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**Daniel E. Thieke**  
*Managing Director*

55 Water Street  
New York, NY 10041

Tel: 212-855-4162  
dthieke@dtcc.com

April 14, 2016

Mr. Brent J. Fields  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, D.C. 20549-1090

Re: Release No. 34-76743, File No. S7-27-15 /Transfer Agent Regulations

Dear Mr. Fields:

The Depository Trust & Clearing Corporation (“DTCC”) appreciates this opportunity to provide comments on the Securities and Exchange Commission’s (the “SEC” or the “Commission”) Advance Notice of Proposed Rulemaking, Concept Release and Request for Comment on Transfer Agent Regulations (the “TA Release”). This letter provides (1) relevant background about DTCC and its interaction, in particular through its subsidiary The Depository Trust Company (“DTC”), with transfer agents, as part of the clearance, settlement and asset servicing system, and (2) our comments in response to questions posed in both the notice of proposal and concept release portions of the Release.<sup>1</sup> As explained in more detail below, we strongly support the SEC’s efforts to replace an outdated regulatory scheme with one that seeks to ensure the safety and soundness of transfer agents as part of the modern clearance and settlement process.

## **I. EXECUTIVE SUMMARY**

DTC is the U.S. central securities depository (“CSD”) and performs a critical function in the National Clearance and Settlement System (“National C&S System”). Transfer agents also perform a vital role in the National C&S System, providing various services as agents of issuers and participating in DTC’s Fast Automated Securities Transfer (“FAST”) program. Transfer agents admitted to the FAST program (“FAST Agents”) act as custodians for DTC with respect to securities issued by the issuer for which the transfer agent acts as registrar. FAST Agents are responsible – on DTC’s behalf – for maintaining records of securities ownership by DTC (*i.e.*, in its nominee name, Cede & Co.) as well as vital records of issuances into, and withdrawals from, the DTC system.

DTCC agrees with the Commission’s observation that the regulation of transfer agents is critically outdated. The existing rules were developed in an environment where most securities transactions involved processing paper certificates, daily NYSE equity market volumes were in the 19.5 million range as compared to market volumes of over 1.5 billion shares today, and the market value of securities were a small fraction of current levels. Yet, as the market has grown larger by every

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<sup>1</sup> Transfer agents also act as redemption, reorganization and tabulator agents. As those functions are not discussed in the TA Release, DTCC’s comments do not address those roles.

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measure, there are fewer transfer agents, with a handful of large firms controlling a substantial portion of the market. While failures of transfer agents have been rare, they have occurred historically, and are bound to occur in the future. DTCC is concerned that transfer agent failures, particularly in the context of other system failures or significant market disruptions, could potentially cause or add to a systemic crisis. DTCC's own mission to reduce risk compels it to identify and mitigate such potential extreme but plausible scenarios.

Accordingly, we believe that the safety and soundness of the National C&S System justifies the Commission's attention to the regulation of transfer agents, and we broadly agree with the Commission's intention to pursue the proposed rulemaking as outlined in the TA Release. In particular, as described in more detail below, we agree with the Commission that, in order to ensure transfer agents' financial stability and operational fitness, transfer agents should be subject to reporting and substantive requirements to ensure their financial stability, more robust registration and reporting requirements, new measures to ensure that data, securities and other assets are safeguarded in the event of threats, including cyber attacks, insolvencies, and security lapses, and appropriate business continuity standards.

DTCC also believes that the capital markets generally, and the goals of the current rule proposals more specifically, would benefit from continued Commission support for the elimination of paper certificates for depository eligible issues in line with the proposed Covered Clearing Agency standards.

We believe that as dematerialization becomes a reality, all transfer agents will either become FAST Agents or enter into correspondent relationships with FAST Agents as a condition of their registration with the SEC (or any other primary regulator).

## **II. INTRODUCTION**

### **A. TRANSFER AGENTS ARE SIGNIFICANT STAKEHOLDERS IN THE NATIONAL C&S SYSTEM AND THEIR SAFETY AND SOUNDNESS IS VITAL TO THE INDUSTRY**

By its very scope and focus, the TA Release recognizes that transfer agents are significant stakeholders in the National C&S System. From DTCC's unique perspective, as reflected in the TA Release and elaborated upon in this comment letter, all transfer agents, but particularly those admitted to DTC's FAST program, play an important role in what is commonly referred to as the indirect holding system, including the services provided by DTC as the U.S. CSD. For these reasons, DTCC supports the Commission's effort to adopt comprehensive regulatory standards governing the safety and soundness of transfer agent operations. Indeed, throughout the TA Release, the Commission has identified significant risks to the marketplace associated with transfer agent services.<sup>2</sup> The proposed rulemaking is timely and necessary to ensure that transfer agents are subject to clear standards designed to mitigate risk to themselves, issuers, investors and the National C&S System.

Although serious breakdowns in transfer agent operations have not been commonplace, they have occurred historically, as noted below. The infrequency of these events should not justify

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<sup>2</sup> See *infra*, n. 12.

complacency. We believe that the outdated and limited scope of existing transfer agent regulation, particularly in comparison to other industry stakeholders, is a “weak link” in the inter-connected network of actors who operate in the highly regulated National C&S System.

DTCC suggests, as an overarching view, that in seeking to reduce systemic risk, the Commission’s analysis and rule-making actions should, to the extent practical, be based on risk analysis rather than the metric-based analysis (*e.g.*, 72-hour transfer turnaround on 90% of routine transactions) that characterized the historic approach to transfer agent oversight.

