

Securities Lawyer 101

DTC Eligibility Q & A

Creating Liquidity with Electronic Trading



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DTC Eligibility Q & A

The [Depository Trust and Clearing Corporation](#) (“DTCC”), through its subsidiaries, provides clearing, settlement and information services for securities. DTCC’s subsidiary, the Depository Trust Company (“DTC”) was created to improve efficiencies and reduce risk in the clearance and settlement of securities transactions. Not all securities are eligible to be settled through DTC.

Issuers must satisfy the criteria set by DTCC to be settled through DTC. All companies must satisfy this criteria in order to be DTC eligible, including both Securities and Exchange Commission (“SEC”) reporting and non-reporting issuers. This Securities Lawyer 101 Series discusses the most common questions we receive about DTC eligibility

Q. What is The Depository Trust Company (“DTC”)?

A. DTC is the only stock depository in the United States.

Q. Why is DTC so important to public companies?

A. When DTC provides services as the depository for a company’s shares, the shares can trade electronically. Without [DTC eligibility](#), it is almost impossible for an issuer to establish an active market in its shares.

Q. How do public companies obtain DTC eligibility?

A. Issuers must satisfy specific criteria to receive initial DTC eligibility, and to remain DTC eligible. Even after those securities become eligible, DTC may limit or terminate its services.

Q. How does DTC limit its services?

A. DTC limits its service by placing a [chill](#) (“DTC Chill”) on a security and terminates its services by placing a [lock](#) (“Global Lock”) on the security.

Q. Is there a conspiracy between the DTC and the SEC to eliminate all small cap public companies by DTC placing global locks and chills on their securities?

A. When DTC eligibility is limited or terminated, issuers and their securities attorneys often scream foul play asserting various [conspiracy theories](#), each more ludicrous than the last. We have all

read about issuers who self-righteously proclaim that their loss of eligibility was due to conniving short sellers, nefarious clearing firms and the purported “agenda” of the SEC to eliminate small broker dealers and microcap issuers.

The reality is that microcap issuers lose DTC’s services for three legitimate reasons, failures to cover, illegal issuances of free trading securities and fraudulent investor relations activity.

Q. If I obtain a legal opinion, will I get DTC eligibility back for my company?

A. Not if the opinion is legally flawed. Many officers and directors of microcap companies are facing the harsh reality that reliance upon a legal opinion will not enable them to get a Chill or Global lock removed. DTC reserves the right to refuse to rely upon the opinion of any issuer’s securities attorney. In the last few years, the SEC has brought multiple enforcement actions against attorneys in connection with tradability opinions rendered for microcap issuers. Often these actions are preceded by a loss of eligibility.

Q. What Is DTCC’s Office of Corporate and Regulatory Compliance and what do they do?

A. DTCC’s Office of Corporate and Regulatory Compliance monitors unusually large deposits of microcap securities that are deposited into DTC when there is a suspicion or indication that the issuer or persons associated with the issuer have

violated the securities laws. With Microcap stocks, this behavior typically involves the deposit of large blocks of illegally unrestricted securities rendered in connection with convertible notes, [reverse merger](#) transactions or [Rule 504](#) offerings.

Q. Does FINRA have anything to do with all the DTC Chills?

A. A review is also prompted when issuers provide notice to FINRA pursuant to Rule 6490, of certain corporate actions. While FINRA examines the corporate action prompting the notice under [Rule 6490](#), DTC reviews matters related to the issuer's shares including the tradability of the securities it holds on deposit in the name of CEDE & Co. DTC staff may discover (previously undetected) illegal free trading share issuances or other fraudulent activity that will persuade them to limit or suspend its services. In these instances, DTC may make referrals to appropriate regulators including the SEC's Division of Enforcement.

Q. How will a DTC Chill or Global Lock impact trading of my company's stock?

A. A Chill restricts DTC's services, including limiting a participant's ability to deposit or withdraw chilled securities. A Chill may last a few days or for an extended period of time depending upon the problems that caused the chill and the issuer's willingness to address them. A "Global Lock" is a termination of all of all services to an issuer. Like a Chill, a Global Lock may last a few days or for an extended period of time, depending on the reason for the action. If the fundamental issue cannot be corrected, then the security will be removed from its depository, and transactions in the security subject to the Global Lock will no longer be eligible for clearing at any registered clearing agency. When this happens, clearance and settlement of open market trades is significantly delayed because trades can only occur upon physical delivery of stock certificates between the buyer and seller's brokerage firms. In such circumstances it could take weeks for trades to clear and settle.

Q. Will DTC tell me why my stock is chilled?

A. DTC does not always disclose the reason for a chill or Global Lock, nor does it suggest how long it will be in effect.

Q. Where can I find a list of chilled stocks?

A. DTC Chills and Global Locks are publicly announced on the DTCC website.

Q. Who can help me remove a DTC Chill?

A. Generally, two people are needed to help an issuer remove a chill. These are a securities attorney acceptable to DTC, who can render a tradability opinion concerning the issuer's unrestricted shares and a DTC Market participant, who can ask that DTC provide its services with respect to a security. Anyone else claiming he can secure eligibility or remove a Chill is not qualified to do so.

Q. Will DTC Ever Remove a Chill or Global Lock?

A. Yes, DTC chills and global locks have been removed from multiple public companies. In some circumstances, DTC obtains additional information from the issuer and an opinion from its securities attorney regarding the activity in question,

Q. What are the fairness procedures that apply to DTC?

A. On September 24, 2009, the SEC determined that DTC must provide issuers with fairness procedures, adding further that its suspension of its services to an issuer is subject to SEC review upon request. Unfortunately, the SEC has not defined adequate fairness procedures precisely. Even with a fairness hearing there can be no assurance that DTC will resume its services for an issuer's securities; it continues to have a broad discretion with respect to its services.

Q. What should I do about if I want to get DTC eligibility or have a DTC Chill removed?

A. Because DTC may choose to refer securities violations it discovers to the SEC's Division of Enforcement, issuers should with a securities attorney at all stages of the DTC process, particularly when information must be provided by the issuer. The selection of a securities attorney to address problems, and potential problems, should not be considered a routine legal matter. Issuers expecting to obtain and maintain eligibility need to recognize that their securities could become subject to a DTC Chill if they go public in a reverse merger or use the services of securities professionals – including unregistered brokers, investor relations firms, transfer agents and even securities lawyers- who have been the subject of SEC investigations and enforcement actions.

For further information about the [Depository Trust Company](#), please contact [Brenda Hamilton](#), Securities Attorney at 101 Plaza Real South, Suite 202 North, Boca Raton, FL, (561) 416-8956, or by email at info@securitieslawyer101.com. This securities law Q & A is provided as a general or informational service to clients and friends of [Hamilton & Associates Law Group, P.A.](#) and should not be construed as, and does not constitute legal advice on any specific matter, nor does this message create an attorney-client relationship. Please note that prior results discussed herein do not guarantee similar outcomes.
