April 14, 2016

Mr. Brent J. Fields, Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Transfer Agent Regulations—File No. S7-27-15

Dear Mr. Fields:

We appreciate the opportunity to respond to the Commission's Advanced Notice of Proposed Rulemaking, Concept Release, and Request for Comment relating to Transfer Agent Regulations (the "ANPR"), published on December 22, 2015.[1] We applaud the Commission's commitment to reform in this area and the 45-day extension of the public comment period, particularly given the broad range of topics and large number of questions included in the ANPR.

While we are generally in support of the broad proposals outlined in the ANPR, there are certain areas where we believe additional guidance and consideration may be warranted. Our comments that follow address four areas of concern:

- Need to consider potential harm to the transfer agent industry as a whole;
- Need to consider tiered requirements and staggered implementation, particularly for smaller transfer agents;
- Need for additional guidance on liability issues stemming from proposed compliance and anti-fraud provisions; and
- Need for additional guidance on proposed changes to Forms TA-1 and TA-2.

1. Need to Consider Potential Harm to the Industry as a Whole

The transfer agency business is changing rapidly and we feel that the Commission ought to consider the potential effect of the proposed rules on the health of the industry as a whole. In particular, consolidation has been the major challenge for transfer agents over the last decade. Since transfer agents provide a critical service for publicly traded companies, it is important that these firms are able to adapt to the new regulatory demands with minimal disruption. Since disruptions in the industry can be costly for transfer agents and their clients alike, it is also important that the Commission's new rules allow existing transfer agents to remain profitable without causing undue risk to clients and shareholders.

[1] Release No. 34-76743 (December 22, 2015).

In determining which rules to adopt and how such rules will be implemented, we ask that the Commission engage in a cost-benefit analysis on the potential consequences of the proposed rules. Specifically, we believe that the Commission should assess whether the risk reduction benefits that accompany the new rules will outweigh the administrative and financial burdens that firms will have to bear.

In particular, we ask to the Commission to consider whether the new rules will pose an undue burden for smaller transfer agents. In the transfer agent industry, microcap companies are considered the most susceptible to fraud. These companies typically trade on less regulated over-the-counter markets and disclose less financial information than larger public companies that trade on regulated exchanges.[2] These microcap companies have limited resources and tend to hire smaller, less well capitalized and less operationally sophisticated transfer agents. By contrast, larger firms typically hire transfer agents operated by large firms such as Computershare, American Stock Transfer & Trust Company, and Wells Fargo.[3] Unlike their larger counterparts, smaller transfer agents—some of which operate out of people's homes—do not have the same capacity as their larger counterparts to investigate potentially fraudulent activity. When the new rules come into effect, larger transfer agents will also be better prepared to adapt to the changes and pass on some of the costs of compliance to clients.

While it certainly appears reasonable to target those actors who are the most susceptible and therefore the worst offenders, smaller transfer agents may find themselves driven out of business or forced to merge as a result of the Commission's new rules. Clients fleeing from smaller transfer agents out of fear that their collapse or merger may adversely affect their shareholders may further aggravate such trends. Should the new proposed rules increase the rate of consolidation in the transfer agency industry, some of the risks that the Commission seeks to reduce may in fact be exacerbated: larger transfer agents—notwithstanding their superior resources—will nonetheless face more frequent conflicts of interest. The consequences of any security breaches will also be greater and more devastating in a highly consolidated, interconnected industry. A transfer agent industry with fewer, highly influential players may also become more visible targets for individuals and parties seeking to commit fraud and disrupt market functioning. Moreover, a reduction in competition brought about by increased regulation may hamper independent security innovations among competing transfer agents. In short, we believe that the Commission should seriously consider the potential adverse consequences of its proposed rules and weigh them against the anticipated regulatory benefits.

