholds, monthly reports to affected issuers may enable resolution of these record differences through issuer involvement without federal regulatory intervention.

Several commenters expressed concern that requiring reports for record differences that are aged only seven days in the case of redeemable securities of registered open-end investment companies would not provide adequate opportunity for registered transfer agents to resolve those record differences. In particular, two mutual fund transfer agents noted that Section 22(e) of the Investment Company Act of 1940 allows them seven days to process redemptions and that requiring reports of record differences aged only seven additional days substantially limits the opportunity to resolve those record differences. For this reason, those transfer agents suggested that a period of thirty days be afforded to resolve record differences in redeemable securities issues of registered open-end investment companies before reporting to issuers.

In response to these comments, the Commission is adopting a uniform thirty-day timeframe after which aged record differences must be reported to issuers. The Commission believes that thirty days provides adequate time for most mutual fund transfer agents to resolve most record differences and that those record differences not resolved within thirty days should be reported to issuers.

Many commenters expressed a general concern that the proposed thresholds for reports to affected issuers regarding aged record differences would result in routine and frequent reports, thus ensuring only issuer apathy.[39] Several commenters responded more specifically to the inquiry in the October Release whether the reporting thresholds should be based on a certain dollar amount or a set percentage of the outstanding securities issued. Most of these commenters suggested the Commission use a set percentage of the outstanding shares, since rigid dollar amounts tend to lose their validity over time. One commenter, however, specifically rejected the use of a set percentage, arguing instead that setting a uniform dollar amount facilitates maximum adherence to the rule.

In response to those varying comments, the Commission has determined to adopt tiered dollar thresholds that depend on issuer capitalization.[40] The Commission has decided not to adopt a uniform percentage of outstanding securities as a threshold because such a threshold does not accommodate the wide range of market values for equity issues or relate the level of financial exposure to issuer capitalization as well as a dollar threshold. In addition, in an effort to avoid setting a dollar threshold level

registered transfer agents that are not performing their functions promptly or accurately. *See* § 240.17Ad–10 (a) and (b).

[36] Under the Rule as adopted, paragraph (a) defines "issuer capitalization" and "aged record difference" for purposes of Rule 17Ad–11. Paragraph (b), as adopted, sets forth the requirements concerning reports to issuers. Amended paragraph (d), as adopted, sets out the required content of these reports.

[37] Rule 17Ad–11(e) provides that market value must be determined as of the last business day on which market value information is available in each reporting period.

[38] The dollar value of the debits and credits for the *same* transaction should not be aggregated, however. For example, suppose the transfer agent transfers a certificate from shareholder A to shareholder B for 50,000 shares of common stock with a market value of $50,000. Because in this example the master securityholder file does not show any shares as having been issued to A, the transfer agent posts to the master securityholder file the tranfer to B of 50,000 shares and posts to a subsidiary file a debit of 50,000 shares to A. For purposes of determining whether a report is required, the aggregate market value of this transaction would be $50,000 (not $100,000).

[39] Several commenters suggested that the dollar and share thresholds are too low and would generate too many reports, which might undermine the desired impact of all reporting. One commenter, however, suggested that the proposed dollar and share threshold levels for reporting aged record differences to issuers are too high, considering that many recordkeeping transfer agents represent small companies with few shares outstanding or shares of low market value. In the case of these issues, the commenter argued, many posting problems could exist before the reporting levels would be reached.

[40] *See* Table in paragraph (b) of Rule 17Ad–11.

that is, for some issues, too high and, for other issues, too low, the Commission has developed the tiered approach and has relied in some respects on commenters' suggestions in setting threshold levels.

In light of the revisions to the buy-in requirement of Rule 17Ad–10, the Commission is adding in paragraph (b)(2) of Rule 17Ad–11 a requirement of reports by recordkeeping transfer agents to affected issuers regarding all buy-ins executed by transfer agents pursuant to Rule 17Ad–10. Moreover, as discussed above,[41] so that recordkeeping transfer agents have all the information necessary to prepare complete reports to issuers, Rule 17Ad–10(c)(2) requires co-transfer agents to report to the recordkeeping transfer agent any buy-ins executed pursuant to Rule 17Ad–10(g).

Reports to Appropriate Regulatory Agencies. As proposed in the October Release, Rule 17Ad–11(b) would require a recordkeeping transfer agent to file with its ARA in accordance with Rule 17Ad–2(h) a report containing the information specified in paragraph (a)(2) [42] within ten business days following the end of each month when the aggregate market value of record differences for all issues handled by that transfer agent exceeds certain levels.[43] Under the adopted Rule, the requirements concerning reports to ARAs are contained in paragraph (c), and the required content of the reports concerning aged record differences and buy-ins is set out in paragraph (d).

The Investment Company Institute and two mutual fund transfer agents indicated their belief that a rule requiring reports of aged record differences to ARAs duplicates the existing requirement to file Form N–1R with the Commission on an annual basis. The information filed on an annual basis by open-end registered investment companies on Form N–1R, however, concerns only delayed, lost and cancelled orders and does not provide timely information to ARAs respecting the source and extent of aged record differences and buy-ins or the identity of registered transfer agents that are experiencing difficulties in posting their records. Accordingly, the Commission continues to believe that reports to ARAs concerning those operational details will create a unique and important early warning and monitoring program respecting transfer agent performance and should be filed by all registered transfer agents, including mutual fund transfer agents.

In response to requests from several commenters, the Commission is modifying the Rule to require reports to ARAs on a quarterly, rather than monthly basis. Moreover, the rule provides that, if ARA reports are required for a particular recordkeeping transfer agent, that transfer agent may, in lieu of preparing a new document, file copies of relevant reports sent to issuers pursuant to paragraph (b). Moreover, to the extent those reports do not disclose all aged record differences in issues for which the recordkeeping transfer agent maintains the master securityholder file, the Rule permits the recordkeeping transfer agent to disclose those aged record differences in an attachment or cover letter.

Commenters suggested various threshold levels for reporting to ARAs aged record differences.[44] Because the frequency of ARA reports is being extended from monthly to quarterly, and because some commenters assumed that the required reports would concern only record differences that constitute actual over-issuances, the Commission is adding an additional upper-level category and is increasing substantially the dollar threshold levels.[45]

For the same reasons that the Commission has determined to require reports to issuers of buy-ins in amended paragraph (b)(2), the Commission is requiring quarterly reports to ARAs of certain buy-ins in new paragraph (c)(2). These reports must disclose the amount of all buy-ins executed pursuant to Rule 17Ad–10(g) by all relevant transfer agents for issues for which the recordkeeping transfer agent maintains the master securityholder file, and must be filed whenever the aggregate market value of all such buy-ins during that quarter exceeds $100,000.

As proposed, paragraph (c) of Rule 17Ad–11 focused on problems experienced by registered transfer agents in posting certificate detail to their securityholder records. This paragraph would require a recordkeeping transfer agent to report immediately to its ARA when any debits or credits for securities transferred, purchased, redeemed or issued are unposted to the master securityholder and/or subsidiary files for more than five business days after debits or credits are required to be posted to the master securityholder file under Rule 17Ad–10. As indicated in paragraph (c)(3), the report would state the existence of unposted debits and credits and would indicate the steps being taken to correct the situation.

Most commenters on this Rule were concerned that five business days from the posting time proposed in Rule 17Ad–10 would be insufficient to enable resolution of problems that relate to co-transfer agent journals or non-routine items. Two of the commenters suggested exempting from the reporting requirement the posting of co-agent journal input and other "unusual event processing," since the posting and issuance of physical certificates should have a higher priority.

