

**MEMO# 29598**

December 23, 2015

## **SEC Seeks Comment On Extensive Revisions Proposed To Its Transfer Agent Rules**

[29598]

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TO:

BANK, TRUST AND RETIREMENT ADVISORY COMMITTEE No. 43-15  
BROKER/DEALER ADVISORY COMMITTEE No. 57-15  
OPERATIONS COMMITTEE No. 31-15  
SMALL FUNDS COMMITTEE No. 36-15  
CHIEF COMPLIANCE OFFICER COMMITTEE No. 22-15

RE:

SEC SEEKS COMMENT ON EXTENSIVE REVISIONS PROPOSED TO ITS TRANSFER AGENT RULES

Yesterday the U.S. Securities and Exchange Commission published an Advanced Notice of Public Rulemaking ("ANPR") and a Concept Release seeking public comment on the Commission's review of its transfer agent regulations. [\[1\]](#) According to the SEC Release, the ANPR is intended to identify a series of new and amended rules that the Commission intends to propose "as soon as is practicable, either individually or in groups or phases." [\[2\]](#) The Concept Release is intended to provide the Commission commentary on "a number of additional transfer agent issues that primarily arise from the diverse array of transfer agent functions and services which (sic) have developed over time." Comment on these issues will provide the Commission staff the ability "to evaluate the need for, and potentially develop, additional rulemaking proposals appropriately tailored to these complex areas." [\[3\]](#) Comments on the SEC Release must be filed within 60 days of their publication in the Federal Register, which is expected in the near future. The portions of the SEC Release that may be of interest to the Institute's members are briefly summarized below. [\[4\]](#)

## **I. Section VI of the SEC Release: The ANPR (pp. 109-150)**

As noted in this section of the SEC Release, the ANPR is intended to provide the public notice that the Commission is considering rulemaking in an area so the public can provide input into the Commission's process. According to the ANPR, the Commission plans to adopt new rules or revise its existing transfer agent rules to:

1. Expand the scope of information captured by Forms TA-1 and TA-2 and capture such information in a structured electronic format;
2. Require that any arrangement for transfer agent services between a registered transfer agent and an issuer be set forth in a written agreement that covers specified topics;
3. Enhance transfer agents' requirements for safeguarding issuers' and securityholders' funds and securities;
4. Subject transfer agents to an anti-fraud provision;
5. Require transfer agents to establish business continuity and disaster recovery plans;
6. Require transfer agents to establish "basic procedures" regarding the use of information technology, including methods of safeguarding personally identifiable information;
7. Revise the recordkeeping requirements to more fully capture the transfer agent's business activities; and
8. Conform and update various terms and definitions to reflect modern systems and usage, as well as to eliminate obsolete rules (e.g., those relating to Y2K issues).

The portion of the ANPR that might impact mutual funds or that we may want to comment on are next discussed.

### **A. Amendments to Form TA-2**

The Commission intends to revise Form TA-2 to require disclosure of certain financial information in order to better target "risk associated with contemporary transfer agent activities." [\[5\]](#) The additional disclosure items would include: statements of financial condition; income and cash flows; all direct or indirect conflicts of interest; the issuers and securities for which the transfer agent is providing transfer agent and other services; and the specific services being provided for each issuer or security, regardless of the nature of such services. Among other issues, the SEC seeks comment on whether:

- Annual financial statements provided to the SEC should be audited;
- The financial statements should be submitted using a data-tagged format such as XML or XBRL;
- The TA forms should require the transfer agent to disclose information regarding the fees imposed or charged by the transfer agent for various services or activities and, if so, the type of information and level of detail that it should require; and
- The SEC should require transfer agents to file "material contracts" with the SEC as an exhibit to Form TA-2.

### **B. Written Agreements Between Transfer Agents and Issuers**

To address the Commission's concerns with the lack of written agreements between some transfer agents and issuers, the Commission intends to propose amendments to require a written agreement between a registered transfer agent and an issuer that covers "certain basic topics" such as the transfer agent services to be provided, the terms of payment and fees to be imposed (including termination fees), and requirements for the turnover of the

transfer agent's records to a successor transfer agent.

