

MEMO# 31232

June 4, 2018

SEC Grants ICI No-Action Relief Permitting Funds to Delay Disbursing Redemption Proceeds when Senior Fraud Suspected

[31232]

June 4, 2018 TO: ICI Members

Broker/Dealer Advisory Committee

Chief Compliance Officer Committee

Operations Committee

Small Funds Committee

Transfer Agent Advisory Committee SUBJECTS: Compliance

Operations

Transfer Agency RE: SEC Grants ICI No-Action Relief Permitting Funds to Delay Disbursing
Redemption Proceeds when Senior Fraud Suspected

As you may recall, last year FINRA adopted Rule 2165 to protect senior investors and other vulnerable adults from suspected financial abuse or exploitation.[\[1\]](#) The rule protects seniors by enabling FINRA's members to delay disbursing proceeds from a transaction requested by a senior investor whenever the member reasonably believes that the transaction is the result of financial abuse or exploitation. The rule includes several conditions a broker-dealer must comply with when relying on the rule. Because FINRA's rule is limited to broker-dealers, the Institute requested that the SEC permit mutual fund transfer agents to protect their senior shareholders who hold their shares directly with the fund by enabling such transfer agents to delay disbursing account proceeds when senior fraud or exploitation is suspected. This relief is necessary to avoid funds and their transfer agents from running afoul of Section 22(e) of the Investment Company Act, which requires redemption proceeds to be paid within seven days of the redemption. Our letter to the SEC requested that the SEC provide mutual funds and their transfer agents relief from Section 22(e) on the same terms and conditions imposed on broker-dealers under FINRA's rule.

We are pleased that the SEC has granted our requested relief.[\[2\]](#) The Institute's letter to the SEC on this issue is attached and briefly summarized below. Consistent with FINRA's Rule 2165, the relief the SEC has granted to mutual funds may be used when a mutual fund's transfer agent has a reasonable belief that financial exploitation[\[3\]](#) of a "Specified

Adult”[\[4\]](#) has occurred, is occurring, has been attempted or will be attempted. The conditions a fund’s transfer agent must comply with when relying on the relief are set forth in the ICI’s letter to the SEC requesting the no-action relief.

Conditions Imposed on Funds Relying on the No-Action Relief

The conditions imposed on any fund electing to rely on the no-action relief are as follows:

1. At the time of opening a non-institutional direct-at-fund account, the transfer agent holding the account:
 - A. Must request from the accountholder the name of and contact information for a trusted contact person age 18 or older who may be contacted about the customer’s account (“Trusted Contact Person”).[\[5\]](#) If the accountholder provides the name of a Trusted Contact Person, the transfer agent must maintain such person’s name and contact information.
 - B. Must disclose in writing, which may be electronic, to the customer that the transfer agent or an employee of the transfer agent is authorized to contact the Trusted Contact Person and disclose information about the customer’s account to address possible financial exploitation or to confirm the specifics of the customer’s current contact information, health status, or the identity of any legal guardian, executor, trustee, or holder of a power of attorney.[\[6\]](#)
2. With respect to any direct-at-fund account that was opened prior to the issuance of the requested relief, the transfer agent will comply with conditions 1.A. and 1.B. above when updating the information for the account either in the course of the transfer agent’s routine and customary business or as otherwise required by applicable laws or rules.[\[7\]](#)
3. The absence of the name of or contact information for a Trusted Contact Person will not prevent reliance on the requested relief in the case of a direct-at-fund account, provided that the transfer agent makes reasonable efforts to obtain such information from the accountholder as required under conditions 1 or 2, above.[\[8\]](#)
4. The transfer agent may place a temporary hold[\[9\]](#) on a disbursement of redemption proceeds from a direct-at-fund mutual fund account provided that, in addition to satisfying conditions 1 and 2, above, it satisfies each of the following conditions:
 - A. The transfer agent reasonably believes that financial exploitation of the Specified Adult who holds mutual fund shares in a direct-at-fund account has occurred, is occurring, has been attempted, or will be attempted;[\[10\]](#)
 - B. The transfer agent, not later than two business days after the date that the transfer agent first placed the temporary hold on the disbursement of redemption proceeds, provides notification orally or in writing, which may be electronic, of the temporary hold and the reason for the temporary hold to: (i) all parties authorized to transact business on the account, including the accountholder, unless a party is unavailable or the transfer agent reasonably believes that the party has engaged, is engaged, or will engage in the financial exploitation of the Specified Adult; and (ii) the Trusted Contact Person(s), unless the Trusted Contact Person is unavailable or the transfer agent reasonably believes that the Trusted Contact Person(s) has engaged, is engaged, or will engage in the financial exploitation of the Specified Adult;[\[11\]](#)
 - C. The transfer agent immediately initiates an internal review of the facts and circumstances that caused the transfer agent to reasonably believe that the financial exploitation of the Specified Adult has occurred, is occurring, has been