The Commission believes that the changes in posting time frames set forth in Rule 17Ad–10 should resolve these commenters' concerns. In the event a recordkeeping transfer agent requires more than five days from transfer to resolve record differences, the Commission believes that the recordkeeping transfer agent nevertheless should post the credit to the master securityholder file and the debit to a subsidiary file, as required by Rule 17Ad–10(a). At that point, no report would be required under Rule 17Ad–11. Moreover, in such an instance, the certificates to which the debit and credit relate will already have been cancelled and issued, and the mere existence of a record difference should not justify neglect in posting the relevant debits and credits. Thus, the Commission is adopting paragraph (c), redesignated as paragraph (c)(3), without significant modification.

Miscellaneous Provisions. Paragraph (d), proposed as paragraph (a)(2), drew no substantial comment, although some commenters requested clarification concerning the information that may be disclosed in reports. That paragraph, as adopted, sets out the information required to be contained in the reports of record differences (paragraph (d)(1)) and buy-ins (paragraph (d)(2)). Both paragraphs (d)(1) and (d)(2) require the

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[41] *See* discussion in text at notes 28–31, *supra*.

[42] Paragraph (a)(2) has been redesignated as paragraph (d).

[43] $100,000 for 5 or fewer issues; $200,000 for 6 to 24 issues; $300,000 for 25 to 49 issues; $400,000 for 50 to 74 issues; $500,000 for 75 to 99 issues; $600,000 for 100 to 999 issues; or $1,000,000 for over 1,000 issues.

[44] For example, the STA suggested a sliding scale identical to that proposed by the Commission with the exception of one category: The STA suggested a threshold of $1,000,000 for a registered transfer agent handling 500 to 999 issues instead of the proposed $600,000 for 100 to 999 issues. Another commenter suggested only two categories: $100,000 for 99 or fewer issues and $200,000 for 100 or more issues. A third commenter suggested only one category—$1,000,000 for each 1000 issues.

[45] The Commission is adopting the change in categories suggested by the STA. *See* footnote 44, *supra*. For the specific reporting thresholds, *see* Rule 17Ad–11(c)(1), *infra*. When aggregating aged record differences under this paragraph (or when aggregating all record differences in an issue for reports under paragraph (b)(1)), a reporting registered transfer agent may not "net" overages and underages in issues. Instead, that transfer agent must aggregate the absolute value of all the aged record differences.

reports to issuers and ARAs to specify the principal dollar amount of debt securities or the number of shares and related market value of equity securities comprising the aged record differences or the buy-ins and the reason for the aged record differences or buy-ins. In addition, paragraph (d)(1) requires those reports to state the steps being taken to resolve any aged record difference, and paragraph (d)(2) requires reports to identify the entity that executed any buy-in. Furthermore, in response to comments, paragraph (d)(1) is being clarified to indicate that aged record differences that existed before the effective date of the rules must be reported to issuers and ARAs. The Commission believes that issuers and ARAs should be informed of the progress made by the current recordkeeping transfer agent in resolving these aged record differences.[46]

Proposed paragraph (d) would provide the basis for calculating market value for purposes of Rule 17Ad–11. According to this paragraph, the market value of an issue would be determined as of the last business day of each month. One commenter explained that it cannot always obtain a quotation as of the last business day of the month, especially for small issues with low transfer volume. This commenter suggested instead that the rule allow a "last available" quotation or a letter from the issuer stating the approximate per share value. Another commenter requested clarification of the source of the market value, especially as it applies to over-the-counter securities or thinly traded bond issues.

In response to the commenters' concerns, the Commission is modifying the paragraph, resdesignated as paragraph (e), to allow registered transfer agents to determine the market value as of the last business day on which market value information is available in the reporting period. For example, reporting transfer agents may use the latest publicly disseminated quotation in the reporting period. Transfer agents should, however, make a good faith effort to obtain an accurate market value for the security. For example, with respect to securities not listed on an exchange or for which price quotations are available in the NASDAQ System, transfer agents generally should not rely on "representative quotations" printed in the "pink" or "white sheets" without, either directly through market makers in the security or indirectly through the issuer, confirming the actual price at which the security is trading.

Finally, the Commission is adopting paragraph (f) of Rule 17Ad–11, proposed as paragraph (e), without modification. That paragraph requires reporting registered transfer agents to retain a copy of any report filed under this rule for three years, the first year in an easily accessible place.

E. Rule 17Ad–12—Safeguarding Funds and Securities

Proposed Rule 17Ad–12 would require registered transfer agents to safeguard funds and securities used in transfer agent operations by prohibiting them from taking any action with respect to those funds or securities unless the transfer agent has taken appropriate steps to ensure the safeguarding of those funds and securities. Proposed Rule 17Ad–12, however, would provide registered transfer agents with considerable flexibility in adopting measures to safeguard funds and securities, because the appropriate steps would be tested "in light of all facts and circumstances." Although the Commission listed in the October Release several safeguarding measures that could be implemented,[47] the Commission noted that each transfer agent should exercise responsible discretion [48] in adopting safeguards appropriate for its own operations.

The Commission received seventeen comments concerning this proposed rule. Overall, the comments favored the general purpose of the proposed rule. Several commenters, however, criticized the construction of the rule insofar as it appeared to require transfer agents that violate this rule to halt all transfer agent activities, which, in turn, would force such transfer agents to violate other regulations, including the turnaround requirements of Rule 17Ad–2. Other commenters sought clarification that compliance with this rule would not require adoption of security measures that were not cost-justified.[49] Three commenters suggested that a minimum insurance requirement would prevent the need for installing unnecessary safeguards and would at the same time help transfer agents minimize costs.

The Commission continues to believe that the adoption of this rule is desirable because it would establish a clear and straightforward legal standard regarding transfer agents' responsibilities to safeguard funds and securities. In response to these comments, however, the Commission is restating this rule to require affirmatively that registered transfer agents assure that funds and securities used in their transfer agent operations are adequately safeguarded. Rule 17Ad–12, as modified, thus will not require a transfer agent to cease acting as such upon violation of this Rule. In addition, the Commission is adding to the Rule the following provision concerning the relevance of cost considerations in making decisions respecting various safeguarding mechanisms and procedures:

> In evaluating which particular safeguards and procedures must be employed, the cost of various safeguards and procedures as well as the nature and degree of potential financial exposure are two relevant factors.

This change should clarify that the decision to select among various safeguards can be based upon, among other factors, the cost-effectiveness of particular alternative safeguards in light of each transfer agent's particular operations and risks.

In the October Release, the Commission noted that transfer agents registered with the Commission should exercise caution in hiring personnel who had been convicted within the previous ten years of any crime involving dishonesty or a breach of trust and should establish suitable safeguards prior to authorizing access by such

[46] A transfer agent who, like some commenters, believes that a stigma is attached to a successor transfer agent when it must report a record difference that was caused by other transfer agents or that existed before the effective date of the rules can note the cause of, as well as the entity responsible for, the aged record difference, in the "reasons" portion of the reports to issuers or to ARAs under paragraph (d)(1).

[47] That list included: A dual control vault for safekeeping of unissued blank certificates and unissued dividend checks; sign-in procedures for vault entry; closed circuit TV cameras; security guards; locked doors to departments or offices where transfer agent activities are performed; identification badges worn by persons entering those areas; magnetized identification or other cards or electronically controlled locked doors for entry to the transfer agents' EDP department; user codes, password procedures or other terminal access controls to ensure security over EDP system terminals in connection with operator identification and the initiation and processing of transactions; and dual control vaults or other secure locations for the original books and records regarding securities transfers (e.g., transfer journals).

[48] As indicated in the October Release, however, although transfer agents have considerable discretion in this regard, they must take into account other applicable federal and state statutes or regulations. The Commission also acknowledged, in the October Release, that most transfer agents, particularly banks, currently have many of these safety measures in place.