2. Need to Consider Tiered Requirements and Staggered Implementation, Particularly for Smaller Transfer Agents

The variation among transfer agents alluded to in Part 1 is further illustrated by some statistics. A distinctive feature of the transfer agent industry is its broad spectrum of participants—while there are approximately 450 registered transfer agents in the United States servicing about 276 million shareholder accounts and 1.5 million issuers[4], just four or five transfer agents account for

[2] http://www.reuters.com/article/us-sec-transferagents-insight-idUSKBN0KL0BD20150112.
[3] *Id*.
[4] *Id*.

nearly 70% of the market share.[5] Thus while large issuers are typically serviced by market leaders Computershare and American Stock Transfer & Trust (together, over 55% of the market in 2014[6]), there are thousands of smaller companies relying on dozens of small transfer agents operating out of back offices or peoples' homes. Given the differences in scale, sophistication, and capacity found throughout the industry, we see two major areas where new policies and procedures may stretch smaller transfer agents' ability to comply.

A. Safeguarding Customers' Funds & Securities

The increased role of transfer agents as "paying agents" and custodians has caused the Commission to propose new and amended rules requiring segregation of client funds, expanded annual reporting and independent audit requirements, and the development of formal policies and procedures "reasonably designed to comply" with "possession and control requirements for the safeguarding of customer funds and securities."[7] Some of the proposed changes include maintaining secure vaults, installing theft and fire alarms, developing specific written procedures for access and control over accounts and information, and enhanced recordkeeping requirements and unclaimed property procedures.[8] For smaller mom-and-pop offices, the cost of installing sophisticated vaults and commercial-grade security alarms may be impractical and prohibitively expensive. And while developing written access and control procedures seems prudent in theory and unlikely to be unduly burdensome from a cost perspective, in practice such regulations may have little effect. For example, in a small shop in which there are only a handful of employees, the same individual may end up wearing multiple hats with respect to compliance, access approvals, review, and recordkeeping. It may be that the Commission's goal is to elevate standards across the industry and hold smaller operators to the same best practices as the market leaders—no matter the consequences. However, it seems to us that practical exigencies and realities may result in shortcuts and workarounds among the bottom half of the league tables, effectively undermining the regulators' intentions.

B. Improving Cybersecurity and IT Governance

Similarly, new requirements with respect to cybersecurity and information technology may place undue burdens on smaller transfer agents. The ANPR acknowledges that transfer agents operate in a market structure that "bears little resemblance" to the landscape that existed in 1977, when the first transfer agent rules were adopted.[9] The changes reflect a "decades-long evolution from a manual securities settlement process . . . to a highly automated electronic environment centered on the processing and transfer of electronic book-entry securities", reflecting "significant technological and operational developments."[10] Currently, most of the rules adopted by the Commission addressing cybersecurity and related issues do not apply to registered transfer agents or address transfer agents' specific activities (e.g. Reg SDR, Reg SCI, Reg S-ID).[11] The Commission's proposed rules would require registered transfer agents to create and maintain (i)

[5] http://www.auditanalytics.com/blog/2014-transfer-agent-market-share.
[6] *Id*.
[7] ANPR at p. 125.
[8] *Id*. at 124.
[9] *Id*. at 1.
[10] *Id*. at 7.
[11] *Id*. at 137.

written business continuity plans with provisions for emergency data back-up and recovery protocols; (ii) basic procedures and guidelines governing use of information technology and the safeguarding of personally identifiable information; and (iii) appropriate procedures and guidelines related to a 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.[12]

As with the safeguarding requirements, we believe that the Commission should consider adopting tiered requirements and staggered implementation to ensure there is adequate time for smaller transfer agents to comply. Just as businesses with lower revenue thresholds or fewer workers have extended timelines to offer expanded health coverage or raise minimum wages[13], so too should smaller transfer agents be given additional time to implement the required changes. To help ease administrative burdens on smaller transfer agents, we recommend that the Commission prioritize rollouts based on considerations such as individual entity capacity, the importance of the reform to the security of the industry, the relative ease of implementation, and the certainty of the solution. Indeed, particularly with respect to cybersecurity protocols and information technology, the rapid pace of development may mean that systems are already obsolete or vulnerable by the time they are approved by regulators. Rather than forcing small operators to bear the cost of repeated updates and multiple installations, a carefully phased implementation would allow for additional experimentation and adjustment over time, as regulators and transfer agents work iteratively to identify problems, figure out solutions, and develop best practices.

