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Table of Contents

In this issue...

- Direct registration system - a Canadian perspective on a U.S.-based solution
- To consolidate or not to consolidate
- CEO's message

This issue by:

- Chardeep Minhas, associate director, relationship management
- James Hinnecke, director, product management
- Thomas C. MacMillan, president & chief executive officer at CIBC Mellon

Direct registration system - a Canadian perspective on a U.S.-based solution

Effective Jan. 1, 2008, all securities listed on U.S. exchanges, including interlisted Canadian companies and their transfer agents, must be eligible for the direct registration system (DRS).

DRS allows investors to hold securities electronically, reducing risk and reducing the costs associated with holding and transferring physical securities. To meet the January deadline, Canadian issuers must ensure that U.S. listed securities are DRS eligible by:

- Participating in the Depository Trust Company's (DTC) Fast Automated Securities Transfer (FAST) program
- Ensuring that company by-laws do not restrict holding securities electronically
- Confirming their transfer agent is eligible to participate as a DTC FAST participant

Issuers that are not in compliance with eligibility requirements will be sanctioned and ultimately subject to delisting according to the Securities and Exchange Commission (SEC).

Meeting the DRS eligibility requirements does not mean automatic participation in DRS. Currently, issuers can elect to participate. It is possible however, that the SEC will require issuers to fully participate in the future.

The decision to participate for an issuer depends on the number of U.S. holders and the activity these holders generate. It is important to note that opting-out of DRS at a later date can cause confusion among U.S. financial intermediaries. In addition, investors whose positions were converted to book form would have to be issued certificates.

The U.S. experience

The roots of DRS can be traced back to the 1960s, when increased trading volumes overwhelmed the U.S. paper-based system of certificated positions.

To deal with this paper crisis, a central depository was recommended and adopted. However, it wasn't until 1992 that a commission was created to determine if technology would make direct registration possible. The commission strongly favoured a direct registration system, but only as an additional form of security registration available to the holder.



In 1994, the U.S. listing criteria was changed to permit U.S. listed companies to issue securities using DRS. As a result of the rule changes by the exchanges, DRS eligible issuers are expected to grow from 2,000 issuers in 2006 to more than 10,000 issuers by 2008.

Although DRS has increased in use over the years - some transfer agents estimate 30 per cent of the register is held within DRS - most of these positions have been created through issuer initiated events such as stock splits and corporate actions. Currently less than two per cent of these shareholders make DRS transactions in any given year. As a result, the U.S. has not seen extensive integration, and industry participants continue to work at making the system more attractive and efficient.

Here are several DRS benefits:

- Allows quicker settlement of transfers as certificates do not need to be delivered to a broker for processing by DTC
- Eliminates the risks and costs associated with paper certificates (replacing certificates, fraudulent claims)
- Processes a large number of positions efficiently
- Reduces broker-dealer costs

There could be future benefits to this system as industry confidence grows. In addition there may be regulation towards immobilization and possible dematerialization [<http://www.sec.gov/rules/concept/s71304/stac061404.pdf>] of the marketplace.

Disadvantages of DRS include:

- Complicated transfer process for Canadian participants who are (or are not) participants within DTC
- Inability to pledge securities held in DRS
- Inability to co-mingle DRS and dividend reinvestment

A Canadian solution?

While DRS is not new, this is the first time that Canadian interlisted issuers are mandated to comply with the system. DRS does not have a corresponding Canadian equivalent and to participate, Canadian investors must use broker-dealers who are DTC participants.

This raises issues as some Canadian broker-dealers do not perceive DTC settlement as conventional practice. In addition, they may not see the benefit in DRS without a corresponding Canadian solution.

While the requirement to be eligible to participate in DRS is mandated, the actual participation is small. As more holders become comfortable with the idea of paperless transactions, the idea of electronic certification of registered positions could exponentially increase. In Canada, this increase may lead to finding a Canadian equivalent to a U.S.-based solution.

By Charndee Minhas, associate director, relationship management



To consolidate or not to consolidate

Quite often, our issuers ask us about merging investor accounts, a process known as consolidation.

Account consolidations can occur either when a new investor is added, or after that person becomes a shareholder. However, CIBC Mellon only consolidates when we are certain that the accounts being merged belong to the same investor.

Initial account setup

CIBC Mellon has checks in place to compare new investor registrations against registrations already present. If the new registration being entered matches an existing one, shares will automatically be posted to that account.

Should there be a difference in the registration (for example, a middle initial instead of a middle name or an address formatted differently) our system allows input specialists the choice to post shares either to the existing registration, or to create a new one.

If there is any doubt that the two registrations are not for the same person, we take a conservative approach and create a new account, unless there are specific instructions from the investor or their representative.

Investor service

When an investor wishes to combine multiple positions and CIBC Mellon is satisfied that the two positions are for the same investor, we can (upon written request) combine the two registrations.

Our system features safeguards that warn against and even inhibit consolidations if investor information does not match - for example, a different name, address, or social insurance number.

Often, we produce lists of investors with duplicate or similar accounts. These lists are used to identify situations where investor information could be potentially combined, reducing the cost of investor service.

From time to time, and prior to a dividend payment, we automatically review the shareholder register and consolidate any accounts that clearly match.

Consolidating investor mailings

We are also asked about the possibility of combining mailings to different investors that reside at the same address, even while continuing to maintain separate registrations.

This process, known as **householding**, is not permitted under Canadian provincial securities acts, and even under some companies' incorporating statutes. This is true for both registered and non-registered positions.

We hope this information has been helpful to you, as an important part of CIBC Mellon's registrar responsibilities is to control the number of investor accounts, and the related costs of investor service and fulfillment.

By James Hinnecke, director, product management

**CEO's message**

On July 1, 2007, The Bank of New York and Mellon merged to create The Bank of New York Mellon Corporation - the leading provider of corporate trust services, serving \$11 trillion in outstanding debt, and market leader in depositary receipts with more than 1,270 sponsored programs. The Bank of New York Mellon is also the leading stock transfer agent in the U.S. This alignment with our core businesses positions us well to:

- Leverage new relationships and technology to provide Canadian issuers with enhanced global presence, and opportunities to provide Canadian solutions for global issuers.
- Draw from expanded resources, knowledge and deep expertise to support flexible and dynamic financing solutions.
- Enhance the overall client experience through combined capital and resource investment in our core business.
- Demonstrate the continued commitment and development of our business.

In the coming years, CIBC Mellon looks forward to exploring new opportunities and capabilities for our clients.

As our size, scale and reach continue to grow, we remain committed to working with you, our issuers, and your investors to provide the best knowledge, tools, skills and expertise to help you achieve your goals.

By Thomas C. MacMillan, president & chief executive officer at CIBC Mellon

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