attempted, or will be attempted; and

D. The transfer agent holds the delayed redemption proceeds in the transfer agent's Demand Deposit Account ("DDA"). The transfer agent must maintain records for both the DDA and the Specified Adult's account documenting that such proceeds in the DDA are being held for the accountholder pending their disposition pursuant to this relief. The amount of redemption proceeds being held for the Specified Adult's direct-at-fund account must also be accurately reflected on or with the next confirmation or account statement that the transfer agent is required to provide to the accountholder.

5. The temporary hold permitted by condition 4 will expire not later than 15 business days after the date that the transfer agent first placed the temporary hold on the disbursement of redemption proceeds, unless otherwise terminated or extended by a state regulator or agency of competent jurisdiction or a court of competent jurisdiction or extended pursuant to condition 6.[\[12\]](#)
6. Provided that the transfer agent's internal review of the facts and circumstances supports the transfer agent's reasonable belief that the financial exploitation of the Specified Adult has occurred, is occurring, has been attempted, or will be attempted, the temporary hold may be extended by the transfer agent for no longer than 10 business days following the date authorized by condition 5, unless otherwise terminated or extended by a state regulator or agency of competent jurisdiction or a court of competent jurisdiction.
7. The transfer agent must establish and maintain written procedures reasonably designed to achieve compliance with the terms and conditions of this relief, including, but not limited to, procedures related to the identification, escalation, and reporting of matters related to the financial exploitation of Specified Adults, as well as procedures on whether to release or reinvest delayed redemption proceeds, taking into account the facts and circumstances of each case, should the transfer agent's internal review support the transfer agent's reasonable belief that financial exploitation of the Specified Adult has occurred, is occurring, has been attempted, or will be attempted.
8. The transfer agent's written procedures must identify the title of each person authorized to place, terminate, or extend a temporary hold on behalf of the transfer agent pursuant to this relief. Any such person will be an employee of the transfer agent who serves in a supervisory, compliance, or legal capacity for the transfer agent.[\[13\]](#)
9. The transfer agent must retain records related to compliance with this relief, which will be readily available to the SEC upon request. The retained records will include records of: (a) request(s) for disbursement that may constitute financial exploitation of a Specified Adult and the resulting temporary hold; (b) the finding of a reasonable belief that financial exploitation has occurred, is occurring, has been attempted, or will be attempted underlying the decision to place a temporary hold on a disbursement; (c) the name and title of the employee that authorized the temporary hold on a disbursement; (d) notification(s) to the relevant parties pursuant to condition 4.B. of this relief; and (e) the internal review of the facts and circumstances pursuant to condition 4.C. of this relief.[\[14\]](#)

Additional Training/Disclosure/Compliance Conditions Imposed by the No-Action Relief

In addition to the transfer agent satisfying each of the above conditions, prior to imposing a

temporary hold on the disbursement of redemption proceeds from a direct-at-fund account in reliance on the requested relief: (a) the transfer agent must develop and document training policies or programs reasonably designed to ensure that the transfer agent's employees comply with the terms and conditions of the requested relief; and (b) the mutual fund for which the transfer agent acts as the recordkeeper for the direct-at-fund account must disclose in its prospectus or statement of additional information that the fund may place a temporary hold on the disbursement of redemption proceeds in accordance with the terms and conditions of the requested relief.

