

# SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

**Release No. 34-76743; File No. S7-27-15**

## **TRANSFER AGENT REGULATIONS**

**AGENCY:** Securities and Exchange Commission

**ACTION:** Advance notice of proposed rulemaking; Concept release; Request for comment

**SUMMARY:** The Securities and Exchange Commission (“Commission”) is publishing this Advance Notice of Proposed Rulemaking, Concept Release, and Request for Comment on Transfer Agent Regulations (“release”) to seek public comment regarding the Commission’s transfer agent rules. The first transfer agent rules were adopted in 1977 and remain essentially unchanged. At the same time, transfer agents now operate in a market structure that bears little resemblance to the structure in 1977. The release, noting the importance of transfer agents within the national market structure, includes a history of transfer agent services and applicable regulations as well as an overview of current transfer agent services and activities, and requests comment on all topics. The release includes an Advance Notice of Proposed Rulemaking in specific areas, such as transfer agent registration and reporting requirements, safeguarding of funds and securities, and revision of obsolete or outdated rules, along with requests for comment, as well as a Concept Release and Request for Comment addressing additional areas of specific Commission interest, including processing of book-entry securities, broker-dealer recordkeeping for beneficial owners, transfer agents to mutual funds, and administration of issuer plans. The Commission intends to consider the public’s comments in connection with any future

rulemaking, and comments to the Advance Notice of Proposed Rulemaking will be used to further consider the sufficiency and scope of the rulemaking proposals described therein.

**DATES:** Comments must be in writing and received by [insert 60 days from date of publication in the Federal Register]

**ADDRESSES:** Comments may be submitted by any of the following methods:

*Electronic Comments:*

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/concept.shtml>);
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-27-15 on the subject line; or
- Use the Federal eRulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

*Paper Comments:*

- Send paper comments to: Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-27-15. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/concept.shtml>). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make publicly available.

**FOR FURTHER INFORMATION CONTACT:** Moshe Rothman, Branch Chief, Thomas Etter, Special Counsel, Catherine Whiting, Special Counsel, Mark Saltzburg, Special Counsel, Lauren Sprague, Special Counsel, or Elizabeth de Boyrie, Counsel, Office of Clearance and Settlement, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010 at (202) 551-5710.

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## I. INTRODUCTION

The United States' securities markets are indispensable to this country's and the world's economy. The Commission believes that issuers, investors, and other participants in the securities markets must be served by a well-functioning national system for the clearance and settlement of securities transactions ("National C&S System") that promotes safe, efficient, prompt, and accurate settlement transactions.<sup>1</sup> Critical to this mission is the development and maintenance of a comprehensive regulatory program that governs the functions of transfer agents and related industry segments critical to the proper functioning of the National C&S System, including entities that clear trades, provide custodial and safeguarding services, and perform other "back-office" functions within the securities industry.

As agents for issuers, transfer agents play a critical role with respect to securities settlement, though they rarely receive much public attention. Among their key functions, they may: (i) track, record, and maintain on behalf of issuers the official record of ownership of each issuer's securities; (ii) cancel old certificates, issue new ones, and perform other processing and recordkeeping functions that facilitate the issuance, cancellation, and transfer of those securities; (iii) facilitate communications between issuers and registered securityholders; and (iv) make dividend, principal, interest, and other distributions to securityholders. A transfer agent's failure to perform its duties promptly, accurately, and safely can compromise the accuracy of an issuer's securityholder records, disrupt the channels of communication between issuers and

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<sup>1</sup> See infra Sections II and III of this release for additional discussion of the National C&S System.

securityholders, disenfranchise investors, and expose issuers, investors, securities intermediaries, and the securities markets as a whole to significant financial loss.<sup>2</sup>

The securities markets and the National C&S System in which transfer agents operate have changed significantly since the Commission first began regulating transfer agents in the 1970s. The changes largely reflect a decades-long evolution from a manual securities settlement process focused on the processing of physical securities certificates to a highly automated electronic environment centered on the processing and transfer of electronic book-entry securities.<sup>3</sup> The changes also reflect significant technological and operational developments in other areas, as well as broader changes in the securities industry and the business and regulatory environments in which transfer agents operate.

