

# Dematerialization Makes Steady Gains

Physical certificates are fast becoming the black-and-white televisions of U.S. capital markets, thanks to the financial services firms and public companies that are utilizing a range of services offered by DTCC's Depository Trust Company (DTC) to advance dematerialization. The result for all parties, including exchanges and individual shareholders, is lower cost and risk, along with greater efficiency and convenience.

One gauge of the industry's forward march is DTC's shrinking vault inventory. As of May 2007, the depository held 2.7 million paper certificates, a 60% decline from 6.7 million in 2001.

## DRS prescription

A key driver of dematerialization is the Direct Registration System (DRS), an electronic book-entry service administered by DTC that allows investors to hold securities positions in their names, directly on the books of the transfer agent or issuer. DRS also allows shares to be transferred between a transfer agent and a broker electronically.

"Two years ago, less than 5% of all withdrawals from the depository were made in DRS statement form. Today that figure is over 60% and climbing," said John Mancuso, DTCC vice president, Securities Processing. "This translates into dramatically fewer paper certificates in

circulation and far more efficient transfers."

In 2006, the major exchanges gave dematerialization a big boost via a listing requirement rule change that took effect Jan. 1, 2007, mandating exchange-listed issuers to be eligible for DRS for all new securities issued on the New York Stock Exchange, NYSE Arca, Nasdaq and the American Stock Exchange. Regional exchanges also adopted corresponding listing rules. By 2008, all existing listed issues will be required to be DRS-eligible.

In approving the requirement, the Securities and Exchange Commission wrote that DRS should provide "more accurate, quicker and more cost-efficient transfers; faster distribution of sale proceeds; a reduced number of lost or stolen certificates and a reduction in the associated certificates replacement costs."

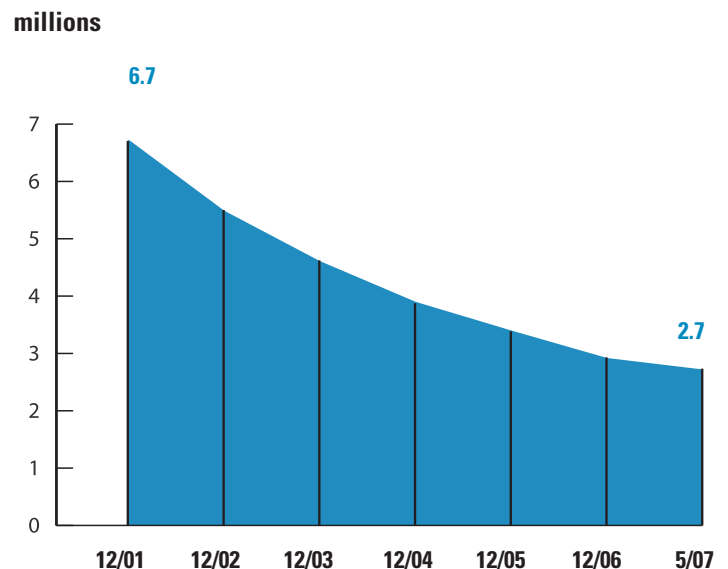
## Brokers and issuers

Many of the leading brokerage houses and banks already default to DRS statements. In other words, for

withdrawals from DTC, if an investor does not specifically insist on a paper certificate, the shares automatically are registered electronically and the investor receives a DRS statement.

Take the case of one brokerage firm that defaulted to DRS in July 2005. In June of that year, it received 3,311 requests for paper certificates and just a single request for a DRS statement. Fast forward to January 2007, when the firm received 130 requests for paper certificates and 1,218 requests for DRS. In percentage terms, requests for DRS statements grew from less than 1% in June 2005 to over 90% in January 2007.

## Certificates in DTC's Vaults



On the issuer side of the equation, an expanding roster of major companies such as Microsoft, UPS, Nuveen, Intel, Chevron Corporation, Federated Department Stores, Inc. and NCR Corporation are also coming on board with dematerialization. They no longer issue physical certificates for their offerings.

### Shred and done

Another DTC program, the Destruction of Non-Transferable Securities, takes excess paper out of circulation by helping firms to

rid themselves of issues that are no longer transferable.

The program allows firms to take inactive positions that may have resulted from companies going out of business or various corporate actions processing, and move the shares from their account to an internal account at DTC. After an issue has been inactive for more than six years, DTC places all firms on notice for a 90-day period that the certificates are scheduled for destruction, and eventually shreds the

certificates. DTC electronically images the deposits upon both receipt and prior to destruction, keeping the records on file, in the rare case they will be needed at a future date. Since August 2004, DTC has shredded more than 515,000 certificates through the program.

### Paperless 'legal' transfers

The Paperless Legal Program is a related piece of the dematerialization puzzle, eliminating the need for accompanying paper documentation on "legal" securities transfers. "Legal" is industry parlance for securities transfers that must be accompanied by paper legal documents, such as trust agreements or death certificates.

This program supports dematerialization by eliminating the longstanding industry practice of handling multiple copies of paper legal documents among broker/dealers, DTC and transfer agents. It operates on a medallion guarantee that certifies the person endorsing the certificates is fully authorized to do so and the proper documentation is in possession of the broker and in good order.

### Pushing forward

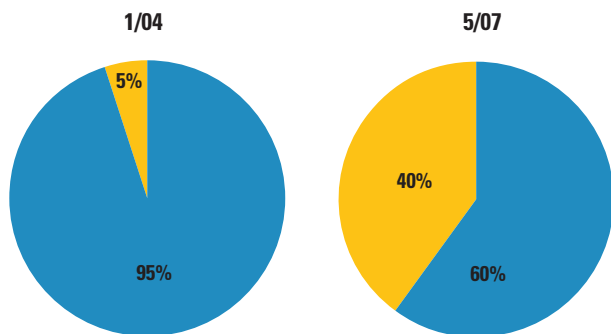
"DTCC has a longstanding commitment to partnering with the industry to move the U.S. markets toward a certificate-free environment," said Joseph Clemente,

DTCC product manager, Asset Services. "We're making good progress and we will continue to look for new ways to create or expand services that advance this industry goal."

For more information on dematerialization, contact Joseph Clemente at [jclemente@dtcc.com](mailto:jclemente@dtcc.com) or 212.855-2425. @

## Requests for Withdrawals

■ Statements  
■ Certificates



## The Case for Paperless

Paper certificates are undeniably inefficient. They slow transaction processing, whereas electronic records expedite the transfer and sale of securities, giving investors greater security and flexibility in purchases and sales of securities assets.

Certificates are also expensive to issue, store, ship and insure. For example, the annual cost to the industry associated with issuing paper securities is \$350 million, which includes an estimated \$50 million to replace certificates that are reported lost, stolen or counterfeited.

Electronic records, on the other hand, eliminate the risk of losing certificates, and because statements have no underlying value, if one is lost, another can be issued at a fraction of the cost. In 2006, the cost of a withdrawal in DRS statement form was just \$5, compared to over \$60 for issuing a paper certificate.

What's more, when corporate actions occur, the use of statements saves all parties the hassle of tracking down certificates. With DRS, a single statement can replace the time-consuming process of locating certificates, transferring them to new parties and re-mailing them to investors. "With the increased number of corporate actions, the impact of this efficiency is tremendous," said John Mancuso, DTCC vice president, Securities Processing.

The competitiveness of the U.S. financial system is another consideration. Indeed, the United States is lagging countries that have already gone paperless, including China, India, Australia, France, Denmark, Switzerland, Argentina and Brazil, to name a few.



The Depository Trust & Clearing Corporation