## **B. OVERVIEW OF DTCC AND ITS WHOLLY OWNED SUBSIDIARIES**

DTCC, through its subsidiaries, provides clearing, settlement, and information services for equities, corporate and municipal bonds, government and mortgage-backed securities, money market instruments and over-the-counter derivatives. DTCC is also a leading processor of mutual fund and insurance transactions, linking funds and carriers with their distribution networks.

DTCC has three wholly-owned subsidiaries that are registered clearing agencies under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), and thus subject to regulation by the Commission. These three clearing agency subsidiaries are DTC, National Securities Clearing Corporation (“NSCC”) and Fixed Income Clearing Corporation (“FICC”).<sup>3</sup>

All three clearing agencies have been designated as Systemically Important Financial Market Utilities by the Financial Stability Oversight Council.<sup>4</sup> In 2015, DTCC’s subsidiaries processed securities transactions valued at more than \$1.5 quadrillion.

DTC, as the U.S. CSD, is the DTCC subsidiary that interfaces most directly with transfer agents. Comments set forth in this letter are presented from DTC’s vantage point.

DTC is a limited purpose trust company organized under the New York State Banking Law, subject to regulation by the New York State Department of Financial Services. DTC is also a State Member Bank of the Federal Reserve System, subject to regulation by the Federal Reserve Bank of New York.

DTC currently provides custody and asset servicing for 1.3 million securities issues. Securities on deposit are valued at approximately \$45.3 trillion. As the nation’s CDS, DTC “serves a ‘critical’ function” in the National C&S System.<sup>5</sup>

The TA Release devotes substantial attention to the history of DTC and NSCC and their central role in today’s National C&S System.<sup>6</sup> We will not duplicate that discussion here, but it is critical to keep in mind in considering DTCC’s comments to the TA Release.

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<sup>3</sup> NSCC provides clearing, risk management, central counterparty services and a guarantee of completion for certain transactions. FICC provides clearing, risk management and central counterparty services (through its Government Securities Division) in the fixed income, mortgage-backed and government securities markets. These clearance and settlement services reduce risks for investors and the entire financial system by guaranteeing the completion of stock and bond transactions in the event of a participant default. Transactions cleared at NSCC are settled at DTC.

<sup>4</sup> See <http://www.treasury.gov/initiatives/fsoc/designations/Pages/default.aspx>.

<sup>5</sup> See 68 Fed. Reg. 35037, 35041 (June 4, 2003).

### C. DTC AND ITS RELATIONS WITH TRANSFER AGENTS

As the nation's CSD, DTC deals extensively with transfer agents in the operation of the National C&S System. The TA Release contains a discussion of the interplay between DTC and transfer agents, both currently and from a historic perspective, and this relationship should be kept in mind in considering DTCC's comments. DTCC has formulated its comments in response to the TA Release in light of the reality of today's National C&S System, and the role that transfer agents play in it.

Of particular note is the relationship between DTC and those transfer agents that are part of DTC's FAST program.<sup>7</sup> Transfer agents admitted to FAST act as custodians for DTC and, in that capacity, perform important functions in the National C&S System. For securities that are part of the FAST program, the FAST Agents hold the securities registered in the name of DTC's nominee, Cede & Co., in the form of global balance certificates for each CUSIP (except that, for exchanged listed issues that are fully participating in DTC's Direct Registration System ("DRS"), FAST Agents are not required to maintain a balance certificate).<sup>8</sup> As DTC participants deposit and withdraw securities from DTC, or deposit and withdraw securities directly with the transfer agent using DTC's Deposit and Withdrawal at Custodian (DWAC) service, the FAST Agent adjusts, as appropriate, the number of units or dollar amount of outstanding securities reflected by these global certificates, updates its books and records accordingly, informs DTC of accepted and/or rejected transactions and electronically confirms to DTC end-of-day outstanding balances for the relevant securities. Thus, as opposed to the traditional system where all Cede & Co. certificates may have been held physically on deposit at DTC, the FAST system has decentralized physical custody and related record-keeping functions, so that DTC's inventory for FAST issues would be held by the FAST Agents, on behalf of DTC as the CSD and Cede & Co. as the registered owner. This reduced the movement of certificates between DTC and transfer agents, thereby reducing the costs and risks associated with the creation, movement and storage of physical certificates. In today's book-entry environment, the FAST program similarly streamlines electronic deposits, withdrawals and the distribution and processing of reorganization events (*e.g.*, tender offers, mergers, buy-backs).

Significantly, in order for a transfer agent to act on behalf of an issuer whose securities participate in DRS,<sup>9</sup> it must be a FAST Agent.<sup>10</sup>

Given the important role played by FAST Agents as custodians for securities deposited at DTC, DTC is particularly attuned to the safety and soundness of FAST Agent operations. DTC has long supported initiatives to address the risks posed by FAST Agents that would (i) take into account the increased volume and value of securities processed, (ii) reflect the current availability of improved technology and other safeguards which would enhance the safety and soundness of securities held in FAST in the name of Cede & Co. on behalf of participant accounts, and (iii) consider the availability

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<sup>6</sup> See TA Release at 30-36.

<sup>7</sup> See TA Release at 32-33 and n. 90.

<sup>8</sup> FAST Agents, however, would need to issue a certificate in the name of DTC's nominee, Cede & Co., upon instruction by DTC.