### **C. Safeguarding Funds and Securities**

After noting: approximately one-third of transfer agents are engaged by issuers to provide administrative, recordkeeping, and processing services related to the distribution of cash dividends, mutual fund redemptions, and other payments to securityholders (i.e., paying agent services); the potential risk of loss from fraud, theft, or other misappropriation; the complexity of dividend distribution processing and processing other unique distributions (e.g., those arising from lawsuits or settlements); and the absence in the Commission's current rules addressing such issues, the ANPR discussed the SEC's interest in proposing new rules or rule amendments "to address transfer agents' expanded role in handling investor funds and securities, as well as the increase in the number and types of transactions currently facilitated by transfer agents." [6] In particular, the Commission plans to revise its rules to require transfer agents to comply with specific minimum best practices related to safeguarding funds and securities such as:

- Maintaining secure vaults;
- Installing theft and fire alarms;
- Developing specific written procedures for access and control over securityholder accounts and information;
- Enhanced recordkeeping requirements;
- Specific unclaimed property procedures; [7]
- Required segregating of client funds from the transfer agent's funds and required written notification from banks holding the funds that they are for the exclusive benefit of customers and not the transfer agent;
- Annual reporting of a statement of financial condition, a statement of income, a statement of cash flows, and certain other financial statements; and
- For those transfer agents acting as paying agents or custodians, requirements to prepare and maintain current and detailed policies and procedures reasonably designed to comply with any new or amended possession and control requirements for the safeguarding of customer funds and securities.

The Commission also plans to revise: (1) Form TA-2 to require disclosure of the number and/or dollar value of "residual and unclaimed" funds; and (2) Rule 17Ad-12 to provide specific requirements for the safeguarding of uncertificated securities, including appropriate controls and limitations on access to a transfer agent's electronic records.

### **D. Applying an Anti-Fraud Provision to Transfer Agents**

According to the ANPR, the Commission proposes to adopt "a new rule prohibiting any registered transfer agent or any of its officers, directors, or employees from making any materially false statements or omissions or engaging in any other fraudulent activity" in connection with the transfer agent's performance of its duties and obligations under the Securities Exchange Act of 1934 and the rules thereunder. It also expects to require transfer agents "to adopt policies and procedures reasonably designed to achieve compliance with application securities laws and applicable rules and regulations thereunder, and to designate and specifically identify to the Commission on Form TA-1 one or more principals to serve as a chief compliance officer." [8] Questions 45-49 of the ANPR seek comment on these proposed rules and rule amendments including whether the Commission should require transfer agents to:

- Maintain, implement and enforce written compliance policies and procedures; (Question 45)
- Designate a CCO and, if so, whether it should “adopt rules governing the reporting lines and relationships of the CCO” and whether the CCO should “be required to file an annual compliance report with the Commission;” (Question 46)
- “[U]ndertake security checks or confirm regulatory and employment history for employees, certain third-party service providers, and associated persons;” (Question 47)
- Register “certain employees” with the SEC; (Question 47)
- “[O]btain certain information concerning [the transfer agent’s] issuer clients, clients’ securityholders and their accounts, and securities transactions;” (Question 48) and
- “[M]aintain originals of all communications received and copies of all communications sent (including both paper and electronic communications) to or from the transfer agent related to its business.” (Question 49)

## **E. Cybersecurity, Information Technology, and Related Issues**

After noting the Commission’s concern “that widely varying safeguarding procedures and controls among transfer agents could create uncertainty and risk in the market,” [\[9\]](#) the ANPR announces the SEC’s intent to propose rules or rule amendments to require, among other things, registered transfer agents, to create and maintain:

- A written business continuity plan, tailored to the size and activities of the transfer agent, that identifies procedures relating to an emergency or significant business disruption, including data back-up protocols;
- Basic procedures and guidelines governing the transfer agent’s use of information technology, including methods of safeguarding securityholders’ data and personally identifiable information; and
- Appropriate procedures and guidelines related to the transfer agent’s operational capacity, such as IT governance and management, capacity planning, computer operations, development and acquisition of software and hardware, and information security.

In connection with these proposed requirements, the ANPR seeks comment on issues including whether the Commission should impose specific cybersecurity standards for transfer agents and, if so, what they should be. [See Question 58.] It also seeks comment on whether it should require transfer agents to:

1. “[D]emonstrate a certain level of operational capacity, such as IT governance and management, capacity planning, computer operations, development and acquisition of software and hardware, and information security;” (Question 59)
2. Maintain a written business continuity or disaster recovery plan and, if so, the items it should be required to include; (Question 60)
3. “[H]ave a minimum level of cybersecurity protection” and, if so what those levels should be; (Question 68) and
4. “[M]aintain minimum insurance coverage for operational risks associated with transfer agent operations and services, including cybersecurity losses;” (Question 69).