As a result, the Commission has observed over time that transfer agents now perform a more diverse array of functions and services, many of which may not be fully addressed by the Commission's transfer agent rules. In addition, the Commission has observed that the manner in which transfer agents carry out their traditional functions may no longer be adequately addressed in the rules. The Commission's consideration of these observations has led it to include two interrelated approaches in this release. Under the first approach, the Commission believes it has

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<sup>2</sup> Maintenance of Accurate Securityholder Files and Safeguarding of Funds and Securities by Registered Transfer Agents, Exchange Act Release No. 19142, 2-3 (Oct. 15, 1982), 47 FR 47269 (Oct. 25, 1982) ("17Ad-9 through 13 Proposing Release") (noting examples of substandard transfer agent performance presenting significant potential adverse consequences). See also Processing Requirements for Cancelled Security Certificates, Exchange Act Release No. 48931 (Dec. 16, 2003), 68 FR 74390, 74391 (Dec. 23, 2003) ("17Ad-19 Adopting Release") (noting examples of substandard transfer agent performance and significant adverse consequences).

<sup>3</sup> Concept Release on Equity Market Structure, Exchange Act Release No. 61358, 2 (Jan. 14, 2010), 75 FR 3594, 3594 (Jan. 21, 2010). When securities are referred to as being in "book-entry" form, it means that the investor does not receive a certificate. Instead, a custodian, usually a broker or transfer agent, maintains electronic records showing that the investor owns the particular security. For additional discussion of book entry securities, see infra note 37.

identified a series of new and amended rules that, based on its current understanding of transfer agents and their functions, it intends to propose. These anticipated new and amended rules, which the Commission intends to propose as soon as is practicable, either individually or in groups or phases, and irrespective of any other changes to the transfer agent rules, are discussed in detail in the Advance Notice of Proposed Rulemaking found in Section VI. The Commission is soliciting public comment on the anticipated rulemaking proposals described in Section VI. Public feedback and data would assist the Commission in further refining and calibrating the anticipated proposals as well as other potential proposals.

Under the second approach, reflected in the Concept Release and Request for Comment contained in Section VII, the Commission discusses and requests comment regarding a number of additional transfer agent issues that primarily arise from the diverse array of transfer agent functions and services which have developed over time. Public comment on these additional issues will allow the Commission to evaluate the need for, and potentially develop, additional rulemaking proposals appropriately tailored to these complex areas. In undertaking these approaches, the Commission remains sensitive to whether any distinctions between the actual activities of transfer agents and what is contemplated by the Commission's rules may create undue uncertainty or risks for the National C&S System and the market participants that rely upon it, including investors, issuers, regulators, and transfer agents. As transfer agents continue to evolve in their roles and activities, any such distinctions, and the commensurate risks associated with them, may also grow.

We begin with an overview of the antecedents, advent, and subsequent history of the National C&S System, including a discussion of the "Paperwork Crisis" which helped precipitate the legislative amendments that gave rise to that system. We then describe the National C&S



System and transfer agents' role within that system as it functions today, followed by a discussion of the current regulatory regime and the core functions performed by transfer agents. The remainder of the release consists of the two sections noted above: the Advance Notice of Proposed Rulemaking in Section VI and the Concept Release and Request for Comment in Section VII.

We are mindful that the role of transfer agents in the National C&S System and the need to address specific risks associated with transfer agents have been topics of discussion and debate, both within and outside the Commission, for many years.<sup>4</sup> We intend for this release to build on those discussions and therefore invite comment on the full range of topics and issues associated with transfer agents and their activities, regardless of whether and in which section those topics and issues are specifically addressed. Thus, while we set forth specific requests for comments, we welcome comments on any concerns related to transfer agent activities, the transfer agent regulatory program, or other areas of concern that commentators may have. We specifically invite comment on any possible regulatory actions regarding the issues and concerns described, including potential new rules or rule amendments or other reasonable regulatory alternatives, as well as any related evidence, quantitative and/or qualitative, relating to a potential regulatory action. Comments received on either or both sections of the release will be considered in connection with any future rulemaking.