<sup>9</sup> See TA Release at 33.

<sup>10</sup> See <http://www.dtcc.com/matching-settlement-and-asset-services/securities-processing/direct-registration-system>

of standardized audit reports to certify processes and controls. Of course, since the financial crisis of 2008, there has been an increased focus on risk mitigation system-wide, demonstrating even more urgently the need to update the regulatory scheme.

As a Self-Regulatory Organization (“SRO”) and registered clearing agency, DTC has historically applied, and will continue to apply, reasonable operating standards, particularly for FAST Agents, as a matter of both DTC’s Rules and Procedures (as approved by the Commission) and its contractual relationships with such FAST Agents. In addition, DTC has a statutory mandate to promote and protect the prompt and accurate settlement of securities transactions. Thus, although DTC does not see any quasi-regulatory role for itself with respect to transfer agents, the Commission, in its rule making, should not foreclose DTC from continuing to apply, amend, or adopt new rules and operating standards necessary to manage DTC’s day-to-day relations with all transfer agents particularly FAST Agents.<sup>11</sup> DTC’s activities, of course, would be subject to the regulatory framework established by the Commission as well as the Commission’s approval of any new rule or procedure of DTC. This issue is addressed in more detail in Section III.C, below.

#### **D. EFFECTS OF DEMATERIALIZATION**

DTC believes that with the eventual advent of full dematerialization of depository eligible issues, subject to additional regulatory requirements, transfer agents will, upon satisfying appropriate standards, either gain admittance to the FAST program, or establish correspondent relationships with FAST Agents in order to obtain or continue their SEC registration. To the extent that a transfer agent establishes a correspondent relationship with a FAST Agent, that transfer agent should still be subject to all rules applicable to transfer agents; that is, despite the correspondent relationship, the “introducing” agent must demonstrate compliance with the governing regulations. Further, to the extent correspondent relationships are established, the Commission may want to adopt rules governing such relationships, similar to those that govern the clearing broker/introducing broker relationship, including requiring agreements that clearly delineate the roles and responsibilities of each party.

It should also be noted in this context that while the volume of physical certificates has decreased dramatically, so long as these certificates exist, the inherent costs and risks remain and DTC, transfer agents and other industry participants must maintain the infrastructure necessary to process these certificates (*e.g.*, processing facilities and personnel and vaults).

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<sup>11</sup> DTC FAST Agent requirements are contained in three documents: (1) DTC’s Operational Arrangements (at 15-18) (*available at* <http://dtcc.com/~media/Files/Downloads/Settlement-Asset-Services/Underwriting/operational-arrangements.ashx>); (2) DTC Operational Criteria for FAST Transfer Agent Processing (*available at* <http://www.dtcc.com/~media/Files/Downloads/Settlement-Asset-Services/agent%20services/Operational%20Criteria%20for%20FAST.pdf?la=en>); and (3) DTC Balance Certificate Agreement (*available at* <http://www.dtcc.com/~media/Files/Downloads/Settlement-AssetServices/agent%20services/Balance%20Certificate%20Agreement.pdf?la=en>); *see also* TA Release at 86.

### **E. TRANSFER AGENT SAFETY AND SOUNDNESS: DTC'S PERSPECTIVE**

Although, as noted in the previous section, the National C&S System has made great strides in furtherance of dematerialization, this does not eliminate or even diminish the need to adopt a robust regulatory scheme governing the safety and soundness of transfer agents, as now proposed by the Commission. The TA Release has identified various transfer agent activities that pose risks to the National C&S System and thus justify the adoption of a comprehensive regulatory scheme.<sup>12</sup> The books and records and internal processes of transfer agents involving both electronic and paper transactions are significant elements of the overall system, and, if anything, their integrity has become more important as trading volumes and values have increased, markets have become more instantaneously reactive to disruptions, and the role of a transfer agent has become concentrated in a small number of major firms.

From DTC's perspective, if, for whatever reason, a transfer agent was unable to balance its records with DTC, the accuracy of DTC's allocation of securities positions to its participants could be called into question. Pending resolution of the discrepancy, DTC may chill deposit activity or suspend book-entry services in order to avoid exacerbating discrepancies. This would not only be disruptive, but could impact the market for the affected issues, and, indirectly, the entire market. DTC would be in a similar situation were a transfer agent suddenly to go out of business or suffer a serious system outage (both scenarios have actually happened). Any prolonged loss or unavailability of issuer or customer records would likely result in DTC suspending various services with respect to the affected issues. Corporate actions, including reorganization events and new issue distributions, could face delay or suspension. If any of these failures materialized in the context of a significant corporate transaction or during a disruption in the capital markets, the impact would likely be amplified. All of these concerns support the Commission's adoption of a comprehensive regulatory scheme to mitigate the risks posed by transfer agents' financial or systems failure, as well as traditional concerns with fire, theft, etc. Again, the reality that the system has remained stable for many years is not a justification for complacency; effective risk management means taking account of extreme but plausible scenarios.

With this overview of DTCC's interests and concerns, we address particular issues posed by the Commission.

### **III. COMMENTS ON ADVANCE NOTICE OF PROPOSED RULEMAKING**

As discussed above, DTCC is broadly supportive of the proposals in the TA Release. DTCC's comments are organized consistent with the Release's five substantive sections: (a) Registration and Annual Reporting Requirements; (b) Written Agreements Between Transfer Agents and issuers; (c) Safeguarding Funds and Securities; (d) Restricted Securities and Compliance Procedures; and (e) Cybersecurity, Information Technology, and Related Issues. (See points A-E below.) DTCC also provides comments on certain items in the Concept Release (see point F below).