3. Need for Additional Guidance on Liability Issues Stemming from Proposed Compliance and Anti-Fraud Provisions

Two additional areas of reform will require further guidance from the Commission.

A. Liability for Chief Compliance Officers

The Commission is proposing a new rule requiring "each registered transfer agent to adopt policies and procedures reasonably designed to achieve compliance with applicable 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 chief compliance officer."[14] While many transfer agents already have a chief compliance officer and program in place, those that do not will now need to formalize the duties under a specific individual and develop formal documentation and governance.[15] For larger and more sophisticated entities, this new rule may represent only an incremental change from existing practice. However, such requirements may prove prohibitive for smaller and less sophisticated players.

[12] ANPR at p. 141.
[13] http://www.nytimes.com/2016/03/29/business/economy/15-hour-minimum-wage-in-california-plan-has-some-worried.html.
[14] ANPR at p. 131.
[15] http://finops.co/uncategorized/sec-puts-transfer-agents-under-sharper-microscope.

In the run-up to, and the immediate aftermath of, the 2008 Financial Crisis, compliance departments at major banks and other financial entities have expanded exponentially. Under the Volcker Rule of the Dodd Frank Act, certain banking entities are required to provide an annual CEO attestation regarding the entity's compliance program.[16] As seen in the banking arena, efforts to impose additional accountability can cause unintended consequences. If "chief compliance officers" can be found personally liable for violations or face criminal or civil sanctions, firms can have difficulty recruiting, hiring, and retaining qualified candidates, leaving their operations exposed to outsized compliance risk. Because qualified candidates will generally need to be more experienced, they typically command higher salaries. Companies may be forced to offer additional compensation or alternative protections, such as D&O insurance or special indemnities.[17] Particularly for smaller, undercapitalized transfer agents, such measures may be unaffordable and unsustainable. If the organization is small enough, owners and sole proprietors may be playing the role of "chief compliance officer" themselves. Without further guidance from the Commission on the scope of liability, managers may decide the risk of personal ruin is too great and exit the business entirely.

In addition, we note that the proposed rules do not define what policies and procedures would qualify as "reasonably designed to achieve compliance." Does the reasonableness vary depending on the capacity of the transfer agent, the volume of transactions, or the types of issuers involved? What steps or activities must a chief compliance officer engage in in order to demonstrate compliance? Who beyond the chief compliance officer may be held responsible? For low volume, low margin transfer agents, a burdensome compliance apparatus may slow the pace of business and place additional drag on profitability, ultimately jeopardizing the entity's viability. Larger transfer agents may simply construct an endless scaffolding of upward attestation, with reports passing through dozens of levels of sign-offs before ever reaching the chief compliance officer's desk. In the absence of clear guidance identifying who in addition to the chief compliance officer can be sanctioned for violations or asked to bear some portion of the liability, the regulation risks missing those on the front lines directly engaged in illegal practices, while shielding those at the top from any reasonable ability to insist upon proper oversight and control.

B. Safe Harbors and Red Flags for Anti-Fraud Provisions

We also believe that the Commission needs to provide additional clarification and guidance for transfer agents seeking to avoid penalty under the proposed anti-fraud provisions. One of the motivations underlying the proposed transfer agent regulations is the Commission's concern about the role of transfer agents in allowing or facilitating investor scams, particularly microcap fraud. In recent years, the Commission has moved aggressively to hold transfer agents responsible for their role in lifting restrictive legends on unregistered stock, allowing fraudsters to sell in the public markets and artificially run up the price in illegal "pump-and-dump" schemes. Indeed in 2014, the Commission brought a fraud case against Registrar & Transfer (since acquired by Computershare) for $127,000 in penalties, disgorgement, and interest, along