[49] Twelve commenters stated that the appropriate measures for safeguarding the funds and securities in the custody or possession of a transfer agent should remain within the discretion of the transfer agent's management or the transfer agent's internal audit department. Most of these commenters indicated, for example, that certain of the security measures enumerated by the Commission were not cost-justified in light of their particular transfer agent operation (since no cash or negotiable instruments were held on the premises).

personnel to funds, securities or records in the possession of the transfer agent. Two commenters expressed concern that exclusion of such personnel from employment under certain circumstances may violate federal laws prohibiting discriminatory hiring practices.

The Commission believes that relevant criminal history is one factor to be considered by registered transfer agents in making employment decisions regarding staff assignments that entail access to funds or securities. Indeed, the Commission believes that Sections 17A and 17(f)(2) of the Act explicitly make it legitimate to include criminal history as one among several employment-related factors.[50] Although the Commission believes that an applicant's criminal record may be relevant in employment decisions and interprets Rule 17Ad-12 to authorize consideration of that factor in making employment decisions, the Commission emphasizes that such decisions remain within the responsible discretion of transfer agent management in light of all facts and circumstances. Relevant facts and circumstances could include the nature of the prior violation, the type of employment activities and the nature of controls over the applicant's future activities and access to funds or securities.

F. Rule 17Ad-13—Annual Study and Evaluation of Internal Accounting Controls

The October Proposal. Proposed Rule 17Ad-13 would require certain registered transfer agents to obtain a report by an independent accountant on the adequacy of internal accounting controls relative to the transfer agents' operations. The proposal would exempt registered transfer agents that perform transfer agent functions for their own securities, for securities issued by wholly owned subsidiaries or for securities issued by other corporations that own 100% of the capital stock of the registered transfer agents (collectively, "issuer transfer agents"). The proposal also would exempt certain other registered transfer agents that qualify under Rule 17Ad-13(f) (generally, transfer agents that are small businesses (referred to in this release as "small transfer agents")). The proposal also would permit the federal bank regulatory agencies to exempt bank transfer agents subject to their jurisdiction that are not otherwise exempt as small transfer agents or issuer-transfer agents, provided that a report similar in scope to the report required by Rule 17Ad-13 is prepared by the bank's internal auditors for the bank's Board of Directors or an audit committee of the Board of Directors. Therefore, assuming the federal bank regulators took appropriate action, the proposal would apply primarily to non-bank professional registered transfer agents that perform transfer agent activities on behalf of other issuers.

The report, as proposed,[51] would be required to be prepared annually by an independent accountant and would be filed with the ARA. The report would be based on a study and evaluation of the system of internal accounting control used in the transfer agent's operations [52] and would describe and comment on any material inadequacy found to exist, as of the date of the examination, or would state that the study and evaluation did not disclose any material inadequacy.[53]

If the accountant's report specified any "material inadequacies," proposed paragraph (d) would require the transfer agent receiving that report to indicate, in writing, to its appropriate regulatory agency and to the accountant within thirty calendar days of receipt of the accountant's report, the corrective action taken, or planned to be taken, by the transfer agent. Sixty calendar days thereafter, the transfer agent would be required to obtain from the accountant and forward to the transfer agent's ARA a written statement regarding whether the corrective action has been implemented, and if not, the reasons therefor.[54]

Finally, paragraph (e) would require that the accountant's report and all documents required by paragraph (d) be maintained by the transfer agent for at least three years, the first year in an easily accessible place.[55]

Comments and Specific Modifications—External Study and Evaluation.[56] The Commission received 32 comments concerning proposed Rule 17Ad-13 from various types of institutions within the securities industry.[57] All commenters except one agreed that some type of internal control examination is appropriate, and thirteen, including the STA, specifically endorsed the concept of an independent accountant's study and evaluation ("Evaluation") of the system of internal accounting control and procedures used by registered transfer agents for operations and safeguarding funds and securities ("External Evaluation"). Eight commenters, however, objected to an annual External Evaluation because it would increase the cost of doing business without, in their view, producing any significant increase in benefits.[58]

The Commission believes that the goal of the External Evaluation, ultimately, is to enhance securityholder protection. The safe and accurate performance of transfer agent functions depends on the accuracy and reliability of the systems and procedures used by registered transfer agents in performing transfer agent activities, and the Commission believes it is imperative that there be systematic verification that transfer agents operate safely and accurately. The Commission also believes that an adequate system of internal accounting control is critical to the accurate and safe clearance and settlement system for securities

[50] Section 17A(d) of the Act, 15 U.S.C. 78q-1, prohibits transfer agents from violating rules adopted by the Commission designed, among other things, to safeguard funds and securities used in transfer agent operations. Section 17(f)(2) of the Act, 15 U.S.C. 78q(f)(2), requires registered transfer agents, among other things, to fingerprint their partners, directors, officers and employees and to submit those fingerprints to the Attorney General of the United States for identification and appropriate processing. Section 17(f)(2), in particular, which was added to the Exchange Act in 1975, is designed to reduce the incidence of securities thefts. The Commission believes, therefore, that Congress would not have authorized transfer agent access to federal records regarding the criminal history of prospective transfer agent personnel, unless it intended transfer agents to use that information in a responsible manner to limit the risk of securities theft. *See also Green v. Missouri Pac. R.R.*, 549 F.2d 1158, 1160 (8th Cir. 1977); *Richardson v. Hotel Corp. of America*, 332 F. Supp. 519 (E.D. La. 1971), *aff'd mem.* 468 F.2d 951 (5th Cir. 1972).

[51] Proposed paragraph (b) has been revised to permit accountants to use the report format specified in SAS 30 as supplemented by Rule 17Ad-13 and has been incorporated into paragraph (a). *See* Rule 17Ad-13(a)(1), *infra*.

[52] *See* American Institute of Certified Public Accountants, Statement on Auditing Standards No. 30, Reporting on Internal Accounting Control, paragraphs 54-59 (July 1980) ("SAS 30").

[53] *See* Rule 17Ad-13(a)(3) for the definition of material inadequacy.

[54] As adopted, paragraph (d) has been revised and redesignated as paragraph (b). *See* Rule 17Ad-13(b).

[55] Paragraph (e) has been redesignated as paragraph (c) in adopted Rule 17Ad-13.

[56] In response to several commenters who criticized use of the term "audit," the Commission has revised Rule 17Ad-13 to clarify that the type of examination intended by this Rule is a "study and evaluation" not related to an audit of transfer agent financial statements.

[57] The Commission received comment letters concerning Rule 17Ad-13 from a wide spectrum of organizations within the securities industry: Seventeen registered transfer agents (including five bank transfer agents, four mutual fund transfer agents and three issuer transfer agents), two broker-dealers, eight trade associaitons, one federal bank regulatory agency, one registered clearing agency and one accounting firm.

[58] Two of these commenters also questioned whether independent public accountants possess the expertise to study and evaluate a transfer agent's internal accounting controls and believed that internal auditors or the appropriate regulatory agency are better able to conduct an Evaluation of a transfer agent's system of internal accounting control.

transactions. Moreover, through the discipline associated with an External Evaluation, transfer agents will be informed on a timely basis about any inadequacies in their system of internal accounting control for transfer agent activities and for safeguarding related funds and securities and should, as a result, be able to make any needed changes on a timely basis.

The Commission believes that the External Evaluation is a critical feature of the scheme of internal disciplines that the rules adopted today are designed to promote. The External Evaluation provides an important objective review and should promote uniform high-quality transfer agent performance. Moreover, the External Evaluation should increase public confidence in the national clearance and settlement system.

Scope of the Study and Evaluation. Two commenters objected to the proposed "checklist approach" to the scope of the Evaluation [59] and suggested that the scope of the Evaluation be left to the independent accountant in accordance with generally accepted auditing standards. The AICPA noted that many registered transfer agents handle funds and securities for purposes unrelated to their transfer agent functions and suggested that the Commission clarify that such funds and securities are not part of the required Evaluation.[60]

In response to these and related comments, the Commission has revised proposed Rule 17Ad–13 to clarify the scope of the Evaluation and to accommodate varying types of registered transfer agents and their activities. The Commission also has revised the rule to focus on transfer agent activities more generically.[61] In addition, the rule as adopted has been revised to clarify that internal accounting controls respecting "funds and securities" to be evaluated are only those related to transfer agent functions and activities.