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<sup>12</sup> See, e.g., TA Release at 76, 86, 121-23 and 135-36.

#### **A. REGISTRATION AND ANNUAL REPORTING REQUIREMENTS**

Given the important role played by transfer agents in the evolving securities industry and in their capacities as custodians of DTC by participating in the FAST program, DTCC supports the Commission's proposal to require more fulsome disclosure in order that the Commission may better monitor transfer agent safety and soundness. In particular, transfer agents must maintain sound finances and stable operations in order to avoid the disruption that would result from an agent's insolvency, inability to perform its functions, malfeasance, or failure to maintain accurate books and records. Accordingly, DTCC believes that transfer agents should submit audited financial statements to the Commission on a periodic basis to inform the Commission and its staff of their financial soundness, and ensure that financial reports meet professional standards and are viewed by regulators and the public as having integrity.

#### **B. WRITTEN AGREEMENTS BETWEEN TRANSFER AGENTS AND ISSUERS**

The Commission has asked whether it should require that any arrangement for transfer agent services between a registered transfer agent and an issuer be set forth in a written agreement.

DTCC believes that it is essential that transfer agents and issuers enter into written agreements in order to document, in clear, legally enforceable terms, each party's responsibilities and obligations. DTCC agrees with the Commission's suggestion that the agreements should address basic topics such as the services to be provided, the terms of payments and fees, and requirements for the turnover of transfer agent records to a successor transfer agent within a prescribed timeframe if the relationship terminates. DTCC would emphasize this last point because DTCC shares the Commission's concerns about disruptions that could be caused by delays in the transfer of records from a transfer agent to its successor. Thus, it is important that the agreement provide for an orderly and expeditious transfer of records to any successor transfer agent, to ensure continuity and accuracy of records.

There have been instances where disputes between transfer agents and issuers have required DTC to suspend (chill) physical securities transactions (*i.e.*, deposits and withdrawals) until the conflicts were resolved. There have been limited, extreme cases where, as a result of issuer-transfer agent discrepancies, DTC has had to cease all book-entry services for an issue (global locks) because the validity of a transfer agent's record of its Cede & Co. balance and/or shares outstanding has been called into question. In one high profile instance several years ago, the SEC instituted a cease-and-desist action against one transfer agent that resulted in the books and records of several issuers being transferred to new agents. As part of this unwind process, several record keeping discrepancies were identified, including the agent's failure to report to DTC that certain issues were no longer in existence. This resulted in discrepancies with the Cede & Co. balances versus DTC participants whose DTC accounts reflected positions that were no longer represented in offsetting custody in the agent's FAST balance with DTC. In one case, a shortfall in the FAST balance necessitated the purchase of additional shares in the open market in order to cover the deficit in assets, contrary to what the agent had, heretofore, routinely confirmed on a daily basis with DTC.

DTCC believes that written agreements setting forth the parties' duties and obligations, particularly in the unwind process, would help ameliorate these potentially serious problems.

In addition to the items discussed by the Commission, DTCC believes that, where applicable, the agreements with issuers should disclose the FAST Agents' relationship with and obligations to DTC. The agreements should also require issuers to acknowledge that the FAST Agent's last confirmation of the FAST balance with DTC is binding upon the issuer. This is essential in order to prevent a disagreement between DTC and the issuer and/or subsequent transfer agent regarding the positions outstanding in the event that the current agent fails to perform its functions as a result of its operational or financial failure or otherwise. This would also serve the salutary purpose of incentivizing issuers to monitor their agent's activities, and to reconcile differences, knowing that the agent's representations to DTC regarding account balances are binding upon the issuer.

DTCC also believes that the agreements should require FAST transfer agents immediately to inform the Commission, issuers and DTC when there are systems disruptions or other problems that materially affect the transfer of securities by these agents.

### **C. SAFEGUARDING FUNDS AND SECURITIES<sup>13</sup>**

DTCC shares the Commission's concerns that securities and funds held by transfer agents are subject to a risk of loss from fraud, theft or other misappropriation or disruption and supports the Commission's proposals to strengthen the practices and procedures involving the safeguarding of funds and securities by transfer agents.

#### **1. IMPLEMENTATION OF PRACTICES AND PROCEDURES FOR SAFEGUARDING FUNDS AND SECURITIES**

DTCC supports the Commission's proposal to require transfer agents to "comply with specific minimum best practices related to safeguarding funds and securities, such as (i) maintaining secure vaults; (ii) installing theft and fire alarms; (iii) developing specific written procedures for access and control over security holder accounts and information; and (iv) enhanced record-keeping requirements . . . ."<sup>14</sup> In this regard, DTCC recommends that the SEC not leave this to the discretion of the transfer agents, but rather should establish standards that ensure that transfer agents have adequate safety controls, policies and procedures. (Cybersecurity is addressed below in Section III.E.) The Commission may also consider requiring attestations from senior personnel of a transfer agent in which they attest that the transfer agent has in place operational procedures and controls that are reasonably designed to comply with the Commission's rules and requirements.