## **F. Recordkeeping Requirements**

The Commission proposes to revise its recordkeeping rules to incorporate any new filing or recordkeeping requirements resulting from the rules it revises as part of this initiative.

## **G. Updating or Eliminating Obsolete Rules**

The ANPR seeks general comment on whether any of the Commission's recurrent transfer agent rules are in need of being updated or deleted due to becoming obsolete. [See Questions 72-87.]

## **II. Section VIII: The Concept Release and Additional Request for Comment [pp. 151-208]**

This Concept Release portion of the SEC's Release discusses and seeks comment on additional regulatory, policy, and other issues associated with transfer agents beyond those discussed in the ANPR including:

- The processing of book-entry securities by transfer agents;
- Differences between transfer agent recordkeeping for registered security holders and broker-dealer recordkeeping for beneficial owners;
- Characteristics of and issues associated with transfer agents to mutual funds;
- Third-party administrator issues for issuer-sponsored plans; and
- Issues associated with outside entities engaged by transfer agents to perform certain services.

The issues in the SEC Release relating to these issues that may be of interest to mutual funds are discussed below.

### **A. Book-Entry Securities**

Recognizing that many of the existing transfer agents rules refer to "certificated" securities but have equal application to book-entry securities, the Commission seeks comment on whether it should address the applicability of the transfer agent rules to book-entry securities, "including those held by investment companies such as mutual funds." [\[10\]](#) [See Questions 88-96.]

### **B. Bank and Broker-Dealer Recordkeeping For Beneficial Owners**

This section of the SEC Release discusses the lack of transparency an issuer's transfer agent may have into the securities held by a beneficial owner in street name. It notes that "broker-dealers, banks, and other intermediaries may provide recordkeeping and transfer services to a larger portion of a given issuer's shareholder base – the intermediaries' customers – than the registered transfer agent for that issuer." [\[11\]](#) Also, "the transfer and recordkeeping services provided to beneficial owners by banks and brokers are largely identical to the recordkeeping and transfer services provided with respect to registered owners by registered transfer agents." [\[12\]](#) Notwithstanding the identical nature of these services, because the transfer agency services provided by banks and broker-dealers are considered to be "securities entitlements" under Article 8 of the Uniform Commercial Code, rather than "qualifying securities," they do not trigger the SEC's transfer agent registration requirement (and regulation). As a result, such entities are not "required to comply with the Commission's transfer agent rules, including the specific recordkeeping, processing, transfer, and other investor protection requirements imposed by those rules." Moreover, while "some banks and brokers may be subject to certain regulatory requirements depending on their specific activities, those regulations may not specifically address securities processing or provide the same investor protection as do the Commission's transfer agent rules." [\[13\]](#) In addition, "some third party administrators and other intermediaries who provide recordkeeping, administrative, and other services for

retirement and issuer plans may not be regulated directly at all by any federal financial regulator.” [14]

In light of these developments, the Concept Release seeks comment on whether entities that are regulated by the Commission, including broker-dealers, banks, or others who provide transfer agent and recordkeeping services to beneficial owners should be required “to provide or ‘pass through’ securityholder information to transfer agents” and, if so, what type of information should they be required to provide. The Concept Release also seeks comment on whether the Commission should limit the transfer agent’s use of any information it requires entities to provide to the transfer agent. [See Questions 99 and 100.]

## **C. Mutual Funds**

### **1. Mutual Fund Transfer Agents**

The Concept Release notes that, over the years, “some transfer agents evolved with the [mutual fund] industry to specialize in the increasingly unique needs of mutual funds, creating a segment of the transfer agent industry that focuses, often exclusively, on servicing mutual funds.” [15] Also, the compensation arrangements for a mutual fund’s transfer agent may differ from those of a transfer agent to an operating company. While an operating company’s transfer agent is generally compensated on a per-securityholder account basis, a mutual fund’s transfer agent may instead receive compensation based on a percentage of a fund’s net assets. The Concept Release notes that “mutual fund transfer agent fees are typically the second largest expense borne by mutual funds, exceeded only by the investment management fee.” [16]

According to the Concept Release, the “collective effect” of the following five factors have resulted in a mutual fund transfer agent’s processing being “more complex or involve additional responsibilities” compared to an operating company’s transfer agent:

1. Mutual fund transfer agents receive cash and perform calculations as part of regular processing of transactions in shares of mutual funds to a greater extent than is involved in the day-to-day work of an operating company transfer agent.
2. As a result of their work with NAVs, mutual funds transfer agents “play a role that serves to assist in the determination of an appropriate price for an investor’s purchase or redemption order.” [17]
3. Some mutual funds provide their investors with options – such as exchanges and systematic account features – that may add to the complexity of the transfer agent’s processing tasks.
4. Mutual funds have different sales load structures (including breakpoint discounts) and distribution methods.
5. Mutual fund transfer agents traditionally have functioned “in a more central role in connection with clearing and settlement of securities transactions” than operating company transfer agents. So, for example, mutual fund transfer agents “interact with sub-transfer agents such as broker-dealers . . . similar to the way in which DTC interacts with Operating Company Transfer Agents.” [18]

In addition, many mutual fund transfer agents may assist mutual funds with their compliance obligations such as in connection with “on boarding” new accounts, AML/OFAC compliance, suspicious activity reporting, and order processing to ensure the proper NAV is used.



## 2. Sub-Transfer Agents to Mutual Funds

The Concept Release also discusses the role of broker-dealers that act as sub-transfer agents for mutual funds and notes that “a key difference” between the mutual fund’s transfer agent and the broker-dealer acting as a sub-transfer agent “is that frequently a mutual fund will compensate the intermediary pursuant to an agreement with the intermediary for the provision of . . . services to fund investors, typically based on the number of shareholder accounts or a percentage of the net assets of the fund, or some combination thereof.” [\[19\]](#) It also notes that “most operating companies do not compensate intermediaries for servicing their beneficial owner customers.”

After next discussing networking arrangements, [\[20\]](#) the Concept Release states as follows:

Finally, the Commission understands that there has been a movement to omnibus sub-accounting arrangements over the years for mutual fund shareholders and that this movement has resulted in a fundamental shift in the roles and responsibilities of traditional shareholder servicing and recordkeeping. The Commission is examining the issues or concerns that may arise in connection with the lack of visibility that issuers and transfer agents acting on their behalf may have regarding the records maintained by intermediaries for their customers who are beneficial owners of mutual funds that are being serviced through omnibus and sub-accounting arrangements. [\[21\]](#)

With the above discussion as a backdrop, the Commission seeks comment “regarding the regulation of transfer agents to registered investment companies based on the unique trading, market, asset class, and other relevant characteristics of the registered investment companies their service.” Among other issues, the Commission seeks comment on whether:

1. Compensating mutual fund transfer agents based upon the fund’s net assets creates any conflict of interest and whether there are alternative fee structures that would not create such conflicts; (Question 111)
2. Mutual fund transfer agents “provide fee rebates” to issuers and, if so, whether these raise any regulatory concerns; (Question 111)
3. Internal and hybrid transfer agency models raise any special regulatory concerns; (Question 111)
4. The Commission should apply any of its clearing agency rules to mutual fund transfer agents; (Question 112)
5. Mutual fund processing through the NSCC raises any regulatory concerns; (Question 113)
6. It presents a conflict of interest for a mutual fund’s transfer agent to also serve as the fund’s administrator; (Question 114)
7. The Commission should address “as of” transactions in its transfer agent rules; (Question 118) and
8. The Commission should “propose rules governing how Mutual Fund Transfer Agents oversee sub-transfer agents to mutual funds.” (Question 120) [\[22\]](#)

It also seeks comment on:

1. What oversight functions, if any, mutual fund transfer agents typically perform for intermediaries performing sub-transfer agent or sub-accounting services to beneficial owners of mutual fund shares and how the initial due diligence of a sub-transfer agent

differs from ongoing due diligence performed? (Question 121)

2. What obstacles mutual fund transfer agents face in overseeing a fund's sub-transfer agents? (Question 121)
3. What problems, if any, are created by transfer agents' lack of visibility into the identity of beneficial owners and products services by intermediaries acting as sub-transfer agents? (Question 122)
4. With respect to any problems identified in response to Question 122, can these be adequately addressed through amendments to the SEC's transfer agent rules or would other changes be necessary (e.g., revisions to the SEC's rules under the Securities Exchange Act of 1934)? (Question 122)

#### **D. Third-Party Administrators**

The Concept Release discusses in detail the role third-party administrators to retirement plans play between the benefit plan participants and the plan. [23] Due to the similarity of these services to those of either a transfer agent or a broker-dealer, the Concept Release seeks comment on whether new rules governing the activities of third-party administrators might "bring greater clarity, consistency, and regulatory certainty to Plan Administration and similar activities by entities registered with the Commission solely as transfer agents as well as by entities that may not be registered with the Commission in any capacity." [24] Questions 125-140 seek comment on whether the Commission should regulate third-party administrators and, if so, how.