Material Inadequacy. Two commenters [62] suggested modifying the definition of "material inadequacy" to conform to the definition of "material weakness" in SAS 30. The AICPA also recommended adding a clarifying footnote to the rule to indicate that the source of the definition of "material inadequacy" is the definition of "material weakness" contained in SAS 30.

While noting that the four conditions listed in the proposed Rule under "material inadequacy" are essentially the same criteria used to evaluate inadequacies in the reports for registered broker-dealers, the AICPA pointed out that the AICPA's Stockbrokerage Auditing Subcommittee and the Commission are attempting further to define the conditions that would rise to a level of a "material inadequacy." The AICPA and Peat, Marwick suggested that the final rule should reflect changes, if any, in the definition of "material inadequacy" that result from these discussions between the AICPA and the Commission.[63] In addition, both commenters objected to the language "or the relevant issue's financial statements" in subparagraph (a)(2)(iii) of proposed Rule 17Ad–13. They suggested that establishing materiality by reference to the issuer's financial statements is neither practical nor economically feasible.[64]

The Commission specifically proposed the term, as well as the definition of, "material inadequacy" to avoid confusing that term with the concept of "material weakness" defined in SAS 30. SAS 30 defined "material weakness" solely in relation to the financial statements of the entity whose controls are being evaluated. The study and evaluation under this rule, however, is intended to detect weaknesses involving amounts that may not be considered material when compared to the transfer agent's assets, but would be considered material when viewed against the transfer agent's ability promptly and accurately to transfer record ownership and safeguard related securities and funds. The Commission believes that this standard is critical to the effective operation of the Rule and has therefore decided to retain the term "material inadequacy" with certain modifications.[65] Specifically, the Commission is deleting the phrase "among other things," as well as items (iii) and (iv) of proposed paragraph (a)(2).[66]

Accountants' Reports. The Commission has incorporated proposed paragraph (b) in adopted paragraph (a)(1) and has revised the latter paragraph to identify certain statements that must be included in the accountant's report. The Commission expects that an accountant preparing reports under this rule will use the general standards and format established by the AICPA in SAS 30, including primarily paragraphs 54–59. The rule, as adopted, requires that the accountant's report state whether the Study and Evaluation was made in accordance with generally accepted auditing standards using the criteria set forth in paragraph (a)(3) of the rule and describe and comment upon any material inadequacies found to exist in the system of internal accounting control as of the date of the Evaluation. The Commission is requiring the accountant to represent, in particular, that the criteria set forth in paragraph (a)(3) of the rule were used, because these criteria differ in important

[59] One commenter stated that a "checklist approach" may be too broad for some registered transfer agents, causing the scope of the evaluation to be "needlessly extended (which could result in increased cost)," and inadequate for others (which would result in material inadequacies being overlooked).

[60] Other commenters sought clarification concerning various aspects of the scope of the Evaluation. One commenter sought clarification as to whether the scope of the Evaluation was limited to an evaluation of "safeguarding controls and procedures of the transfer agent or an evaluation of each individual transfer account." This commenter believed that the evaluation should be limited only to the examination of the transfer agent's safeguards and controls to ensure that these safeguards provide reasonable assurance against losses from unauthorized use or disposition of funds and securities, that transfers are promptly recorded, and that transactions are executed in accordance with management's authorization and should not extend to the accuracy of each individual transfer account. Although the primary scope of the Evaluation is the system of internal accounting control in the aggregate, the Commission believes that accountants may wish to test individual securityholder accounts if deemed necessary, in accordance with generally accepted auditing standards, to opine with respect to the system taken as a whole. *See* revised Rule 17Ad–13(a), *infra*.

[61] *See* Rule 17Ad–13(a)(2), *infra*.

[62] The Commission received comment letters from the AICPA and from Peat, Marwick Mitchell & Co. ("Peat, Marwick") concerning the definition of "material inadequacy."

[63] Peat, Marwick recommended that the Commission not adopt this rule until the AICPA's Stockbrokerage Committee, in consultation with the Commission, defines "material inadequacy" for purposes of broker-dealer External Evaluations. Failing that, Peat, Marwick recommended that the Commission, as an interim measure, adopt the specific language of Paragraph 30 of SAS 30.

[64] Commenters also objected to the ambiguity introduced by the phrase "among other things" in proposed Rule 17Ad–13(a)(2).

[65] Indeed, paragraph 54 of SAS 30, by implication, recommends that an agency set "specific criteria for the evaluation of the adequacy of internal accounting control procedures for their purposes and * * * require a report based on those criteria." *Id.*, ¶54. The Commission has used a similar definition of material weakness in connection with the annual study and evaluation of clearing agency systems of internal accounting control. *See* Securities Exchange Act Release No. 16900 (June 17, 1980) 45 FR 41920 (June 23, 1980). In light of the special recordkeeping and turnaround role of registered transfer agents in the national clearance and settlement system, the Commission is not prepared to conclude at this time that the criteria for evaluating transfer agent internal accounting controls should be co-extensive with the criteria for evaluating brokerage firm systems of internal accounting control.

[66] The Commission appreciates the comment that reference to issuers' financial statements would create unproductive studies and present special problems. The Commission accordingly, has determined to delete that reference in Rule 17Ad–13.

respects from traditional definitions of material weakness.

The accountant's report serves not only as a prevention and maintenance device for transfer agents, but also as an early warning mechanism for ARAs. In that respect, the accountant's report should enable the ARAs, particularly the Commission, to focus limited resources on problem areas that might affect investor protection and the national clearance and settlement system processes.

Filing Requirement. The Commission is modifying proposed paragraph (c) (incorporated into the adopted rule as paragraph (a)) to conform the filing requirement under that paragraph to the filing requirement in Rule 17Ad–2(h). Thus, within ninety days of the date of the Evaluation a registered transfer agent must submit the report to the transfer agent's ARA and the Commission, or if the ARA is the Commission, to the Commission and the appropriate regional office of the Commission.

Notice of Corrective Action. The Commission recognizes that in some cases registered transfer agents may be unabel both to propose corrective action within 30 days of the report and to implement it within 90 days. The Commission also recognizes that in cases where material inadequacies exist, the independent accountant, before issuing an opinion regarding the effect of corrective action, ordinarily would need to review and test the corrective measures and in any event could not express an opinion concerning decisions that depend on cost/benefit assessments. The Commission, therefore, in response to comments has extended the 30 day reporting requirement respecting proposed corrective action to 60 days and has eliminated the requirement that the independent accountant prepare a follow-up report concerning the effect of any corrective action.[67]

Exemptions. Eleven commenters supported certain exemptions from the annual report requirement, as proposed for different types of registered transfer agents, including issuer transfer agents and bank transfer agents. Two commenters, however, objected to any exemptions from this section because they believe that an annual External Evaluation is the only means to insure the public that the transfer agent is in compliance with all recordkeeping and reporting requirements.

Exemptions for Issuer Transfer Agents. One commenter suggested that the word *"wholly"* in proposed subparagraph (f)(1)(ii) of Rule 17Ad–13, as it refers to a subsidiary of a parent company, be changed to *"principally."* This commenter contended that without that change, a company that is substantially owned by another company could be required to undergo a costly annual External Evaluation for a relatively small number of securityholders.

In response to this commenter, the Commission has extended the scope of this exemption to include transfer agents that perform functions for securities issued by subsidiaries in which the transfer agent owns more than 51% of the subsidiary's common stock. Similarly, the Commission has revised the issuer exemption to include transfer agents that perform transfer agent function on behalf of companies that own more than 51% of the transfer agent's common stock. These exemptions recognize the issuer's special interest in, and obligation respecting, efficient and accurate recordkeeping in instances where the issuer is capable of exercising direct ownership and management control over the registered transfer agent's operations.