The relief further requires the fund to establish, as part of the fund's compliance policies and procedures pursuant to Rule 38a-1, escalation and periodic reporting protocols between the fund and the transfer agent^[15] under which the transfer agent will provide the fund or its designee information regarding instances in which the transfer agent relied upon this relief. According to the relief, such information should include, for example, the transfer agent's findings of a reasonable belief, as documented under condition 9 above, that financial exploitation of a Specified Adult holding mutual fund shares in a direct-at-fund account has occurred, is occurring, has been attempted, or will be attempted, and how the matter was resolved consistently with the terms and conditions of this relief.^[16]

Reliance on the Relief is Voluntary

Importantly, just as FINRA Rule 2165 does not *require* any broker-dealer to delay the disbursement of account proceeds when financial exploitation of a Specified Adult is suspected, no fund or its transfer agent is required to delay the disbursement of account proceeds when financial exploitation or abuse is suspected. However, if a fund or its transfer agent elects to provide such protection to Specified Adult shareholders, it must do so consistent with all conditions required by the relief.

Next Steps

The Institute's Transfer Agent Advisory Committee plans to work with members' transfer agents to address issues raised by the relief and to facilitate their implementation of the relief's requirements for members interested in relying on it. We anticipate that this work will include identifying red flags that may be associated with potential financial abuse of senior citizens as well as assisting in the development of procedures to comply with the requirements of the relief.

Tamara K. Salmon
Associate General Counsel

[Attachment](#)

endnotes

[1] See Institute [Memorandum No. 30661](#), dated April 3, 2017, which summarizes FINRA Rule 2165, relating to Financial Exploitation of Specified Adults, and Rule 4512, relating to Trusted Contacts.

[2] See Investment Company Institute (Pub. Avail. June 1, 2018), which is available at: <https://www.sec.gov/divisions/investment/noaction/2018/investment-company-institute-060>

[3] The term “financial exploitation” as used in FINRA’s rule and the relief granted by the SEC means: (1) the wrongful or unauthorized taking, withholding, appropriation, or use of a Specified Adult’s funds or securities; (2) any act or mission by a person, including through the use of a power of attorney, guardianship, or any other authority regarding a Specified Adult to either convert the Specified Adult’s money, assets, or property or to obtain control of such assets, money, or property through deception, intimidation, or undue influence.

[4] As used in the relief, the term “Specified Adult” has the same meaning as in FINRA Rule 2165. It includes senior investors (*i.e.*, natural persons aged 65 or older) and natural persons age 18 or older who the transfer agent reasonably believes has a mental or physical impairment that renders the individual unable to protect his or her own interest.

[5] When FINRA adopted rule 2165, it also adopted Rule 4512 relating to Trusted Contacts and required broker-dealers to attempt to obtain a Trusted Contact for all customer accounts. [Mutual funds and their transfer agents have no similar obligation outside our no-action relief.] As with FINRA Rule 4512, under the no-action relief the Trusted Contact Person is intended to be a resource for the transfer agent in administering the customer’s account, protecting assets, and responding to possible financial exploitation. The transfer agent may use its discretion in relying on any information provided by the Trusted Contact Person. The transfer agent may elect to notify an individual that he or she was named as a Trusted Contact Person; however, such notification is not required. The transfer agent and the customer may benefit from the trusted contact information in many different settings. For example, consistent with the disclosure, if the transfer agent has been unable to contact the customer after multiple attempts, the transfer agent could contact a Trusted Contact Person to inquire about the customer’s current contact information. Or if the customer is known to be ill or infirm and the transfer agent has been unable to contact the customer after multiple attempts, the transfer agent could contact a Trusted Contact Person to inquire about the customer’s health status. The transfer agent also could reach out to a Trusted Contact Person if it suspects that the customer may be suffering from Alzheimer’s disease, dementia, or other forms of diminished capacity. The transfer agent could contact a Trusted Contact Person to address possible financial exploitation of the customer before placing a temporary hold on a disbursement.