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<sup>4</sup> For example, in 2011 the Commission hosted a roundtable on the execution, clearance, and settlement of microcap securities which covered, among other topics, the role of transfer agents in the issuance and transfer of restricted securities. See transcript, available at <https://www.sec.gov/spotlight/microcap/microcaproundtable101711-transcript.txt>.

We are also mindful that market developments have occurred beyond the changes that are the focus of this release and that affect transfer agents. For example, transfer agents and market participants now often communicate with one another using structured data on electronic platforms. Data standardization efforts have emerged to further enhance these electronic communication methods, such as the international standards effort focusing on corporate actions, which may ultimately be used by transfer agents.<sup>5</sup> Although these issues are not specifically addressed herein, comments on, and specific data about, any such developments are welcome.

The Commission is sensitive to the effects that could result from any regulatory action, and accordingly we also seek input on the economic effects or tradeoffs associated with any potential regulatory action, including any costs, benefits, or burdens of such action, and any effects on efficiency, competition, and capital formation. We are also mindful that the various aspects of the transfer agent regulatory program and securities transfer process that we address in this release are interconnected, and that changes to one aspect may affect other aspects, as well as complement or frustrate other potential changes. Therefore, we encourage the public to consider these relationships when formulating comments, and invite comment on whether alternative approaches, or a combination of approaches, would better address the concerns raised.

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<sup>5</sup> See, e.g., XBLR: The Business Reporting Standards, <https://www.xbrl.org/the-consortium/get-involved/corporate-actions-working-group/>.

## II. THE NATIONAL CLEARANCE AND SETTLEMENT SYSTEM: HISTORY AND BACKGROUND

### A. Transfer of Certificated Securities

Investment securities confer certain intangible rights and benefits upon the holder.<sup>6</sup> For example, the rights and benefits represented by a share of stock generally include the right to share in the capital and surplus of the corporation and receive certain other benefits and specified rights. Because securities confer intangible rights, historically the transfer of investment securities from one person to another has required special rules. In the past, the most common way to transfer investment securities, such as shares of stock, was to transfer a paper certificate that represents the benefits of ownership (“certificated security”).<sup>7</sup> Certificated securities have been issued in the United States since the 1700s<sup>8</sup> and are evidence that the owner is registered on the books of the issuer (or its transfer agent) as a securityholder.<sup>9</sup> Although the shares themselves represent an intangible right,<sup>10</sup> the certificate is a negotiable instrument under state

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<sup>6</sup> Egon Guttman, *Modern Securities Transfers* § 1:5 (4th ed. 2010).

<sup>7</sup> The Uniform Commercial Code (“UCC”) defines a “certificated security” as “a security that is represented by a certificate.” U.C.C. 8-102(a)(4). The UCC, which was first published in 1952, is a uniform act designed to standardize the law of sales and other commercial transactions in all 50 states. The UCC has the effect of law only when adopted by a state, and while it has been adopted by all 50 states, there are numerous state-by-state variations in the adopted texts.

<sup>8</sup> The first major American issue of publicly traded securities occurred in 1790 when the federal government issued \$80 million of bonds to refinance federal and state Revolutionary War debt. In 1792, five securities—two bank stocks and three government bonds—began trading on what was to become the New York Stock Exchange. For a historical discussion of the development of trading on the exchange, see Teweles and Bradley, *The Stock Market* 95-119 (6th ed. 1992).

<sup>9</sup> Guttman, supra note 6.