Exemptions for Bank Transfer Agents. In response to comments from the staff of the BGFRS and others, the Commission is modifying this exemption to exempt bank transfer agents from Rule 17Ad–13 unless otherwise informed by their ARA. This change, as noted by the commenters, will reduce the administrative burden that would be associated under the proposed rule with either rulemaking by the federal bank regulatory agencies or case-by-case processing of bank exemption requests. In order to claim the exemption, however, bank transfer agents must obtain an annual report on their system of internal accounting control similar to the scope of the report required by Rule 17Ad–13, prepared either by the bank's internal auditors or independent accountants.

Some commenters argued that an exemption for bank transfer agents that internally review system controls would affect the ability of non-bank transfer agents to compete with exempt banks for transfer agent business. These commenters continued that non-banks required to obtain an external accountant's report must pay expenses that banks will not incur. Under the proposal, however, banks will not be eligible for an exemption unless they obtain, in fact, an internal Evaluation similar in scope to the Evaluation required for non-bank transfer agents under Rule 17Ad–13. That internal Evaluation, while perhaps less expensive as a general matter than an External Evaluation, nonetheless involves similar work and similar expense. The Commission cannot conclude from the record and its experience with systems control reviews that the incremental difference in cost between external Evaluations and internal Evaluations would have any appreciable impact on competition among similarly sized and similarly situated registered transfer agents. Moreover, bank transfer agents currently absorb substantial costs associated with bank regulation and oversight, including bank examinations, and, as is not the case with non-bank transfer agents, internal and external bank examinations are coordinated elements in an extensive regulatory scheme designed to assure safety and soundness in the banking industry. As a result, the competitive impact of the rules is more likely to neutralize existing expense disparities, rather than introduce a new factor adversely and inappropriately affecting competition among different types of registered transfer agents. For those reasons, the Commission is adopting the proposed exemptions as paragraph (d)(3).

Other Proposed Exemptions. One commenter suggested that the Commission exempt named transfer agents from Rule 17Ad–13, provided the service company complies with the annual examination requirements of Rule 17Ad–13 and provides the named transfer agent with a copy of that report. The Commission is declining to adopt that suggestion, however. In the Commission's experience, named transfer agents that contract with service companies do not receive more than 500 items for transfer nor more than 500 items for processing in six consecutive months and, therefore, qualify for the small transfer agent exemption.

G. Minimum Net Worth/Insurance Requirement

In the October Release, the Commission solicited comment on whether to establish minimum net worth and/or insurance requirements for registered transfer agents (other than bank or issuer transfer agents). Most commenters favored a minimum insurance requirement and many favored both minimum insurance and minimum net-worth requirements. These

[67] Instead, the registered transfer agent would be required to obtain specific comments from the independent accountant concerning previously identified material inadequacies in the next accountant's report. *See* Rule 17Ad–13(a)(1)(iii), *infra*.

commenters, however, suggested widely varying ranges of minimum insurance and net worth levels.

The Commission believes that minimum insurance and/or net worth requirements are appropriate regulatory measures to enhance the financial capacity of registered transfer agents. The Commission also believes, however, that it is important to move forward with the regulations adopted today. Thus, the Commission will assess the impact of those regulations on transfer agent operations and performance over the ensuing month and will then consider the need for and substance of minimum net worth/insurance requirements.

H. Transfer Turnaround Time Frames

In the October Release, the Commission requested specific comment concerning the present minimum transfer and processing turnaround performance standards set forth in Rule 17Ad–2 (a) and (b) and the threshold for the exemption in Rule 17Ad–4(b) for "exempt transfer agents." Several commenters, including the STA, suggested that the Commission lengthen the minimum performance times. The overwhelming majority of the commenters, however, including three other transfer agent trade associations (the Corporate Transfer Association, Inc., the Western Stock Transfer Association, Inc. and the Midwest Stock Transfer Association, Inc.) generally approve the current minimum performance standards.

Commenters recommending that the Commission extend the turnaround time frame from 3 to 5 business days cited difficulties in handling mail items. Most commenters that responded to the question concerning mail items, however, believed that it is important to foster regulatory continuity in this area by maintaining the uniform three day turnaround standard for all routine items, noting that their present systems are all designed to accommodate that standard.

Because the majority of commenters believed, as does the Commission, that the turnaround performance rules work well, the Commission has determined not to amend the applicable time frames for non-exempt transfer agents. At the same time, however, the Commission agrees with the recommendation made by commenters concerning the need for a specific turnaround time frame for exempt transfer agents under Rule 17Ad–4(b) and, as a result, is today issuing in a separate release a proposed amendment to Rule 17Ad–2 that would require such items to be turned around in five business days.[68]

II. Deletion of the Notice Requirements—Rule 17Ad–4 (b) and (c)

Rule 17Ad–4(b) exempts from certain portions of the Turnaround Rules a registered transfer agent that receives within any six consecutive months, with respect to all issues serviced, fewer than 500 items for transfer and fewer than 500 items for processing, provided the transfer agent files with its ARA within ten business days of the close of the sixth such month, a notice described in that section (an "Exemption Notice"). Rule 17Ad–4(c) requires a transfer agent to monitor its transfer and processing volume and to file a notice with its ARA when it exceeds the threshold for the exemption provided in Rule 17Ad–4(b).

In the October Release, the Commission proposed to eliminate the requirement that, under appropriate circumstances, a registered transfer agent file an Exemption Notice with its ARA. Only four commenters specifically addressed these proposed amendments. Two registered transfer agents and the OCC supported adoption of the proposal; the BGFRS, however, opposed the proposal because it uses Exemption Notices in carrying out its regulatory and examination responsibilities under the Act. For the same reason, the staff of the Federal Deposit Insurance Corporation ("FDIC") also opposed the proposal.

The Commission is adopting the proposed amendments to Rule 17Ad–4 (b) and (c), modified, in particular, to account for the views of the BGFRS and FDIC. As adopted, these amendments will eliminate the Exemption Notice filing requirement for registered transfer agents whose ARA is either the Commission or the OCC, while retaining that requirement for registered transfer agents whose ARA is either the BGFRS or the FDIC. The Commission notes, however, that as amended with respect to Commission and OCC registered transfer agents, Rule 17Ad–4(b) will continue to require the preparation of an Exemption Notice and will require those transfer agents to maintain a copy of the Exemption Notice among their records in lieu of filing the Exemption Notice with either the Commission or the OCC.

III. Effective Dates

Rule 17Ad–12 and the amendments to Rule 17Ad–4 (b) and (c) will become effective on July 25, 1983. Rules 17Ad–9, 17Ad–10, 17Ad–11 and 17Ad–13 will become effective on September 30, 1983. Delayed effectiveness will permit registered transfer agents to effect any necessary changes in their recordkeeping systems and to make arrangements with an independent accountant to obtain a report on internal accounting controls consistent with Rule 17Ad–13.

IV. Regulatory Flexibility Act

Pursuant to 15 U.S.C. 605(b), the Chairman of the Commission has certified that the proposed rules, if promulgated, would not have a significant economic impact on a substantial number of small entities. The Commission did not receive any comments specifically addressing the Chairman's certification. The Commission received several comments concerning the cost of complying with Rule 17Ad–10 and, more particularly, with the prompt posting and buy-in requirements of that Rule. In response to those comments, as discussed in greater detail above, the Commission has generally relaxed the prompt posting requirement to avoid imposing significant new costs on any registered transfer agents; has adopted a separate, more relaxed posting time-frame for those transfer agents that qualify as small entities under the Regulatory Flexibility Act; and has limited the buy-in requirement to instances in which an actual physical overissuance occurs. That change should reduce drastically the frequency and expense of required buy-ins.