In addition, in response to the Commission's specific question, DTCC believes that independent auditors should verify transfer agents' securities holdings against DTC's records to guard against record-keeping irregularities or potential fraud. To its knowledge, DTC has never received a request from a transfer agent's auditor to confirm that a transfer agent's securities position matches what is reflected on DTC's records. DTCC believes this is an example of a weakness in the evaluation and monitoring of transfer agents that should be addressed in the current rulemaking.

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<sup>13</sup> While it is certainly the case that physical certificates are becoming relic of the past, so long as they continue to exist transfer agents should employ practices to secure them from fire, theft and loss in accordance with their obligations under Rule 17Ad-12.

<sup>14</sup> See TA Release at 124.

DTCC also supports the Commission's efforts to safeguard funds by addressing the risks posed by transfer agents that act as paying agents. An important part of DTC's services to its participants is the allocation of interest, dividends, and payments in connection with reorganization events. To the extent that these funds are distributed to DTC by transfer agents acting in the capacity of paying agents, DTC believes that the Commission's rulemaking should require agents to adopt sound practices to safeguard funds earmarked for DTC and, ultimately, DTC's participants. The goal is to avoid the disruption, uncertainty and, ultimately, the litigation that will ensnare all actors where transactions are left uncompleted because the necessary funds are not available as expected.

## **2. ADDITIONAL FINANCIAL MONITORING**

As discussed above, DTCC is also concerned that transfer agents remain financially stable and secure. DTC therefore supports the Commission's efforts to monitor the financial condition of transfer agents by requiring agents to make the following audited periodic submissions to the Commission: statement of financial condition, statement of income, statement of cash flows and any other statements the Commission deems necessary to sufficiently monitor the financial and business health of a transfer agent.

## **3. INSURANCE REQUIREMENTS**

DTCC supports new rules mandating insurance requirements for transfer agents. Currently, DTC requires that FAST Agents maintain a standard form Financial Institutional Bond or a commercial crime policy in the amount of \$10 million. DTCC believes that the Commission should adopt minimum levels based on its evaluation of the volume and value of the business and the risks specific to a transfer agent's operations.

## **D. RESTRICTED SECURITIES AND COMPLIANCE PROCEDURES**

### **1. RESTRICTED SECURITIES**

Before providing specific comments in response to the Commission's questions regarding restricted securities, some general comments are in order. Transfer agents play a key role in preventing the distribution of restricted securities into the marketplace. They are responsible for affixing and removing restrictive legends and, in the case of restricted securities held in electronic form, procedures analogous to affixing and removing restrictive legends.<sup>15</sup> Transfer agents perform their functions contemporaneously with and even as part of transactions that may implicate the illegal distribution of restricted securities. These activities occur prior to any resale of the securities in question, and frequently just prior to such resale. Transfer agents have access not only to the issuer, but typically as well to the person who intends to resell the securities. Accordingly, transfer agents are in a position to inquire, investigate and perform necessary due diligence. These are important gatekeeping functions

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<sup>15</sup> DTCC's DWAC service provides participants with the ability to make electronic book-entry deposits and withdrawals of eligible securities into and out of their DTC book-entry accounts using a FAST Agent as the distribution point. FAST Agents will not use DWAC to deposit securities that are restricted and not DTC-eligible into the DTC system. See <http://www.DTCC.com/matching-settlement-and-asset-services/securities-processing/deposit-withdrawal-at-custodian>.

with respect to the resale of restricted securities, and are performed well before the securities are deposited at DTC.<sup>16</sup>

In this regard, the Commission has asked whether it should provide specific guidelines and requirements for registered transfer agents in connection with removing a restrictive legend and in connection with issuing any security without a restrictive legend, such as: (1) obtaining an attorney opinion letter; (2) obtaining approval of the issuer; (3) requiring evidence of an applicable registration statement or evidence of an exemption; and/or (4) conducting some level of minimum due diligence (with respect to the issuer of the securities, the shareholder and/or the attorney providing a legal opinion).

DTCC believes that it will serve the interests of all concerned, issuers, investors, brokers and the National C&S System, if the Commission establishes clear and rigorous standards regarding the handling of restricted securities by transfer agents. At a minimum, transfer agents should be required to conduct due diligence sufficient to determine that the resale of the shares has been properly registered, or that the proposed transactions are exempt from registration. Specific due diligence guidelines would assist transfer agents in determining whether the holder satisfies applicable criteria for a specific exemption from registration, *e.g.*, guidelines to determine whether any applicable holding periods have been satisfied, the issuer is or has been a “blank check” or “shell company,” and whether the intended recipient of the shares would be deemed an affiliate. This will go a long way towards preventing improper distribution and the prohibited deposit of restricted securities at DTC for book-entry services. Moreover, diligent transfer agent screening of securities will impede those seeking to engage in illegal distribution schemes.

In order to ensure that transfer agents are following guidelines for the handling of restricted securities, transfer agents, like broker-dealers and clearing agencies, must have effective compliance departments overseen by compliance officers. This important point, including requirements that transfer agents adopt written compliance policies, is addressed in more detail below (at III.D.2).

Relatedly, the Commission has also asked whether transfer agents should be permitted to rely on the written legal opinion of an attorney under certain circumstances and, if so, in what circumstances. DTCC believes that transfer agents should not be able to rely solely on a written legal opinion, particularly given their access to the parties involved in the transfer. Transfer agents should review the totality of the circumstances – which they are in a unique position to examine – as outlined in the Commission’s proposed guidelines, in determining whether restrictions should be removed. Legal opinions may be one of the factors that the agent may take into account, if there are no other “red flags,” as discussed below, and the attorney is duly qualified and his/her opinion is independent.