<sup>10</sup> Id.

law, which allows the registered owner of the certificated security to transfer the bundle of intangible rights to a third party.<sup>11</sup>

This ability to transfer the rights associated with share ownership helps drive the securities markets.<sup>12</sup> Generally, under the UCC, “voluntary transfer of possession” is all that is required to effect such a transfer.<sup>13</sup> But in order to qualify as a “protected purchaser” under the UCC, and therefore acquire an interest in the security free of any adverse claim, the buyer must give value, not have notice of any adverse claim to the security, and obtain control of it.<sup>14</sup> Thus, for a buyer of registered certificated securities to achieve protected purchaser status, the voluntary transfer of possession could involve a significant amount of paperwork and manual processing, even in a direct transaction between a seller and a buyer:

[E]ither the certificate or a stock power must be indorsed, the signature guaranteed, authority to transfer title documented, and the stock certificate and the other documentation delivered, not to mention the registration of transfer on the stockholders list, the destruction of the old certificate and the issue of a new one.<sup>15</sup>

Historically, transactions involving certificated securities effected on securities exchanges could be significantly more complex:

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<sup>11</sup> Id. at § 1:12.

<sup>12</sup> Generally, the UCC governs the transfer of securities. For further discussion of the UCC, see Section IV.D.

<sup>13</sup> Guttman, supra note 6, at § 1.11, U.C.C. 1-201(b)(14).

<sup>14</sup> U.C.C. 8-303. “Control” over a registered security is achieved by obtaining control of the security indorsed to the holder or in blank, or if the issuer registers the holder in the securityholder list. See U.C.C. 8-106(b), off. cmts. 2-3.

<sup>15</sup> David C. Donald, The Rise and Effects of the Indirect Holding System: How Corporate America Ceded Its Shareholders to Intermediaries 7 (Sept. 27, 2007), available at <http://ssrn.com/abstract=1017206>.

In sales and purchases by persons other than brokers and specialists, the owner of the security will instruct a broker to sell, the broker will transfer the order to the exchange floor/system or a market maker, where it will be matched wholly or partially with one or more buy orders. Once the order is executed, the seller will have to deliver the executed certificate(s) to his broker so that the selling broker can deliver it to the buying broker, market maker, specialist, or central counterparty. Once the buying broker receives delivery, she will have to deliver to the issuer's transfer agent with a request for registration of transfer on the stockholder list. The latter, after inspecting all necessary documentation, will register the transfer, cancel the old certificate, and issue a new certificate to the buyer. Thus, beyond indorsement of the certificate and its delivery, each stage of the transaction will demand the documents, guarantees and assurances that constitute "good delivery" on the respective exchange.<sup>16</sup>

B. Transfer Agent Processes For Transferring Certificated Securities

Historically, from the transfer agent's perspective, the transfer of certificated securities held by registered owners was a time-consuming manual process. First, the transfer agent would receive from the broker a bundle of documents (the "transfer bundle") that typically included the following: (i) a "ticket" pinned to the bundle of documents that served as a transmittal letter and receipt;<sup>17</sup> (ii) transfer instructions telling the transfer agent what action to take; (iii) the security

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<sup>16</sup> Id. at 7-8.

<sup>17</sup> Historically, the term "ticket" referred to a broker-originated window ticket, which indicated the identity of the delivering broker, the securities, and the quantity. It would be prepared by a broker in triplicate and accompanied the transfer instructions and stock certificates when presented by the broker to the transfer agent for transfer. SEC, Study of Unsafe and Unsound Practices of Brokers and Dealers, H.R. Doc. No. 92-231, at 182 n.32 (Dec. 1971) ("Unsafe Practices Study"). Today, a ticket may provide similar information, either in electronic form, or in a highly structured and standardized paper form capable of being scanned and converted to electronic form.

certificates of the selling securityholder; (iv) a power of attorney;<sup>18</sup> and (v) a “guarantee,” typically affixed to the power of attorney or certificate, guaranteeing the genuineness of the signature of the selling securityholder indorsing the certificate over for transfer.<sup>19</sup>

As an example of the extensive process for transferring certificated securities, prior to 1975, for New York City transfer agents, nearly 90 percent of these transfer bundles were received from messengers at the transfer agent’s “window,” which was a physical drop-off location at the transfer agent’s offices, rather than through the mail, in which case the transfer bundles would be routed to the mail room.<sup>20</sup> Upon receipt at the window, the transfer agent would perform a visual reconciliation to confirm that the number of securities shown on the ticket matched the number on the certificates. If the transfer agent found a difference, the transfer would be rejected as “out of balance” and returned to the broker, a process known as a “window rejection.”<sup>21</sup> If no difference was found, the transfer agent would continue the process with a more detailed inspection, starting with a detailed review of signature guarantees,

