

MEMO# 6768

March 15, 1995

UPDATE ON SECURITIES REGISTRATION DEPOSITORY ("SRD")

March 15, 1995 TO: SEC RULES COMMITTEE No. 42-95 STATE LIAISON COMMITTEE No. 15-95 UNIT INVESTMENT TRUST COMMITTEE No. 31-95 RE: UPDATE ON SECURITIES REGISTRATION DEPOSITORY ("SRD")

As discussed at the recent Committee meetings, at its January 1995 meeting, the Board of Directors of SRD, Inc. (the "Board") increased the size of the Industry Advisory Group ("IAG") from five members to ten members. As a result, the IAG, which previously consisted of representatives of the Institute, the Securities Industry Association ("SIA"), the American Bar Association, Scudder, Stevens & Clark, and ClearSky, Inc., now includes representatives of Federated Investors, Fidelity Investments, Merrill Lynch Pierce Fenner & Smith, Inc., Prudential Securities, Inc., and Van Kampen- American Capital. In anticipation of the first meeting of the expanded IAG and the Board, which was held on March 4th, the IAG sent the Board a letter expressing its continuing concerns with certain unresolved policy issues. As explained in detail in the attached letter to the Board, of primary concern to the members of the IAG is the uncertainty associated with the SRD with respect to: (1) the ability to rely upon representations made by the Board; (2) the pricing of the SRD services; and (3) the savings to be realized by filing through the SRD. To address these concerns, the IAG's letter recommends that the Board: (1) convince potential users of the SRD that representations by the Board may be relied upon; (2) ensure that users have an equal say with the Board in pricing decisions in order to avoid unbridled future price increases; and (3) require states to agree to certain terms as condition of using the SRD. The IAG's letter advises the Board that if it continues to ignore the concerns of industry, "the SRD is unlikely to win widespread industry acceptance and thus may prove to be no more than a rather expensive and embarrassing debacle for both the SRD and NASAA." The IAG's letter to the Board and the Board's response at the March meeting are summarized below.

1. Reliance upon Board Representations The IAG's letter expresses concern with the degree to which potential users may rely upon representations made by the Board to placate the concerns expressed by industry. This concern arises from recent actions by the Board that are contrary to written representations made in October 1994 to the IAG. The IAG's letter cites the following three examples: (1) the Board agreed to "consult in advance" with the IAG on the Board's budget and then informed the IAG that the Board will present the Board's budget to the IAG only after it has been approved by the Board; (2) the Board met without inviting members of the IAG to such meetings, notwithstanding its representation to invite the IAG to "all meetings" of the Board and the Board's Executive Committee; and (3) the Board agreed that the price of the SRD "shall remain unchanged for a period of two years from the inception of the SRD" and then stated that such price may be adjusted for inflation. At the March 4th meeting, the Board agreed that the price of the SRD will remain

unchanged, with no adjustments for inflation, until March 1998 when the BoardGs contract with General Electric Information Services ("GEIS") expires. [GEIS will be developing and maintaining the SRD.] With respect to attendance by the IAG at Board meetings, the Board commented that the IAG will be invited to Board meetings, though the Board may discuss issues among themselves before such meetings. There was no mention of the IAG being invited to attend meetings of the BoardGs Executive Committee. Most importantly, there were no assurances provided regarding the binding nature of these current representations.