#### **E. Additional Request for Comment**

The Concept Release concludes with a request for any other issues, not previously discussed in the Release, that the Commission should consider as part of this initiative. Included in the list of questions posed by the Commission in this section are the following:

1. Do the transfer agent rules accomplish the Commission's regulatory objectives of protecting investors and enabling the Commission to evaluate a transfer agent's performance of its functions properly? (Question 150)
2. Should the Commission propose different rules for different types of transfer agents depending on the particular issuer type, asset class, or market segment serviced the transfer agent? (Question 156)
3. Is the role that transfer agents play in the proxy process useful for efficient, accurate, and timely communications between issuers and their securityholders? (Question 164)
4. Would creation of an SRO for transfer agents be useful or appropriate? (Question 165)
5. Should the Commission propose any other amendments to the transfer agency rules that are not discussed in the SEC Release? (Question 168)

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#### **endnotes**

[1] See Transfer Agent Regulation, Advance notice of proposed rulemaking; Concept release; Request for comment, SEC Release No. 34-76743 (December 22, 2015), which is available at: <http://www.sec.gov/rules/concept/2015/34-76743.pdf>. The ANPR begins on



page 109; the Concept Release begins on p. 151. Pages 159-187 focus on transfer agents to mutual funds. In this memo, the ANPR and Concept Release are referred to collectively as the “SEC Release.”

[2] SEC Release at p. 8.

[3] *Id.*

[4] The Institute plans to schedule calls with Institute committees or groups in the near future as necessary to obtain input for the Institute’s comment letter.

[5] SEC Release at p. 112.

[6] SEC Release at pp. 123-124.

[7] If the Commission “were to require transfer agents to disclose information pertaining to residual or unclaimed funds,” the ANPR seeks comment on what type of information and level of detail should be required, and how frequently it should be required to be reported. SEC Release at p. 127.

[8] SEC Release at p. 131. Note that these proposals are discussed in the ANPR under the heading of “Restricted Securities and Compliance with Federal Securities Laws.”

[9] SEC Release at p. 140.

[10] SEC Release at p. 153.

[11] SEC Release at p. 156.

[12] *Id.*

[13] SEC Release at p. 157.

[14] SEC Release at p. 158.

[15] SEC Release at p. 165. According to the Concept Release, today, in general, there are three types of mutual fund transfer agents: (1) an internal; (2) an external; and (3) a hybrid. Pages 168-169 of the SEC Release discuss the differences between these three types of mutual fund transfer agents. It also discusses the variety of factors have impacted the role of a mutual fund’s transfer agent over the years. These factors include, among others: the shift to omnibus account arrangements and its corresponding “lack of transparency of beneficial owners, their trading activities and related records” for mutual fund transfer agents; the increasing complexity of mutual fund recordkeeping, in part due to the proliferation of share classes; the need for mutual fund transfer agents to maintain “extensive CUSIP databased that define the characteristics and processing rules for each fund share class to ensure prospectus compliance and accurate processing and recordkeeping of mutual fund transactions.” As a result of these developments, mutual fund transfer agents “have made significant investments in technology advancements to manage more frequent and diverse transaction processing and shareholder communications through different channels. These changes in our industry “are among the factors informing the Commission’s examination of its transfer agent rules.” SEC Release at pp 162-164.

[16] SEC Release at p. 170.

[17] SEC Release at p. 171.

[18] SEC Release at p. 174.

[19] SEC Release at p. 177.

[20] SEC Release at pp. 178-180.

[21] SEC Release at p. 180 (footnotes omitted).

[22] In addition to the above issues, the Commission also seeks comment on whether it remains appropriate to have disparate exemptive treatment for UITs and closed-end funds under Rule 17Ad-4 in light of the fact that these two products trade in a substantially similar manner. SEC Release at pp. 181-2.

[23] SEC Release at pp. 191-195.

[24] SEC Release at p. 198 (footnote omitted).

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