[16] https://www.fdic.gov/regulations/reform/volcker/faq/attestation.html.
[17] http://ironcoveins.com/2011/06/25/dodd-frank-requires-the-need-to-hire-a-chief-compliance-officer-is-the-cco-adequately-protected.

with a $25,000 fine and a yearlong supervisory ban for the former chief executive.[18] Because transfer agents act as "gatekeepers" and occupy a "unique position" in the securities markets, former Commissioner Luis Aguilar has argued that, "The commission should adopt rules providing additional safeguards to protect against the unlawful distribution of unregistered securities."[19]

The recent ANPR seeks to address these risks by promulgating new rules that would prohibit "any registered transfer agent or any of its officers, directors, or employees from directly or indirectly taking any action to facilitate a transfer of securities if such person knows or has reason to know that an illegal distribution of securities would occur in connection with such transfer."[20] In addition, such persons are prohibited from making "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 Exchange Act and the rules promulgated thereunder."[21] These new rules would bring transfer agents further in alignment with other market players by applying language similar to that governing broker-dealers and other financial fiduciaries. However, it is important to recognize that mutual fund shares are already registered, so these rules would not typically apply to mutual fund transfer agents. In addition, the Commission's underlying assumption that sales of unregistered shares are passing primarily through transfer agents should be examined. More likely, unregistered restricted stock is exchanging hands on a person-to-person basis, or via private placements. If the Commission's goal is to reduce the incidence of microcap fraud, placing increased scrutiny and heightened regulatory requirements on transfer agents may have the perverse effect of pushing illegal transactions further outside of the agency's reach. Last, while the industry would welcome additional instruction related to privately held shares to reduce the risk of a regulatory investigation,[22] the constructive knowledge standard is problematic and likely too vague to serve as sufficient guidance. We believe that transfer agents are adequately incentivized to avoid the expense and reputation risk of a high-profile probe, and are seeking clear rules and specific safe harbors to avoid unwitting, but costly mistakes. As articulated by a small transfer agent in Florida: "The problem is, the SEC has not defined what [the] red flags are."[23]

The ANPR seeks comment on whether it should require transfer agents to (1) submit attorney opinion letters; (2) obtain approval of the issuer; (3) require evidence of either applicable registration statements or exemptions; or (4) conduct a minimum level of due diligence on the issuer, shareholder, or attorney before removal of restricted securities legends.[24] It is also considering the identification of specific red flags that would trigger a duty of inquiry by the transfer agent.[25] With respect to the specific requirements listed, we are sympathetic to the Commission's concern that attorney opinion letters are susceptible to abuse.[26] Nevertheless, we think these letters might be of use if filed in advance for certain transactions with the highest risk

[18] http://finops.co/uncategorized/sec-puts-transfer-agents-under-sharper-microscope/
[19] http://www.reuters.com/article/us-sec-transferagents-insight-idUSKBN0KL0BD20150112/
[20] ANPR at p. 131.
[21] *Id*.
[22] https://www.computershare.com/us/about/Documents/Paul-Capozzi-STA-Article-April2015.pdf.
[23] http://www.reuters.com/article/us-sec-transferagents-insight-idUSKBN0KL0BD20150112.
[24] ANPR at p. 132.
[25] *Id*. at 133.
[26] *Id*. at 130.

of fraud, and if transfer agents are made aware that they can be penalized or held partially liable for willfully or recklessly accepting untrustworthy counsel. The existence or lack thereof of a proper attorney opinion letter could also be weighed as one factor, or "red flag," in an ex ante decision of whether to pursue further diligence or an ex post determination of whether transfer agents engaged in wrongdoing. Similarly, the availability or formal submission of registration statements or exemptions could also count as a trigger factors or red flags, depending on the type of issuer, the transaction characteristics, the transfer agent, or other attributes. In our opinion, requiring the Commission to approve the issuer may result in bureaucratic backup and place unnecessary strain on already sparse agency resources, while seeming to shift the burden of responsibility away from the transfer agents and onto the Commission officials issuing the approvals. Similarly, requiring a uniform level of minimum due diligence risks ending up as either the lowest common denominator or too blunt of a solution. As such, we are in favor of a more categorical, objective approach based on the identification of clearly defined red flags. Regardless of which factors the Commission ultimately chooses, we believe that creating safe harbors and developing more specific rules around when restrictive legends can and cannot be lifted would encourage broader adoption by reducing uncertainty around potential liability and by enabling transfer agents to better manage their risk.