[6] The transfer agent must provide this disclosure even if a customer fails to identify a trusted contact. Among other things, such disclosure may assist a customer in making an informed decision about whether to provide the Trusted Contact Person information.

[7] In the absence of applicable laws or rules, the transfer agent should consider asking the customer to review and update the name of and contact information for a Trusted Contact Person on a periodic basis or when there is a reason to believe that there has been a change in the customer’s situation. The transfer agent should note as well that a customer’s request to change his or her Trusted Contact person may be a possible red flag of financial exploitation. For example, a senior customer instructing the transfer agent to change his Trusted Contact Person from an immediate family member to a previously unknown third party may be a red flag of financial exploitation.

[8] Asking a customer to provide the name of and contact information for a Trusted Contact Person ordinarily would constitute reasonable efforts to obtain the information. A mailing address, phone number and email address for the Trusted Contact Person may be the most useful contact information to the transfer agent.

[9] Unless the transfer agent reasonably believes that doing so would cause further harm to a Specified Adult, the transfer agent is encouraged to attempt to resolve a matter with a customer before placing a temporary hold.

[10] This relief will not impact a mutual fund's obligations under Federal law relating to the reporting of suspicious financial activity (e.g., anti-money laundering and SAR reporting), the prevention of identity theft under the SEC's Red Flags Rules, and activities related to Customer Identification Programs. As a practical matter, as with other transfer agent services noted herein, mutual fund transfer agents provide services to mutual funds in these areas and perform these functions on their behalf.

[11] The lack of an identified Trusted Contact Person, the inability to contact the Trusted Contact Person, or a person's refusal to act as a Trusted Contact Person would be considered to mean that the Trusted Contact Person is not available. Furthermore, the inability to contact a party authorized to transact business on an account would be considered to mean that the party was not available.

[12] The transfer agent is not precluded from terminating a temporary hold after communicating with either the customer or a Trusted Contact Person. A customer's objection to a temporary hold or information obtained during an exchange with the customer or Trusted Contact Person may be used in determining whether a hold should be placed or lifted. While not dispositive, the transfer agent should weigh a customer's or Trusted Contact Person's objection against other information in determining whether a hold should be placed or lifted.

[13] This condition is intended to ensure that the transfer agent's decision to place a temporary hold is elevated to an employee with appropriate authority.

[14] SEC-registered transfer agents are subject to record retention requirements of Rules 17Ad-6 and 17Ad-7 under the Securities Exchange Act of 1934. Consistent with the records required by Rule 17Ad-6(c), the records listed in condition 9 must be maintained for a period of not less than six years, the first six months in an easily accessible place.

[15] As the Commission stated in the adopting release for Rule 38a-1 under the Act: "The chief compliance officer, in exercising her responsibilities under the rule, will oversee the fund's service providers, which will have their own compliance officials. A chief compliance officer should diligently administer this oversight responsibility by taking steps to assure herself that each service provider has implemented effective compliance policies and procedures administered by competent personnel. The chief compliance officer should be familiar with each service provider's operations and understand those aspects of their operations that expose the fund to compliance risks. She should maintain an active working relationship with each service provider's compliance personnel. Arrangements with the service provider should provide the fund's chief compliance officer with direct access to these personnel and should provide the compliance officer with periodic reports and special reports in the event of compliance problems." 68 FR 74714, 74722 (Dec. 24, 2003) (the "Rule 38a-1 Adopting Release"). We understand that transfer agents generally have established fraud prevention processes as well as escalation and reporting protocols with the funds they service.

[16] This information could be provided to the mutual fund separately or included with other information already shared with the mutual fund as part of the fund's existing oversight of the transfer agent. As recognized in the Rule 38a-1 Adopting Release, mutual

funds already “contractually delegate functions under [the anti-money laundering program required of them] to a fund’s service provider but must take steps to ensure that the service provider’s compliance program is reasonably designed, and to monitor its implementation to ensure its effectiveness.” See fn. 91.

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