The Commission has also asked whether there are types of securities or categories of transactions that require a heightened level of scrutiny or review by transfer agents before removing a restrictive legend or processing a transfer and, if so, which ones and why.

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<sup>16</sup> Transfer agents are best positioned to possess detailed and accurate information regarding the ownership history of the securities that they process, inasmuch as they are hired by issuers for this among other purposes.

While DTCC believes that transfer agents should perform due diligence prior to removing restrictive legends on any security, transfer agents should invoke a heightened standard for microcap issues. In DTC's experience, most of the problems involving the improper distribution of restricted securities have been with microcap issues. As reflected in the TA Release, thinly traded, low-cost securities are fertile ground for illegal distributions, along with market manipulation and securities fraud.<sup>17</sup>

Accordingly, a heightened standard for microcap issues is appropriate and necessary. It is also consistent with the Financial Industry Regulatory Authority's ("FINRA") guidance that microcap issues deserve particular attention in combatting illegal distributions of restricted securities. For example, FINRA has advised broker-dealers that deposits of large blocks of physical certificates in "thinly traded or low-priced securities" are a "red flag" of distributions in violation of Section 5 of the Securities Act of 1933.<sup>18</sup> Transfer agents should be required to monitor for similar "red flags." In that regard, DTC believes it would be of assistance to transfer agents if the Commission were to help identify "red flags" for transfer agents, particularly in light of the shift to electronic transactions, as FINRA has done for brokers.

The Commission has also asked whether transfer agents currently share their ownership history information of the securities they possess with other market intermediaries, such as broker-dealers and securities depositories and, if not, whether transfer agents should be required to do so. DTCC believes that there has not been sufficient sharing of information by transfer agents and that broker-dealers, in particular, in performing their gatekeeping functions, should have greater, more timely access to the ownership history information maintained by transfer agents.

## **2. WRITTEN COMPLIANCE POLICIES AND PROCEDURES AND CHIEF COMPLIANCE OFFICERS**

The Commission has asked whether it should require transfer agents to maintain, implement, and enforce written compliance and/or supervisory policies and procedures, similar to those required of broker-dealers and adopt rules requiring registered transfer agents to designate and identify a chief compliance officer ("CCO").

As discussed above, DTCC supports the adoption of rules that require transfer agents to adopt and implement written compliance and supervisory standards that would bring transfer agent regulation in line with oversight of other players in the financial industry. In particular, DTCC believes that transfer agents should be required to implement and maintain written policies and procedures that are reasonably intended to ensure transfer agent compliance with applicable rules and regulations. This would assist transfer agents and would also aid the Commission's inspection process.

DTCC also believes that in order to develop and implement compliance standards, transfer agents should employ CCOs. The CCO would serve as the point person for implementing the new policies

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<sup>17</sup> Although microcap securities are generally issued by companies with low market capitalizations (*e.g.*, \$50 mm - \$300 mm) and trading at less than \$1/share, DTCC believes that the heightened standard should apply to all securities that trade at less than \$5/share, generally not listed on a national exchange but sold over-the-counter, and issued by companies with market capitalizations of less than \$100 million.

<sup>18</sup> See Financial Industry Regulatory Authority, Inc., *Regulatory Notice 09-05*, available at <http://www.finra.org/Industry/Regulation/Notices/2009/P117713>.

and procedures that would be necessary to implement the requirements contemplated by the TA Release. Also, the CCO would provide the necessary leadership and accountability for the compliance requirements, and help to ensure that the agent has qualified staff to fulfill its obligations. Other industry actors are required to have CCOs and, given their important role, transfer agents should as well.

## **E. CYBERSECURITY, INFORMATION TECHNOLOGY AND RELATED ISSUES**

### **1. CYBERSECURITY**

The Commission has asked whether it should impose specific cybersecurity standards for transfer agents and, if so, what would be an appropriate standard?

This question highlights a prime example of how the marketplace and risks have evolved since the transfer agent rules were last updated and why new regulations are necessary. DTCC believes that transfer agent activities, particularly the activities of FAST Agents, are vulnerable to significant cybersecurity risks. In the first instance, these agents hold identifying information of security holders and maintain electronic records that reflect the ownership of securities (including for individuals who hold securities through the DRS system). Additionally, because, as the Commission has recognized, the National C&S System is largely automated, transfer agents must take adequate measures to ensure the integrity of their own data as well as their ability to communicate electronically with broker-dealers and DTC without interruption. DTCC thus supports the Commission's proposal to impose cybersecurity standards for all transfer agents.

DTCC recognizes that transfer agents have different systems and cybersecurity needs based on the nature of their operations. DTCC believes, however, that all transfer agents should be required to have a minimum level of cybersecurity protection to safeguard information and operations, and that major agents should have more extensive measures in place. This is particularly the case since, as noted above, DTCC believes that, ultimately, all transfer agents will become, directly or indirectly, members of the FAST program.

Regulation SCI could provide a basis for drafting rules for transfer agents. DTC is subject to Regulation SCI and it believes that certain of its provisions are applicable to transfer agents, particularly for those performing the functions incumbent upon FAST Agents. The fact that transfer agents are not currently subject to Regulation SCI should not foreclose the application of certain of its principles to transfer agents. Indeed, the Commission, in its Regulation SCI adopting release, contemplated that Regulation SCI could be extended in the future to cover transfer agents and other market participants.