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<sup>18</sup> A power of attorney may also be referred to as a “stock power” (or “bond power” with respect to debt securities) and grants legal authority to the registered securityholder’s broker, to a transfer agent, or to another intermediary to transfer the securityholder’s securities ownership on behalf of the securityholder. A seller may use a power of attorney rather than indorse the assignment and transfer form on the back of the security certificate. For examples of forms of transfer and assignment (i) by stock power; (ii) by bond power; and (iii) by execution of the transfer and assignment form on the back of a security certificate, see Mark S. Rhodes, Transfer of Stock app. A § 678.3041 at forms 1-3 (7th ed. Apr. 2015).

<sup>19</sup> North American Rockwell Information Systems Company, Securities Industry Overview, Final Report to the American Stock Exchange 47 (1969) (“Rockwell Study”).

<sup>20</sup> It was estimated at the time that New York transfer agents only received approximately 10 percent of certificates by U.S. mail. The pattern was the opposite for transfer agents outside of New York, which were estimated to receive the vast majority of certificates for transfer through the mail. Id. at 51.

<sup>21</sup> Id. at 47-52.

indorsements,<sup>22</sup> and attachments in order to determine if the certificates were in “good order” for transfer.<sup>23</sup> If the transfer agent found a deficiency, it would attach a rejection sheet to the certificate in question and return it to the broker, a process referred to as an “examination rejection.”<sup>24</sup> If the certificates were found to be in good order, the transfer agent would perform “stop checking,” the process of verifying each certificate number against a file it maintained listing certificates reported stolen, missing,<sup>25</sup> or with “stop transfers” or legal holds.<sup>26</sup>

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<sup>22</sup> Transfer agents may have reviewed indorsements but generally did not maintain signature cards for each registered securityholder or otherwise verify authenticity of the signature by comparing it to specimen signatures. Rather, the signature guarantee provided by the broker was intended to provide assurance concerning the authenticity of the seller’s signature. Today, the signature guarantee process has been enhanced and standardized through non-governmental Medallion guarantee programs. For additional information regarding Medallion guarantees, see infra note 267.

<sup>23</sup> Rockwell Study, supra note 19, at 53.

<sup>24</sup> It was estimated that, in the mid- to late-1960s, window rejections were as high as 20 percent and examination rejections were as high as 30 percent. Id.

<sup>25</sup> Id. Today, there is a national system operated by the Securities Information Center (“SIC”) as the Commission’s designee for maintaining a database concerning missing, lost, counterfeit, and stolen securities that “reporting institutions” (brokers, dealers, registered transfer agents, certain types of banks, and others) report information to and inquire into concerning the status of securities certificates. See Exchange Act Rule 17f-1, 17 CFR 240.17f-1. However, transfer agents still maintain their own lists of securities subject to stop transfers. For additional discussion of reporting requirements for lost and stolen securities, see infra Sections IV.A.1 and IV.A.2.

<sup>26</sup> A “stop transfer” or a “stop order” is a demand made by a registered securityholder to an issuer that a security should not be transferred without the securityholder having an opportunity to assert a claim to the security, typically because the security has been destroyed, lost, or stolen. See U.C.C. 8-403; Guttman, supra note 6, at § B:11, form 62 (providing a form of stop transfer notice). Under U.C.C. 8-403, an owner’s notification that a security certificate has been lost constitutes a demand that the issuer not register transfer. U.C.C. 8-403, cmt. 2 (2005). If, after a stop transfer demand has become effective, a certificated security in registered form is presented to an issuer with a request to register transfer (or an instruction is presented to an issuer with a request to register transfer of an uncertificated security), the issuer must promptly provide a notice with certain information to both the person who made the stop transfer demand and the person seeking to transfer the security. See U.C.C. 8-403(b). When a security has been destroyed, lost, stolen, or is otherwise missing, in addition to providing a stop transfer notice, a registered securityholder commonly will seek to replace the security. The process of replacement is described in detail infra in Section IV.A.2.

