

- ▶ Surprisingly, paper stock certificates are still common currency
- ▶ New listing rules boost electronic registration
- ▶ Electronic registration lowers risks and costs
- ▶ Less paper distribution quells environmental concerns, boosting reputation
- ▶ Withdrawals-by-transfer are also being electronically processed

By **Brendan Sheehan**

Advancing the paperless revolution

Despite more than 40 years of dematerialization, many paper stock certificates still circulate on numerous exchanges. This might come as surprising news to many people who just assume that everyone has street-name accounts these days. The push for paperless certificates began in the late 1960s, and many issuers have long since moved to paperless stock issuance. Yet a surprising amount of paper still makes its way into the system at significant cost to all involved: the issuers themselves, brokers, transfer agents and sometimes even the stockholders.

Today, approximately 7,500 corporations issue their stock directly through an electronic registration system. This number recently was boosted by about 200 as a new listing standard was enacted by the two major exchanges, NASDAQ and the NYSE, and many of the regional exchanges. The new standard mandates that all listed issuers be eligible to participate in a direct electronic registration system by March 31, 2008.

Cheaper and better

According to the Depository Trust Company (DTC), which runs the Direct Registration System (DRS), an electronic registration system helps eliminate risks and unnecessary costs associated with processing paper stock certificates. Such a system allows eligible securities to be registered directly under the investor's name on

the issuer's books. The technology and the system are not new, but companies are increasingly recognizing the value of going completely paperless.

James Femia, managing director of the Depository Trust and Clearing Corporation (DTCC), says, 'It is apparent that issuers recognize the benefits of DRS, providing the ownership option to investors as it provides shareholders with the best possible level of service.'

The advantages of DRS include more accurate, quicker and highly cost-efficient transfers between the clearing house and the transfer agent, and this in turn makes the selling of stock faster and cheaper. Additionally, DRS accounts for a significant

reduction in the number of lost or stolen certificates.

It also makes things much easier for the investor, who no longer has to manage piles of hardcopy certificates and shift through paperwork but instead is issued a statement of ownership that is easily updated after every purchase or sale.

Many companies that have adopted electronic registration also continue to issue some paper certificates. Several hundred, however, have completely eliminated paper stock and gone 'certificateless'. The Securities Industry and Financial Markets Association (SIFMA) has urged all its members to stop issuing paper certificates and to use DRS instead. According to figures from the DTC, approximately 300 issuers, including such industry leaders as Chevron and Intel, have ceased



issuing paper certificates and now rely wholly on DRS to register shareholders. Others still have designated DRS as the default whenever investors request to be registered on the books of eligible issuers.

Joseph Trezza, DTCC's vice president of operations and leader of its dematerialization program, says that 'DTCC, in conjunction with SIFMA and other organizations, continues to work toward the elimination of paper certificates.'

Apart from increased efficiency, using an electronic registration system provides significant cost savings. Data from SIFMA suggests the annual cost of issuing and processing hardcopy stock certificates is approximately \$300

equally important to the cost benefits of adopting electronic distribution of shareholder and regulatory materials. 'Proactively adopting technologies that reduce our environmental impact is very important to Sun and places us in good standing to those investors [and regulators] who see this as important, which is most of them,' said Maria Pizzoli, then-assistant general counsel at Sun Microsystems, during a *Corporate Secretary*/Foley and Lardner webcast in January. 'The reputational benefits are significant,' she added. The same could easily be said for stock certificates.

As Trezza explains, DRS is reaping the benefits in other areas as well. Withdrawals-by-transfer (WT) of securities from DTC have been moving away from physical certificates withdrawals and are instead being electronically processed.

'We've set the stage by adding over 7,300 exchange-listed issuers to DRS and gaining the industry's voluntary compliance to default to statement WTs for DRS-eligible issues. At this point in time, in excess of 85 percent of WTs requested are for DRS-eligible issues. It just makes sense to eliminate the option for a certificate for DRS-eligible issues to be withdrawn from DTC,' says Trezza. 'It's DTC's goal to eliminate the issuance of these certificates in 2009. If an investor insists on receiving a certificate, and if the issuer still offers certificate ownership, the investor or his or her broker-dealer can contact the transfer agent directly to transfer the DRS statement to a certificate.'

There is little doubt that the 'paperless revolution' is gaining pace across all sections of the financial markets. Regulators and exchanges are passing rules to encourage and/or mandate reductions in paper distribution of a vast array of documents. The US has made significant advancements in this field in recent years but still lags in many other markets that have already gone completely paperless in various aspects, including the issuance of stock certificates. As we move further down this path, it is becoming clearer that everyone will benefit from greater utilization of electronic registration and distribution tools.

DEMATERIALIZATION BASICS

- ▶ **What's wrong with paper certificates?** They're expensive to issue, store, ship and insure. And every year more than 1.2 million are reported lost, stolen or counterfeit, costing investors as much as \$50 million to have replacements issued.
- ▶ **What's the cost every year for the paper stock certificates issued to investors?** \$250 million or more, paid for by investors, brokers, banks and custodians.
- ▶ **Don't all securities have paper certificates?** No. Many securities now, including corporate and municipal bonds, US government securities, futures and options, money market instruments and mutual funds, are issued electronically – entirely without paper. Even US Savings Bonds now come in paperless form.

Source: DTCC

million. Approximately one sixth of this cost (\$49 million) includes reissuing lost or stolen certificates.

Going green

While the cost savings resulting from the industry's adoption of a completely paperless model can be significant, they are not the only consideration. Investor activism and regulatory attention increasingly are turning to environmental issues and the elimination of paper can put all those involved in a particularly good light.

Speaking at separate *Corporate Secretary* events earlier this year, senior executives from both Microsoft and Sun Microsystems pointed to a desire to be seen as leaders 'in the move towards greater corporate social responsibility' by eliminating paper annual reports and proxy materials. While not referring directly to stock certificates, both companies recognize the environmental benefits of paper elimination and pollution reduction to be

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