An example of a Regulation SCI concept that is applicable to transfer agents is that they should be required to notify the SEC, as well as DTC and relevant issuers, in the event of systems disruptions and provide necessary updates. DTCC also believes that those transfer agents with material holdings should test their business continuity and disaster recovery plans annually, as required by Regulation SCI.

Regulation SCI also provides for reasonably designed policies and procedures to ensure that systems maintain operational capabilities and promote fair and orderly markets. Given the nature of transfer agent services, certain criteria of Regulation SCI, such as the business resumption standards, may not be appropriate for all transfer agents. However, at a minimum, transfer agents should be required to implement safeguards and protections similar to those required for broker dealers and consistent with the approach set forth by FINRA in its February 2015 Report on Cybersecurity. Consistent with the FINRA Report, a sound cybersecurity system should include:

- A comprehensive governance framework. That framework should include defined risk management policies and procedures along with controls tailored to the nature of the transfer agent's cybersecurity risks and the resources available. At a minimum, the governance framework should delineate the roles and responsibilities of various people within the organization to enable the transfer agent to become aware of relevant cybersecurity risks, estimate their severity and decide how to manage each risk.
- Risk assessments. Transfer agents should conduct regular risk assessments to identify cybersecurity risks and prioritize their remediation.
- Technical controls. Based on their situation, transfer agents should implement technical controls to protect their software and hardware as well as the data itself. DTCC does not believe that there is one universal standard that should be applied because each transfer agent may have different systems and requirements. However, transfer agents should seek to implement controls that are consistent with recognized standards and best practices.
- Incident response plans. Transfer agents should have policies and procedures regarding the escalation and response to cybersecurity incidents.
- Vendor management and outsourcing. To the extent transfer agents rely on outside vendors or outsource their functions, they should have sufficient policies and procedures in place to assess and manage the cybersecurity risks associated with those activities.

## **2. BUSINESS CONTINUITY**

The TA Release seeks comment on the features of a written business continuity or disaster recovery plan if the Commission were to propose that transfer agents maintain such plans. DTCC believes that a robust business continuity plan is essential to ensure that transfer agents are prepared for disruptions and are able to quickly resume operations with minimal disruption. FINRA Rule 4370 provides an appropriate framework for the contents of a business continuity plan and, at a minimum, a plan should include provisions for prompt notice to the Commission, DTC and other stakeholders of an outage, data back-up and recovery (hard copy and electronic); the re-establishment of all mission critical systems; and how transfer agents will ensure access to securities and the transfer of key records and data if unable to continue in business.

#### **IV. COMMENTS ON CONCEPT RELEASE**

##### **A. THE EXISTING RULES SHOULD BE MODIFIED TO REFLECT THE INCREASE IN BOOK-ENTRY SECURITIES**

As discussed above, as the goal of full dematerialization edges closer to realization, the Commission's oversight of transfer agents should evolve accordingly. Several questions in the concept release recognize this shift and address its impact on transfer agents' daily operations and the existing rules that govern transfer agents.<sup>19</sup> As full dematerialization becomes a reality, it may be possible to simplify the process of adopting or amending relevant rules by focusing primarily on the electronic environment.

As a starting point, DTCC believes that there should be no substantive difference in the rules for certificated securities and uncertificated securities, and that all holders, including Cede & Co., should receive the same rights and protections without regard to whether the securities are represented by a security certificate or an electronic record. Accordingly, DTCC believes that the Commission should clarify that all rules, unless noted otherwise, apply equally to certificated and book-entry only positions and that holders of uncertificated securities should have the same rights and protections as holders of certificated securities, unless the distinction is driven by legitimate legal, regulatory or operational differences.

As we have emphasized, the existing regulatory scheme should be modernized to reflect the shift to a predominantly electronic system. For example, in response to the Commission's specific question, the turnaround and processing requirements of Rules 17Ad-1 and 17Ad-2 should be modernized to reflect the prevalence of electronic transactions. Turnaround times should be shorter when dealing with electronic transactions than with paper certificates. There is no reason to apply universally standards that were adopted based upon the more cumbersome process inherent in transferring ownership of physical certificates. Faster turnaround time has particular risk management advantages and is certainly aligned with the industry's planned move to shorten the settlement cycle to T+2 in September 2017.

Also, given the prevalence of book-entry securities and the move towards full dematerialization, the Commission's rulemaking should acknowledge DTC's requirement that FAST Agents balance their positions with DTC daily. The Commission's rulemaking should also recognize that if an agent ceases operations, the last balance confirmed with DTC is binding upon the issuer. DTC participants routinely balance their positions with DTC on a daily basis and DTC requires monthly and yearly officer attestations from its participants in which they confirm that DTC's information is correct. The Commission should require a similar protocol for transfer agents.

More generally, to the extent the industry still uses paper certificates, the established metrics-based performance standards (for example, 72-hour turnaround on 90% of routine transactions) designed to measure the transfer and processing of paper certificates should be replaced or amended to include risk-based standards that reflect the speed and nature of book-entry transactions.

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<sup>19</sup> See, e.g., TA Release at 153 (No. 88), 154 (No. 90) and 205 (No. 153).

**B. THE CONCEPT OF TRANSFER AGENT DEPOSITORIES LACKS THE BENEFITS OF THE CSD MODEL AND IS NOT A VIABLE ALTERNATIVE**

The Commission has asked whether the introduction of certain alternatives to the current central securities depository model, such as a modified transfer agent depository (“TAD”), could be beneficial to issuers, security holders, and/or the National C&S System.