The next step was to prepare the transfer journal entries documenting the cancellation of the old certificate and the issuance of the new certificate.<sup>27</sup> Entering information into the transfer journal was considered the most time consuming part of the transfer process because it was a manual process, requiring gathering discrete pieces of information from different documents in the transfer bundle.<sup>28</sup> Concurrently, the transfer agent would cancel the old certificate and prepare a new certificate from the supply of blank certificates the transfer agent kept on hand.<sup>29</sup>

Prior to sending certificates to a registrar, the transfer agent's staff would perform several audits to verify the accuracy of the transfer journal and new certificate.<sup>30</sup> After completion of these audits, the transfer agent would send the certificates to a registrar, which would perform an additional audit or quality control check primarily focused on verification that the share quantities on the cancelled certificates and newly issued certificates matched and that the new certificates were not issued in a manner resulting in an overissuance.<sup>31</sup> If the registrar was independent of the transfer agent, as historically required by certain stock exchange rules, the transfer agent would remove the window tickets from batches of securities to be sent to the

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<sup>27</sup> This record may also be referred to as a "transfer blotter," or a "transfer log," among other terms. As used throughout this release, we refer to it as a "transfer journal." A transfer journal is a continuous record of the transfer of ownership of securities, including the identity of the party presenting the item for transfer, whether the transfer was completed, and to whom the securities were made available

<sup>28</sup> Rockwell Study, supra note 19, at 53.

<sup>29</sup> Id. at 53-54, 57. These blank certificates typically would have been ordered by a corporate officer of the issuer and been engraved by a bank note company before being delivered to the transfer agent. The engraving was both aesthetic and a security feature designed to prevent counterfeiting. Id. at 100. To avoid trading interruptions caused by running out of certificates, transfer agents had to carefully forecast certificate demand and monitor their inventory of blank certificates. Id. Today, it is the understanding of the Commission's staff that some certificates may not be engraved but are produced by transfer agents through "print-on-demand" services.

<sup>30</sup> Id. at 53. For additional discussion of the registrar function, see, e.g., infra Section II.C.1

<sup>31</sup> Id. at 53-54. For more information regarding overissuances, see infra note 235 and accompanying text.



registrar, sequence the batches of old and new certificates separately by security issue, and send the bundles by messenger to the registrar, typically overnight.<sup>32</sup> The registrar would perform the audit described above, countersign the new certificates,<sup>33</sup> and then return them to the transfer agent.<sup>34</sup> The transfer agent would then need to reorganize the certificates and reattach them to their window tickets before sending the new certificates and accompanying documents to the designated receiving party, usually by messenger.<sup>35</sup>

In 1977, the concept of the “uncertificated security” was introduced in Article 8 of the UCC.<sup>36</sup> This innovation allowed issuers to issue uncertificated (i.e., certificateless) book-entry securities, the transfer of which is greatly simplified compared to the transfer of certificated securities because transfer can be effected and protected purchaser status can be achieved by simply registering the transferee’s name on the books of the issuer.<sup>37</sup>

### C. Paperwork Crisis of the 1960s

Prior to 1968, individual clearing brokers<sup>38</sup> found it necessary to maintain a relationship with a separate clearing agency for each securities exchange.<sup>39</sup> In the over-the-counter (“OTC”)

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<sup>32</sup> Id. at 53.

<sup>33</sup> Before the new certificate would be sent out to the designated receiving party, the transfer agent would also countersign the new certificate. Thus, new certificates typically would include the signature of an officer of the issuer and countersignatures by the transfer agent and registrar.

<sup>34</sup> Rockwell Study, supra note 19, at 53.

<sup>35</sup> Id.

<sup>36</sup> See U.C.C. 8-102(a)(18) (defining new term uncertificated security as “a security that is not represented by a certificate”); U.C.C. 8-101 (citing “Reasons for 1977 Change,” and introducing the subject of uncertificated securities). See also Egon Guttman, Toward the Uncertificated Security: A Congressional Leap for States to Follow, 37 Wash. & Lee L. Rev. 717, 729-32 (1980).