2. Pricing of the SRD Services The IAGGs letter reiterates that pricing issues remain of paramount concern to potential users of the SRD, and unless users are granted meaningful input into pricing decisions, they will not be comfortable that the SRD is providing its services as economically and efficiently as possible. In discussing this concern, the IAGGs letter details those decisions that impact price that have already been made by the Board without industry input, including the BoardGs decision to pay NASAA 10% of all SRD revenues ad infinitum. [The IAGGs letter again requests justification for this payment to NASAA.] To address this particular concern, the IAG had earlier recommended creation of a pricing committee that is equally comprised of members of NASAA and filers and that is vested with authority as to all SRD pricing decisions. In the event of an impasse, the IAG has suggested submitting the issue to impartial arbitration or mediation. In response to this recommendation, in its last correspondence to the IAG, the Board agreed to permit the IAG to "review" any price changes. The attached letter restates the IAGGs previous recommendation and relates that the BoardGs response thereto is unacceptable because, so long as the ultimate pricing decision remains vested in the Board, users will not have assurances against unwarranted future price increases, which assurances are necessary for widespread acceptance or usage of the SRD. At the March 4th Board meeting, the Board and the IAG again discussed providing users meaningful input into pricing decision. According to the Board, it opposes the IAGGs pricing committee concept because (1) it could ultimately bankrupt NASAA and (2) the Board believes that no standards could be provided to an arbiter or mediator upon which to resolve any impasse. With respect to the concern of bankrupting NASAA, apparently the Board is concerned that the pricing committee may set the price below cost, thereby requiring NASAA to continually infuse capital into the SRD and depleting NASAAGs reserves. In lieu of a pricing committee, the Board has offered to create a cost oversight committee, which would be comprised of two Board members and two representatives of the IAG. This oversight committee would meet once a month to review all costs incurred by the SRD in the previous month to make sure such costs were reasonable and necessary. The Board did not specify what was to occur in the event the members of this oversight committee determined a cost was unreasonable or unnecessary. While the members of the IAG welcomed the opportunity to review the monthly expenditures of the SRD, the IAG reiterated to the Board that this oversight committee does not provide the meaningful input requested by the IAG because (1) such committee will always be conducting a retroactive review of the SRDGs expenditures and (2) the ability to redress any unreasonable or unnecessary expenditures or to determine the price of the SRD would presumably remain vested solely in the Board.

3. Savings to Result from Use of the SRD Though no details of savings have been provided, the SRD has consistently been touted by the SRD and by NASAA as an electronic filing system that will save filers "millions of dollars" in costs that are currently incurred through the manual paper filing system. These savings would result, in part, from the SRD (1) supplanting the need to make manual filings and (2) being a reliable conduit for filing purposes. The IAGGs letter expresses concern that although the SRD is expected to electronically provide states the same information they currently receive in hard copy, it may not supplant the need to make manual filings. Because electronic delivery will not facilitate a state analystGs review of the information contained in the registration statement and because the analyst will not

be able to manipulate the information on the computer screen, the IAG is concerned that analysts will require issuers to file a duplicate hard copy of the information. Such a requirement, of course, would largely eliminate the benefits of electronic filing. Assuming, however, that the SRD would (1) supplant the need to make manual filings and (2) cost \$3.00 per month to maintain each permit on the SRD, which is the current estimate provided by the SRD, members of the IAG have estimated that, rather than resulting in any savings, the SRD would increase costs anywhere from 37-100%. In addition to the \$3.00 fee that only covers monthly permit maintenance, the SRD has estimated that filers will incur additional costs (e.g., for converting permits onto the system and for functions such as electronically filing fees with the SRD or communicating with states via e-mail) of approximately 10% of the permit maintenance charges. These additional costs, coupled with the fact that the SRD does not plan to provide potential filers with assurances that the SRD will supplant the need to make manual filings, should result in the costs associated with using the SRD being even greater than currently estimated by the IAG. These preliminary estimates were provided to the Board during the March 4th meeting and the Board appeared to be disturbed by them. Because the members of the IAG used different methodologies to determine these estimates, the Board decided to devise a uniform methodology to be used to survey members of the industry to determine whether these estimates of increased costs by the IAG are valid. If the estimates are determined to be valid, it appears that the Board will need to rethink completely its current pricing system. As soon as this methodology is available, we will provide it to members of the Institute to assist us and the Board in determining whether the SRD will result in any savings to potential filers as currently priced.

4. Timetable At the time of the IAG's letter, the Board had planned to begin implementation of the SRD on April 1, 1995. At the Board's March 4th meeting, however, it was announced that, due to delays in executing the contract with GEIS and the Memorandum of Understanding with the SEC to permit the SRD to access EDGAR documents, implementation has been delayed until June. When initially implemented, the SRD will only be able to convert existing permits onto the system and process renewal of such permits. The system is not expected to be able to process all initial registrations until sometime in 1997. The next meeting with the Board is scheduled for March 29th. Tamara K. Cain Assistant Counsel Attachment