4. Need for Additional Guidance on Proposed Changes to Forms TA-1 and TA-2

Finally, while we believe that the new rules will enhance the Commission's ability to regulate transfer agents, we feel that additional guidance may be needed to ease administrative burdens with respect to the proposed amendments that seek to expand the scope of information collected on Forms TA-1 and TA-2. The proposed changes will require transfer agents to disclose, in many cases, extensive information concerning their business practices and clientele. Such disclosures may present undue administrative challenges, particularly for smaller transfer agents who may lack the immediate resources to deal with the proposed changes.

A. Disclosure of Conflicts of Interest

We would first like to draw attention to the proposal that would require transfer agents to disclose on Forms TA-1 or TA-2 all of their actual and potential conflicts of interest.[27] Potential conflicts of interest can take many forms and the complexity of today's markets means that it is almost impossible for a firm of any size to avoid a broadly construed conception of conflict of interest. For instance, it is common for mutual fund transfer agents to also serve as administrators for the same fund. Would such activity give rise to a conflict of interest? Similarly, would the fact that a transfer agent and an issuer fall under common ownership also give rise to a conflict of interest? In a market that is undergoing consolidation, it may be particularly difficult for transfer agents to predict potential conflicts of interest that may arise. Such confusion may lead transfer agents to either overproduce or omit relevant information.

To mitigate such uncertainty, we suggest that the Commission provide clear parameters as to what constitutes a conflict of interest. For example, the Commission might consider reviewing whether transactions that may give rise to conflicts of interest but that are also market practice

[27] ANPR at p. 112.

should be disclosed. The Commission may also need to examine the temporal scope of potential conflicts. Specifically, how far should a transfer agent look ahead in time when determining potential conflicts of interest? And how does the Commission plan on attributing liability when a transfer agent fails to sufficiently disclose their conflicts of interest? Does the Commission plan to engage an actual or constructive knowledge standard? The Commission may also wish to consider what remedies transfer agents can apply should they be found to be in breach of the new conflicts disclosure rules.

In addition, the Commission may wish to issue a fuller explanation as to the purpose of collecting extensive conflicts of interest information in this particular area. We note that currently, the Commission does not require similar intermediaries to catalogue and reveal information concerning direct and indirect conflicts of interest. While registered advisers and mutual funds have a fiduciary and legal duty to understand their conflicts of interest, manage them, and disclose them, these disclosures are typically delivered to shareholders, not regulators. In addition, mutual fund boards of directors are generally expected to oversee potential conflicts of interest between a fund's transfer agent and the fund. Given that mutual fund transfer agents are already subject to regulation with regard to conflicts of interest, they may need to be specifically exempted from the new regime.

B. Disclosure of Material Contracts

A second proposal that may warrant additional guidance is the proposed rule requiring transfer agents to file material contracts with the Commission as an exhibit to Form TA-2 in order to "increase the ability of the Commission to monitor trends, gather data, and address emerging regulatory issues."[28] Again, it appears unclear how the filing of material contracts with the Commission would aid its regulatory efforts. It appears that such a requirement would single out transfer agents from other registrants.[29] The requirement could also impose burdens on transfer agents that may outweigh potential gains. While public companies are required to describe their material contracts in their registration statements, such companies are already subject to increased scrutiny (for good reason) by virtue of their public company status. Nevertheless, we note that their "material contracts" are often included without fee schedules. In the case of transfer agents, requiring public disclosure of exact terms, counterparties, specific services, pricing agreements, and other details of individual registrants' most important business relationships could reduce competition and appears unduly invasive. Indeed, transfer agents are already required to provide statistical information and data in their Form TA-2. We suggest that the Commission reconsider the need for further disclosures.

