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The US still has $780 billion worth of physical stock certificates. It's time to digitize them.

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- **Michael Bodson is the president and CEO of the DTCC.**

- **In this op-ed, Bodson makes the case for the US digitizing the $780 billion worth of physical stock certificates that still remain.**

As the financial services industry gazes toward the future, with intense debates about digitized securities, paperless currencies, and no-contact payment systems, the ongoing coronavirus pandemic has refocused attention on an antiquated, often overlooked and paper-intensive practice in our industry: the physical processing of securities certificates.

It's extraordinary but true. In 2020, as automation permeates every aspect of our industry, we still manually process thousands of transactions – handling certificates, stamping and signing documents, receiving checks and moving certificates to vaults for safekeeping.

Calling this practice a holdover from a bygone era is akin to comparing a Tesla to a covered wagon. It's clear that dematerialization – eliminating all paper securities and converting existing physical certificates to electronic records while working with industry stakeholders and regulators to revise practices and regulations – is an idea whose time is long overdue.

$780 billion worth of physical certificates still exist

While most physical certificates have been eliminated over the past five decades, the Depository Trust Company (DTC) still holds $780 billion worth of physical certificates in its vault. And throughout the pandemic, teams at banks, broker-dealers, transfer agents and market infrastructures have operated with limited on-site personnel and wrestled with workarounds to keep the system functioning efficiently.

At times, circumstances forced offices to close entirely, leaving industry stakeholders with little or no access to physical securities held at those locations. The industry can no longer afford that kind of vulnerability.

In fact, the call for dematerialization is not new. Nearly 50 years ago, the US Securities and Exchange Commission noted in its study, Unsafe and Unsound Practices of Brokers and Dealers, that "burdensome" manual processing helped to create the Paperwork Crisis of the late 1960s, which resulted in exchanges closing one day a week to process mountains of paper records.

Dematerialization was the "best approach" for resolving the physical processing issue, the study noted, but it was viewed then as a "utopian solution" requiring "very extensive legal work and lead time to implement."

In response to the Paperwork Crisis, the industry launched DTC in 1973 to streamline securities processing by immobilizing physical securities and creating electronic book entries to automate what had been a highly manual process. Since then, industry groups, including the Securities Industry Association – now part of the Securities Industry and Financial Markets Association (SIFMA) – have worked with industry stakeholders to dematerialize and create greater efficiency while reducing cost and risk.

But complete dematerialization has remained elusive because the system works well – until it doesn't.

The pandemic has created an chance to reconsider dematerialization

The planets nearly aligned in 2012 after Superstorm

Sandy flooded DTC's vault in lower Manhattan, soaking about 1.7 million stock certificates worth $2 trillion. No funds were lost, but it took more than six months to recover, clean and reconcile the certificates, reinforcing once again the challenges involved in processing paper.

Unfortunately, other matters continued to take priority over full dematerialization as firms focused on meeting new regulatory mandates stemming from the 2008 financial crisis, transforming technology, increasing resilience, and protecting against cyberattack, among other key issues.

Fast forward to 2020 and the pandemic, which should act as the catalyst for the United States to join dozens of countries across Europe, Asia-Pacific, Africa, and Latin America in eliminating all physical certificates.

The benefits are significant: contactless processing, greater efficiency, reduced risk,and significant cost savings. On that last point, manual processing of physical certificates costs on average 10 times as much as automated processing – a drain on resources at a time when firms face intense earnings pressures.

DTCC outlined a roadmap in a white paper released last month, From Physical to Digital: Advancing the Dematerialization of US Securities, which calls for working groups comprised of market participants, stakeholders, and regulators to establish firm deadlines to achieve full dematerialization during the next four years.

SIFMA, along with other industry stakeholders, supports the initiative, noting that eliminating "the issuance and handling of physical securities will result in a more cost-effective, efficient, transparent, secure, competitive and resilient Marketplace."

This is a complex industry challenge that will require strong collaboration with industry firms, exchanges, transfer agents, regulators and other stakeholders.

We believe it is possible that, together, the industry can dramatically reduce the number of remaining physical stock certificates in the next three years by converting the existing inventory of certificates to electronic entries - no small feat as DTC alone currently holds 491,844 certificates representing 188,849 issues in its vault.

We believe that the industry can achieve full dematerialization of equities by embracing direct, electronic registration, which would eliminate the issuance of physical certificates as well as the recurring handling of approximately 80,000 physical deposits annually.

Dematerialization is no longer the "utopian solution" described by the SEC in 1971. All of the component pieces to achieve full dematerialization are available to us now, and as the pandemic has made clear, the time has come to embrace 21st century technology and relegate paper certificates to decorative frames hanging on a home study wall once and for all.

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