V. Paperwork Reduction Act

The collection of information required by these rules has been cleared by the Office of Management and Budget. The rules have been assigned the following clearance numbers: Rule 17Ad–4 (b) and (c): 3235–0138 (expires January 31, 1986); Rule 17Ad–10: 3235–0273 (expires January 31, 1984); Rule 17Ad–11: 3235–0274 (expires January 31, 1986); Rule 17Ad–13: 3235–0275 (expires January 31, 1986).

VI. Statutory Basis and Competitive Considerations

Pursuant to the Securities Exchange Act of 1934 and particularly Sections 2, 17(a), 17A(d) and 23(a) thereof, 15 U.S.C. 78b, 78q(a), 78q–1(d) and 78w(a), the Commission is adopting amendments to Rule 17Ad–4(b) and is adopting new Rules 17Ad–9, 17Ad–10, 17Ad–11, 17Ad–12 and 17Ad–13 in Chapter II of Title 17 of the Code of Federal Regulations. The Commission has determined, as discussed above, that the rules will further the development of a prompt and accurate national clearance and

[68] *See* Securities Exchange Act Release No. 19881 (June 10, 1983).

settlement system and will further the particular goals of Section 17A of the Act. In addition, in accordance with Section 23(a)(2) of the Act, the Commission has considered whether the rules will impose a burden on competition not necessary or appropriate in furtherence of the purposes of the Act. For the reasons discussed in the text of the Release above, the Commission finds that the Rules adopted today will not impose a burden on competition that is not necessary or appropriate in furtherance of the purpose of the Act and, in particular, Section 17A of the Act.

List of Subjects in 17 CFR Part 240

Reporting requirements, Securities.

VII. Text of Amendments

17 CFR Part 240 is amended as follows:

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

1. By revising paragraphs (b) and (c) of § 240.17Ad–4 to read as follow:

§ 240.17Ad–4 Applicability of Sections 240.17Ad–2, 240.17Ad–3 and 240.17Ad–6(a) (1) through (7) and (11).

* * * * *

(b)(1) For purposes of this section, "exempt transfer agent" means a transfer agent that during any six consecutive months shall have received fewer than 500 items for transfer and fewer than 500 items for processing.

(2) Except as provided in paragraph (c) of this section, an exempt transfer agent that satisfies the requirements of paragraph (b)(3) shall be exempt from the provisions of §§ 240.17Ad–2 (a), (b), (c), (d) and (h), 240.17Ad–3 and 240.17Ad–6(a) (2) through (7) and (11).

(3) Within ten business days following the close of the sixth consecutive month described in paragraph (b)(1) of this section, an exempt transfer agent shall:

(i) If its appropriate regulatory agency is either the Commission or the Office of the Comptroller of the Currency, prepare and maintain in its possession a document certifying that the transfer agent qualifies as exempt under paragraph (b)(1) of this section; or

(ii) If its appropriate regulatory agency is either the Board of Governors of the Federal Reserve System or the Federal Deposit Insurance Corporation, file with the appropriate regulatory agency a notice certifying that it qualifies as exempt under paragraph (b)(1) of this section.

(c) Within five business days following the close of each month, every exempt transfer agent shall calculate the number of items which it received during the preceding six months. Whenever any exempt transfer agent no longer qualifies as such under paragraph (b)(1), within ten business days after the end of such month: (1) It shall prepare and maintain in its possession a document so stating, if subject to paragraph (b)(3)(i) of this section; or (2) it shall file with its appropriate regulatory agency a notice to that effect, if subject to paragraph (b)(3)(ii) of this section. Thereafter, beginning with the first month following the month in which such document is required to be prepared or such notice is required to be filed, the registered transfer agent no longer shall be exempt under paragraph (b) of this section. Any registered transfer agent which has ceased to be an exempt transfer agent under this paragraph shall not qualify again for exemption until it has conducted its transfer agent operations pursuant to the foregoing sections for six consecutive months following the month in which it was required to prepare the document or prepare and file the notice specified in this paragraph.

* * * * *

2. By adding §§ 240.17Ad–9 through 240.17Ad–13 to read as follows:

§ 240.17Ad–9 Definitions.

As used in this section and §§ 240.17Ad–10, 240.17Ad–11, 240.17Ad–12 and 240.17Ad–13:

(a) "Certificate detail," with respect to certificated securities, includes, at a minimum, all of the following, and with respect to uncertificated securities, includes items (2) through (8):

(1) The certificate number.

(2) The number of shares for equity securities or the principal dollar amount for debt securities;

(3) The securityholder's registration;

(4) The address of the registered securityholder;

(5) The issue date of the security;

(6) The cancellation date of the security;

(7) In the case of redeemable securities of investment companies, an appropriate description of each debit and credit (*i.e.*, designation indicating purchase, redemption, or transfer); and

(8) Any other identifying information about securities and securityholders the transfer agent reasonably deems essential to its recordkeeping system for the efficient and effective research of record differences.

(b) "Master securityholder file" is the official list of individual securityholder accounts. With respect to uncertificated securities of companies registered under the Investment Company Act of 1940, the master securityholder file may consist of multiple, but linked, automated files.

(c) A "subsidiary file" is any list or record of accounts, securityholders, or certificates that evidences debits or credits that have not been posted to the master securityholder file.

(d) A "control book" is the record or other document that shows the total number of shares (in the case of equity securities) or the principal dollar amount (in the case of debt securities) authorized and issued by the issuer.

(e) A "credit" is an addition of appropriate certificate detail to the master securityholder file.

(f) A "debit" is a cancellation of appropriate certificate detail from the master securityholder file.

(g) A "record difference" occurs when either: (1) The total number of shares or total principal dollar amount of securities in the master securityholder file does not equal the number of shares or principal dollar amount in the control book; or (2) the security transferred or redeemed contains certificate detail different from the certificate detail currently on the master securityholder file, which difference cannot be immediately resolved.

(h) A "recordkeeping transfer agent" is the registered transfer agent that maintains and updates the master securityholder file.

(i) A "co-transfer agent" is the registered transfer agent that transfers securities but does not maintain and update the master securityholder file.

(j) A "named transfer agent" is the registered transfer agent that is engaged by an issuer to perform transfer agent functions for an issue of securities but has engaged a service company to perform some or all of those functions.

(k) A "service company" is the registered transfer agent engaged by a named transfer agent to perform transfer agent functions for that named transfer agent.

(l) A "file" includes automated and manual records.

§ 240.17Ad–10 Prompt posting of certificate detail to master securityholder files, maintenance of accurate securityholder files, communications between co-transfer agents and recordkeeping transfer agents, maintenance of current control book, retention of certificate detail and "buy-in" of physical over-issuance.

(a)(1) Every recordkeeping transfer agent shall promptly and accurately post to the master securityholder file debits and credits containing minimum and appropriate certificate detail representing every security transferred, purchased, redeemed or issued;

Provided, however, That if a security transferred or redeemed contains certificate detail different from that currently posted to the master securityholder file, the credit shall be posted to the master securityholder file and the debit and related certificate detail shall be maintained in a subsidiary file until resolved. The recordkeeping transfer agent shall exercise diligent and continuous attention to resolve the resulting record difference and, once resolved, shall post to the master securityholder file the debit maintained in the subsidiary file. Postings of certificate detail shall remain on the master securityholder file until a debit to a securityholder acount is appropriate.

(2) As used in this paragraph, the term "promptly" means the following number of days after issuance, purchase, transfer, or redemption of a security:

(i) With respect to recordkeeping transfer agents (other than transfer agents that perform transfer agent functions with respect to redeemable securities issued by investment companies registered under Section 8 of the Investment Company Act of 1940) that are exempt transfer agents under § 240.17Ad–4(b), 30 calendar days;

(ii) With respect to recordkeeping transfer agents (other than transfer agents that perform transfer agent functions with respect to redeemable securities issued by investment companies registered under Section 8 of the Investment Company Act of 1940) that: (A) Perform transfer agent functions solely for their own or their affiliated companies' securities issues, and (B) employ batch posting systems, ten business days; and

(iii) With respect to all other recordkeeping transfer agents, five business days;

Provided, however, That all securities transferred, purchased, redeemed or issued prior to record date, but posted subsequent thereto, shall be posted as of the record date.