<sup>37</sup> Guttman, supra note 6, at § 6:4. Book-entry securities are discussed in more detail throughout the release, including in Sections III.A and VII.A.

<sup>38</sup> For further information on introducing and clearing brokers, see Figure 1 and accompanying text, infra.

market,<sup>40</sup> most securities transactions were settled without going through a clearing agency or were cleared by small user-owned clearing corporations. In either instance, brokers had to settle most transactions by physical delivery or receipt of certificates, and had to maintain an office or establish a correspondent relationship with an entity with an office near the clearing agency.

As trading volume increased throughout the 1960s and early 1970s, the burdensome manual process associated with transferring certificated securities created what came to be known as the Paperwork Crisis. It was, at the time, “the most prolonged and severe crisis in the securities industry”<sup>41</sup> since the Great Depression and to this day is one of the largest challenges the U.S. securities markets have faced. The manual settlement processes for certificated securities could not keep up with increasing trading volumes, deliveries to customers of both cash and securities were frequently late, and stock certificates were lost in the rising tide of paper. The substandard performance of transfer agents was “a significant contributing factor” to

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<sup>39</sup> A clearing agency may be referred to as a clearing corporation or a depository, depending on its functions. Clearing corporations typically compare member transactions, clear, net and settle trades, and provide risk management services, such as trade guarantees. Depositories immobilize securities by holding them on deposit for their participants and effect transfers of interests in those securities through book-entry credits and debits of participants’ accounts at the depository. For additional discussion, see *infra* Section III. See also, e.g., Exchange Act Section 3(a)(23)(A), 15 U.S.C. 78c(a)(23)(A) (defining the term “clearing agency”); Clearing Agencies, SEC, <https://www.sec.gov/divisions/marketreg/mrclearing.shtml> (last visited Nov. 25, 2015). Currently, DTC is both the only CSD in the United States and the only CSD registered with the Commission as a clearing agency. See Exchange Act Section 3(a)(23)(A), 15 U.S.C. 78c(a)(23)(A) (requiring CSDs to register with the Commission as a clearing agency).

<sup>40</sup> The term “OTC” refers generally to securities that are not listed on a national securities exchange. Many equity securities, corporate bonds, municipal securities, government securities, and certain derivative products are traded in the OTC market. The OTC Bulletin Board (“OTCBB”), which is a facility of FINRA, for example, is an electronic inter-dealer quotation system that displays quotes, last-sale prices, and volume information for many securities that are not listed on a national securities exchange, including domestic, foreign and American depository receipts (ADRs). For additional discussion, see, e.g., Over the Counter Market, SEC, <https://www.sec.gov/divisions/marketreg/mrotc.shtml> (last visited Nov. 20, 2015).

<sup>41</sup> Unsafe Practices Study, *supra* note 17 at 1.

the Paperwork Crisis.<sup>42</sup> At times during 1967 and 1968, the New York Stock Exchange (“NYSE”) closed early on some days and during a substantial portion of 1968 closed entirely on Wednesdays to attempt to allow the brokerages and other firms to keep up with the volume.<sup>43</sup>

In the immediate aftermath of the Paperwork Crisis, more than 100 broker-dealers went bankrupt or were acquired by other firms and “[t]he inability of the securities industry to deal with its serious operational problems . . . contributed greatly to the loss of investor confidence in the efficiency and safety of [the U.S.] capital markets.”<sup>44</sup> However, other consequences of the Paperwork Crisis were deeper and longer lasting. As discussed below, over the next years and decades, Congress, federal and state regulators, and industry participants, including brokers, dealers, banks, and securities exchanges, worked together to drastically reshape critical operational aspects of the securities industry, ultimately leading to major revisions to both federal and state securities laws, and the advent of the modern national market system and National C&S System as they exist today.

### *1. Industry Responses (1968-1970)*

#### Formation of the Central Certificate Service (1968)

In immediate response to the Paperwork Crisis, regulators and industry participants studied and adopted alternative settlement systems and other potential options which might

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<sup>42</sup> Id. at 37-8.