DTCC opposes any such initiative. The National C&S System is the most efficient and cost-effective in the world. While, many years ago, the TAD concept (which was conceived in an environment of physical certificates) might theoretically have been a solution to the paperwork crisis of the 1960s, Congress, the States (by adopting and amending Article 8 of the Uniform Commercial Code), the Federal Reserve System (by adopting consistent regulations for Fed book-entry securities), bond trustees (by adopting appropriate terms and conditions for template indentures) and the industry developed the indirect holding system based on the CSD model. This system has become the bedrock of efficiency, safety and soundness in servicing the nation’s capital markets. The CSD model has grown with and adapted to the enormous market expansion of the past decades. It has responded to the advent of electronic trading and it has weathered several serious crises, including the September 11 attacks and the financial crisis of 2008 (*e.g.*, the wind down and close out of Lehman Brothers Inc.). In times of crisis, the CSD model ensures that high transaction volumes can be processed seamlessly while handling the failure of major market participants so as to minimize the systemic effects on other market players and the system as a whole. The CSD model also seamlessly connects all market participants including, brokers, banks, exchanges, transfer agents, paying agents, issuer and paying agents (IPAs), underwriters, service bureaus, foreign CSDs and other market participants and provides them all with uniform access to the clearance and settlement system. The CSD model thus provides essential asset services for securities issued under the Securities Act of 1933.

Further, the CSD model is fully integrated into and, as the Senate described in enacting Section 17A, “critical” to the broader clearance and settlement system.<sup>20</sup> That broader system provides innumerable services to the nation’s capital markets. These include, just by way of example, central counterparty services, trade guarantee, risk rating of members, netting and facilitation of the stock loan and pledge markets. Any effort to decouple the CSD from the National C&S System, would require drastic overhaul of the entire system (likely requiring substantial legislative action) to ensure that it could continue to operate and achieve Congress’s key goal in enacting Section 17A, *i.e.*, “[t]he prompt and accurate clearance and settlement of securities transactions, including the transfer of record ownership and the safeguarding of securities and funds related thereto. . . .” Section 17A(a)(1)(A).

Dismantling the indirect holding system, in favor of TAD or any other new approach, would not only be vastly disruptive, it is neither necessary nor realistic.

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<sup>20</sup> See *supra*, n. 5.

### C. DTCC DOES NOT REGULATE TRANSFER AGENTS

The Commission has asked whether current DTC requirements, such as those related to DRS and FAST, operate as so-called *de facto* regulation of transfer agents by DTC and whether those rules create inconsistencies and/or conflicts. The answer is an unqualified “no.”

As a registered clearing agency, DTC is required by Section 17A(b)(3)(F) of the Exchange Act to have rules designed to “promote the prompt and accurate clearance and settlement of securities transactions” and “to assure the safeguarding of securities and funds which are in [its] custody and control.” Further, as an SRO, DTC is required by Section 19(h)(1)(C) of the Exchange Act to ensure that participants comply with its rules.<sup>21</sup> DTC has thus adopted certain standards with respect to transfer agents acting in their capacities as FAST and DRS Agents.<sup>22</sup> These standards are set forth in DTC’s Operational Arrangements, as filed with the Commission, as well as contractual documents entered into between DTC and agents, including the Balance Agreement. The standards contained in these documents are designed to promote efficiency, reduce cost and mitigate risk, while furthering the safety and soundness of the National C&S System.

DTC’s standards for FAST and DRS agents are not inconsistent with transfer agent obligations under existing Commission rules or the proposed rules. The standards are subject to SEC approval and do not usurp or conflict with the Commission’s authority and regulatory actions.

The Commission has also asked whether it should adopt any of DTC’s current requirements or standards and, if so, which ones? As discussed above, DTCC believes that certain of DTC’s requirements, such as daily balancing of positions with FAST Agents, insurance coverage, operational arrangements, SEC-required notices to DTC in the event an agent terminates or initiates service, and notice to DTC in the event securities are lost<sup>23</sup> should be made applicable by the Commission to all transfer agents.

Lastly, none of DTCC’s comments herein should be construed to (i) preclude DTC from adopting and enforcing its own rules and procedures applicable to FAST and DRS Agents acting in that capacity or (ii) preempt or supersede such rules and procedures of DTC designed to satisfy its own obligations (a) as a registered clearing agency (relating to the prompt and accurate clearance and settlement of securities transactions and the safeguarding of funds and securities in its custody or control) and (b) as an SRO (relating to the enforcement of compliance with its rules by participants).

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<sup>21</sup> FAST and DRS Agents are “Limited Participants.” As such they (i) are permitted to use only certain DTC services; (ii) are not required to make deposits to the DTC Participants Fund; and (iii) are otherwise treated as participants of DTC. *See* DTC Rule 2 Section 1.

<sup>22</sup> *See* TA Release at 86-87.

<sup>23</sup> *See supra*, n. 11.

Mr. Brent J. Fields

April 14, 2016

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V. CONCLUSION

DTCC appreciates the opportunity to comment on the Commission's proposals and the questions posed in the concept portion of the release. Please let us know if you have any questions or comments. My contact information is [REDACTED] and [REDACTED].

Sincerely,



Daniel E. Thieke

Managing Director, General Manager Settlement and Asset Services