(3) With respect to posting certificate detail from transfer journals received by the recordkeeping transfer agent from a co-transfer agent, the time frames set forth in paragraph (a)(2) shall commence upon receipt of those journals by the recordkeeping transfer agent.

(b) Every recordkeeping transfer agent shall maintain and keep current an accurate master securityholder file and subsidiary files. If such transfer agent has any record difference, its master securityholder file and subsidiary files must accurately represent all relevant debits and credits until the record difference is resolve. The recordkeeping transfer agent shall exercise diligent and continuous attention to resolve all record differences.

(c)(1) Every co-transfer agent shall dispatch or mail promptly to the recordkeeping transfer agent a record of debits and credits for every security transferred or issued. For the purposes of this paragraph, "promptly" means within two business days following transfer of each security.

(2) Within three business days following the end of each month, every co-transfer agent shall mail to the recordkeeping transfer agent for each issue of securities for which it acts as a co-transfer agent, a report setting forth:

(i) The principal dollar amount of debt securities or the number of shares and related market value of equity securities comprising any buy-in executed by the co-transfer agent during the preceding month pursuant to paragraph (g) of this section; and

(ii) The reason for the buy-in.

(d) Every co-transfer agent shall respond promptly to all inquiries from the recordkeeping transfer agent regarding records required to be dispatched or mailed by the co-transfer agent pursuant to § 240.17Ad–10(c). For the purposes of this paragraph, "promptly" means within five business days of receipt of an inquiry from a recordkeeping transfer agent.

(e) Every recordkeeping transfer agent shall maintain and keep current an accurate control book for each issue of securities. A change in the control book shall not be made except upon written authorization from a duly authorized agent of the issuer.

(f) Every recordkeeping transfer agent shall retain a record of all certificate detail deleted from the master securityholder file for a period of six years from the date of deletion. In lieu of maintaining a hard copy, a recordkeeping transfer agent may comply with this paragraph by complying with § 240.17Ad–7(f) or § 240.17Ad–7(g).

(g) A registered transfer agent, in the event of any actual physical overissuance that such transfer agent caused and of which it has knowledge, shall, within 30 days of the discovery of such overissuance, buy-in securities equal to either the number of shares in the case of equity securities or the principal dollar amount in the case of debt securities. This paragraph requires a buy-in only by the transfer agent that erroneously issued the certificate(s) giving rise to the physical overissuance.

(h) Subsequent to the effective date of this section, registered transfer agents that:

(1) Assume the maintenance and updating of master securityholder files from predecessor transfer agents,

(2) Establish a new master securityholder file for a particular issue, or

(3) Convert from manual to automated systems,

must carry over any existing certificate detail required by this section on the master securityholder file.

A recordkeeping transfer agent shall not be required to add certificate detail to the master securityholder file respecting certificates issued prior to the effective date of this section.

240.17Ad–11 Reports regarding aged record differences, buy-ins and failure to post certificate detail to master securityholder and subsidiary files.

(a) *Definitions.* (1) "Issuer capitalization" means the market value of the issuer's authorized and outstanding equity securities or, with respect to a municipal securities issuer, the market value of all debt issues for which the transfer agent performs recordkeeping functions on behalf of that issuer, determined by reference to the control book and current market prices.

(2) An "aged record difference" is a record difference that has existed for more than thirty calendar days.

(b) *Reports to Issuers.* (1) Within ten business days following the end of each month, every recordkeeping transfer agent shall report the information specified in paragraph (d)(1) of this section to the persons specified in paragraph (b)(3) of this section, when the aggregate market value of aged record differences in all equity securities issues or debt securities issues maintained on behalf of a particular issuer exceeds the thresholds set forth in the table below.

Issuer capitalization	Aggregate market value of aged record differences exceeds	
	For equity securities	For debt securities
(1) $5 million or less	$50,000	$100,000
(2) Greater than $5 million but less than $50 million	250,000	500,000
(3) Greater than $50 million but less than $150 million	500,000	1,000,000
(4) Greater than $150 million	1,000,000	2,000,000

(2) Within ten business days following the end of each month (or within ten days thereafter in the case of a named transfer agent that receives a report from a service company pursuant to paragraph (b)(3)(i)(C)), every recordkeeping transfer agent shall report

the information specified in paragraph (d)(2) of this section to the persons specified in paragraph (b)(3) of this section, with respect to each issue of securities for which it acts as recordkeeping transfer agent, concerning any securities bought-in pursuant to § 240.17Ad–10(g) or reported as bought-in pursuant to § 240.17Ad–10(c) during the preceding month.

(3) The report shall be sent:

(i) By every recordkeeping transfer agent (other than a recordkeeping transfer agent that performs transfer agent functions solely for its own securities):

(A) To the official performing corporate secretary functions for the issuer of the securities for which the aged record difference exists or for which the buy-in occurred;

(B) With respect to an issue of municipal securities, to the chief financial officer of the issuer of the securities for which the aged record difference exists or for which the buy-in occurred; or

(C) If it acts as a service company, to the named transfer agent; and

(ii) By every named transfer agent that is engaged by an issuer to maintain and update the master securityholder file:

(A) to the official performing corporate secretary functions for the issuer of the securities for which the aged record difference exists or for which the buy-in occurred; or

(B) with respect to an issue of municipal securities, to the chief financial officer of the issuer of the securities for which the aged record difference exists or for which the buy-in occurred.

(c) *Reports to Appropriate Regulatory Agencies.*—(1) Within ten business days following the end of each calendar quarter, every recordkeeping transfer agent shall report the information specified in paragraph (d)(1) of this section to its appropriate regulatory agency in accordance with § 240.17Ad–2(h), when the aggregate market value of aged record differences for all issues for which it performs recordkeeping functions exceeds the thresholds specified below:

(i) $300,000 if it is a recordkeeping transfer agent for 5 or fewer issues;

(ii) $500,000 for 6–24 issues;

(iii) $800,000 for 25–49 issues;

(iv) $1 million for 50–74 issues;

(v) $1.2 million for 75–99 issues;

(vi) $1.4 million for 100–499 issues;

(vii) $1.6 million for 500–999 issues;

(viii) $2.6 million for 1,000–1,999 issues; and

(ix) An additional $1 million for each additional 1,000 issues.

(2) Within ten business days following the end of each calendar quarter, every recordkeeping transfer agent shall report the information specified in paragraph (d)(2) of this section to its appropriate regulatory agency in accordance with § 240.17Ad–2(h), concerning buy-ins of all issues for which it acts as recordkeeping transfer agent, when the aggregate market value of all buy-ins executed pursuant to § 240.17Ad–10(g) during that calendar quarter exceeds $100,000.

(3) When the recordkeeping transfer agent has any debits or credits for securities transferred, purchased, redeemed or issued that are unposted to the master securityholder and/or subsidiary files for more than five business days after debits and credits are required to be posted to the master securityholder file or subsidiary files pursuant to § 240.17Ad–10, it shall immediately report such fact to its appropriate regulatory agency in accordance with § 240.17Ad–2(h) and shall state in that report what steps have been, and are being, taken to correct the situation.

(d) *Content of Reports.*—(1) Each report pursuant to paragraphs (b)(1) and (c)(1) of this section shall set forth with respect to each issue of securities:

(i) The principal dollar amount and related market value of debt securities or the number of shares and related market value of equity securities comprising the aged record difference (including information concerning aged record differences existing as of the effective date of this section);

(ii) The reasons for the aged record difference; and

(iii) The steps being taken or to be taken to resolve the aged record difference.