However, should the Commission decide to proceed with required disclosure of material contracts, we strongly recommend additional guidance as to what constitutes materiality. Would the Commission adopt the same definition as used in the fraud context, i.e. whether a reasonable investor would view the information as significantly altering the "total mix" of information available? It would also be helpful for the Commission to define the scope of materiality. For instance, would contracts that individually appear immaterial become material when considered

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[28] ANPR at p. 113.
[29] *Cf.* Item 11 of Form ADV, which requires advisers to disclose information about specific conflicts of interest that might arise in connection with an advisory relationship.

in relation to other information? Would the materiality standards differ for larger transfer agents whose more extensive client roster may create greater cause for concern? While materiality has long evaded any bright-line definitions and arguably requires an investigation into the facts, the sheer volume of contracts that are processed by transfer agents may warrant an exception. We ask the Commission to consider the possibility of applying bright-line rules in this context, or establishing safe harbors so that transfer agents who inadvertently fail to file the necessary contracts can engage remedies and avoid reputational and pecuniary penalties. Without clear boundaries, the Commission may find itself inundated with filings that are beyond the capacity of the Commission to monitor or review.

C. Disclosure of Residual and Unclaimed Funds

Lastly, we would like to draw the Commission's attention to the proposed requirement that transfer agents disclose the number and/or dollar value of residual and unclaimed funds.[30] The ANPR states that "the Commission's staff understands that transfer agents may hold residual funds from thousands to millions of dollars and securities for long periods of time ranging from over a month to several years, before distributing the funds or securities either to the intended recipients or escheating the funds or securities to a state or territory."[31] First, it is not clear why the Commission has reason to know the number and dollar value of residual and unclaimed funds, when transfer agents are already subject to state escheatment laws. Given the expectation of compliance and existing enforcement at the state level, an additional check by the Commission seems duplicative. Nevertheless, the proposed rule requiring transfer agents to segregate client funds and obtain written notification from banks that the funds are held for the exclusive benefit of the customers is difficult to argue against.[32] Indeed, unclaimed funds held by a mutual fund security-holder are already invested and held separately from the account of the mutual fund's transfer agent. As such, we suggest that the Commission include in its guidance some form of carve-out for mutual funds with respect to this proposed rule. Furthermore, while the disposition of unclaimed funds does pose potential fraud risks, it is also important that the Commission more clearly define what constitutes a "lost security-holder." While the Commission deems a shareholder to be lost based on returned mail, states generally deem accounts to be abandoned and subject to escheatment if the account owner fails to have contact with the mutual fund—even though the shareholder is receiving all mail sent by the transfer agent and may not have a reason to contact the transfer agent due to the long-term nature of mutual funds.[33] We suggest the Commission consider aligning its definition of "lost security-holder" with that of state law to reduce potential confusion and duplicative paperwork for transfer agents.

In conclusion, we believe that the Commission's proposal to revise the current transfer agent rules will greatly enhance public confidence in the industry and serve to protect the interests of shareholders. However, we feel that any new changes should be accompanied by clear guidelines

[30] ANPR at p. 118.
[31] *Id*. at 119.
[32] *Id*. at 124.
[33] http://www.sutherland.com/NewsCommentary/Legal-Alerts?find=149636&printTo=pdfwd&pagePath=NewsCommentary%2FLegal-Alerts&preferredSection=

to ensure that new rules are implemented efficiently and that transfer agents are not unduly burdened. We are grateful to the Commission for providing us the opportunity to comment on the proposed rules and we hope that the Commission will consider our recommendations.

Sincerely,

Marisa Choy
Carmen Lu

Yale Law School students, Class of 2016
Yale Law School Financial Markets and Corporate Law Clinic[34]

[34] This comment does not purport to express the views of Yale Law School, if any.