(2) Each report pursuant to paragraphs (b)(2) and (c)(2) of this section shall set forth with respect to each issue of securities:

(i) The principal dollar amount of debt securities and related market value or the number of shares and related market value of equity securities comprising any buy-in executed pursuant to § 240.17Ad–10(g);

(ii) The party that executed the buy-in; and

(iii) The reason for the buy-in.

(e) For purposes of this section, the market value of an issue shall be determined as of the last business day on which market value information is available during the reporting period.

(f) A copy of any report required under this section shall be retained by the reporting transfer agent for a period of not less than three years, the first year in an easily accessible place.

§ 240.17Ad–12 Safeguarding of funds and securities.

(a) Any registered transfer agent that has custody or possession of any funds or securities related to its transfer agent activities shall assure that: (1) All such securities are held in safekeeping and are handled, in light of all facts and circumstances, in a manner reasonably free from risk of destruction, theft or other loss; and (2) all such funds are protected, in light of all facts and circumstances, against misuse. In evaluating which particular safeguards and procedures must be employed, the cost of the various safeguards and procedures as well as the nature and degree of potential financial exposure are two relevant factors.

§ 240.17Ad–13 Annual study and evaluation of internal accounting control.

(a) *Accountant's Report.* Every registered transfer agent, except as provided in paragraph (d) of this section, shall file annually with the Commission and the transfer agent's appropriate regulatory agency in accordance with § 240.17Ad–2(h), a report specified in paragraph (a)(1) of this section prepared by an independent accountant concerning the transfer agent's system of internal accounting control and related procedures for the transfer of record ownership and the safeguarding of related securities and funds. That report shall be filed within 90 calendar days of the date of the study and evaluation set forth in paragraph (a)(1).

(1) The accountant's report shall:

(i) State whether the study and evaluation was made in accordance with generally accepted auditing standards using the criteria set forth in paragraph (a)(3) of this section;

(ii) Describe any material inadequacies found to exist as of the date of the study and evaluation and any corrective action taken, or if no material inadequacy existed, the report shall so state;

(iii) Comment on the current status of any material inadequacy described in the immediately preceding report; and

(iv) Indicate the date of the study and evaluation.

(2) The study and evaluation of the transfer agent's system of internal accounting control for the transfer of record ownership and the safeguarding

of related securities and funds shall cover the following:

(i) Transferring securities related to changes of ownership (*i.e.*, cancellation of certificates or other instruments evidencing prior ownership and issuance of certificates or instruments evidencing current ownership);

(ii) Registering changes of ownership on the books and records of the issuer;

(iii) Transferring record ownership as a result of corporate actions (*e.g.*, issuance, retirement, redemption, liquidation, conversion, exchange, tender offer or other types of reorganization);

(iv) Dividend disbursement or interest paying-agent activities;

(v) Administering dividend reinvestment programs; and

(vi) Distributing statements respecting initial offerings of securities.

(3) For purposes of this report, the objectives of a transfer agent's system of internal accounting control for the transfer of record ownership and the safeguarding of related securities and funds should be to provide reasonable, but not absolute, assurance that securities and funds are safeguarded against loss from unauthorized use or disposition and that transfer agent activities are performed promptly and accurately. For purposes of this report, a material inadequacy is a condition for which the independent accountant believes that the prescribed procedures or the degree of compliance with them do not reduce to a relatively low level the risk that errors or irregularities, in amounts that would have a significant adverse effect on the transfer agent's ability promptly and accurately to transfer record ownership and safeguard related securities and funds, would occur or not be detected within a timely period by employees in the normal coruse of performing their assigned functions. Occurrence of errors or irregularities more frequently than in isolated instances may be evidence that the system has a material inadequacy. A significant adverse effect on a transfer agent's ability promptly and accurately to transfer record ownership and safeguard related securities and funds could result from any condition or conditions that individually, or taken as a whole, would reasonably be expected to:

(i) Inhibit the transfer agent from promptly and accurately discharging its responsibilities under its contractual agreement with the issuer;

(ii) Result in material financial loss to the transfer agent; or

(iii) Result in a violation of §§ 240.17Ad-2, 17Ad-10 or 17Ad-12(a).

(b) *Notice of Corrective Action.* If the accountant's report describes a material inadequacy, the transfer [illegible] shall, within sixty calendar days after receipt of the report, notify the Commission and its appropriate regulatory agency in writing regarding the corrective action taken or proposed to be taken.

(c) *Record Retention.* The accountant's report and any documents required by paragraph (b) of this section shall be maintained by the transfer agent for at least three years, the first year in an easily accessible place.

(d) *Exemptions.* The requirements of § 240.17Ad-13 shall not apply to registered transfer agents that qualify for exemptions pursuant to this paragraph, 17Ad-13(d).

(1) A registered transfer agent shall be exempt if it performs transfer agent functions solely for:

(i) Its own securities;

(ii) Securities issued by a subsidiary in which it owns 51% or more of the subsidiary's capital stock; and

(iii) Securities issued by another corporation that owns 51% or more of the capital stock of the registered transfer agent.

(2) A registered transfer agent shall be exempt if it:

(i) Is an exempt transfer agent pursuant to § 240.17AD-4(b); and

(ii) In the case of a transfer agent that performs transfer agent functions for redeemable securities issued by companies registered under Section 8 of the Investment Company Act of 1940, maintains master securityholder files consisting of fewer than 1000 shareholder accounts, in the aggregate, for each of such issues for which it performs transfer agent functions.

(3) A registered transfer agent shall be exempt if it is a bank or financial institution subject to regulation by the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency or the Federal Deposit Insurance Corporation, provided that it is not notified to the contrary by its appropriate regulatory agency and provided that a report similar in scope to the requirements of § 240.17Ad-13(a) is prepared for either the bank's board of directors or an audit committee of the board of directors.

Dated: June 10, 1983.

By the Commission.

George A. Fitzsimmons,

Secretary.

[FR Doc. 83-16452 Filed 6-20-83; 8:45 am]

BILLING CODE 8010-01-M

[illegible]MENTAL PROTECTION

[illegible]

Tolera[illegible] Administered by the [illegible] Protection Agency; [illegible]

Correction

In FR Doc. 83-13779 beg[illegible] 23385 in the issue of Wednes[illegible] 25, 1983, make the following corre[illegible] on page 23386: In the second column, § 193.219, in the last line of paragraph (b), "June 1, 1954" should read "June 1, 1984".

BILLING CODE 1505-01-M

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Food and Drug Administration

21 CFR Parts 436 and 442

[Docket No. 82N-0362]

Antibiotic Drugs; Sterile Cefoperazone Sodium; Correction

AGENCY: Food and Drug Administration.

ACTION: Final rule; correction.

SUMMARY: The Food and Drug Administration (FDA) is correcting a document that amended the antibiotic drug regulations to provide for the inclusion of accepted standards for a new antibiotic drug, sterile cefoperazone sodium. The diluent and reference concentration are corrected.

DATE: Effective January 7, 1983.

FOR FURTHER INFORMATION CONTACT: Joan M. Eckert, National Center for Drugs and Biologics (HFN-140), Food and Drug Administration, 5600 Fishers Lane, Rockville, MD 20857, 301-443-4290.

SUPPLEMENTARY INFORMATION: In FR Doc. 83-203 in the issue for Friday, January 7, 1983 (48 FR 788), the following corrections are made:

PART 436—TESTS AND METHODS OF ASSAY OF ANTIBIOTIC AND ANTIBIOTIC-CONTAINING DRUGS

1. In the amendment to Part 436 appearing under item 2 on page 789, § 436.338(d) and (e) (1) and (2) (i) and (ii) is corrected to read as follows:

§ 436.338 High-pressure liquid chromatographic assay for cefoperazone.

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