<sup>43</sup> Id. at 219, n. 4. See also New York Stock Exchange, Inc., Crisis in the Securities Industry, A Chronology: 1967-1970 10-16 (1971) (report prepared for the Subcommittee on Commerce and Finance of the Committee on Interstate and Foreign Commerce of the U.S. House of Representatives).

<sup>44</sup> S. Rep. No. 94-75, at 3-4 (1975) (“Senate Report on Securities Act Amendments of 1975”) (report prepared by the Senate Committee on Banking, Housing, and Urban Affairs on the Securities Act Amendments of 1975). For additional information about the Paperwork Crisis, see also Unsafe Practices Study, supra note 17, at 13-30; Securities Transaction Settlement Concept Release, Exchange Act Release No. 49405 (Mar. 11, 2004), 69 FR 12922 (Mar. 18, 2004).

reduce or eliminate the problems associated with the traditional process for transferring certificated securities. First, in June 1968, the NYSE established the Central Certificate Service (“CCS”) as a division of the Stock Clearing Corporation. Broker-dealers and banks who were members of the NYSE were permitted to deposit their certificated securities with CCS, which would hold the certificates in custody and transfer them into the name of a CCS nominee.<sup>45</sup> The certificated securities deposited by that member would be represented by an appropriate book-entry credit reflected in that member’s account at CCS. Because all securities held by CCS were registered in its nominee’s name, deliveries of securities between CCS members could be effected by appropriate credits and debits to the members’ securities accounts rather than by physical delivery of certificates. In this manner members’ accounts would be debited and credited to reflect transactions among them, but the registered owner of the securities – CCS’s nominee – would never change. Movement of certificates was thus eliminated, resulting in their “immobilization.”<sup>46</sup> At the time, CCS was the most prominent example of the central securities depository model discussed below in Section II.B.2. In 1970, CCS opened its services to

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<sup>45</sup> Unsafe Practices Study, supra note 17, at 184. The registration of securities into the name of a nominee rather than the name of the investor is commonly referred to as “street name” registration, which stands for “Wall Street name.” See The Stock Market, supra note 8, at 249-251, 307. A nominee is usually a partnership formed exclusively to act as the record holder of securities and thereby to facilitate their transfer. See Preliminary Report of the Securities and Exchange Commission on the Practice of Recording the Ownership of Securities in the Records of the Issuer in Other than the Name of the Beneficial Owner of Such Securities 2-15 (Dec. 4, 1975) (“Preliminary Street Name Study”) (providing extensive discussion of the history of the practice of nominees and street name ownership, the scope of the practice, the concept of beneficial ownership and then-current practices). For further discussion of registered ownership and street name ownership (or beneficial ownership), see infra Section III.A. See also infra note 87, regarding DTC’s nominee, Cede & Co.

<sup>46</sup> Unsafe Practices Study, supra note 17, at 184.

members of the American Stock Exchange,<sup>47</sup> and in 1973 CCS changed its name to the Depository Trust Company (“DTC”).<sup>48</sup>

Rockwell Study (1969)

Around the same time, the American Stock Exchange hired the North American Rockwell Information Systems Company to study and appraise the securities industry’s operations. In 1969, it produced the Rockwell Study. Among other things, the Rockwell Study found that the securities industry’s operations were unnecessarily complicated and had not kept pace with technology and recommended that the actual physical movement of securities be reduced.<sup>49</sup>

To address unnecessary complexity, for example, the Rockwell Study focused on whether more efficient clearance and settlement of securities could be achieved by allowing single entities to perform both registrar and transfer agent functions. If so, the entity would need to function in a way that still would preserve the independent audit and shareholder protection function that a registrar historically was viewed, by many participants in the securities industry, as providing.<sup>50</sup> However, at the time when the Commission adopted the majority of its transfer

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<sup>47</sup> The American Stock Exchange, a major New York securities exchange founded in 1908, operated for a century before being acquired by the New York Stock Exchange and ceasing operations as an independent entity in 2008.

<sup>48</sup> For further discussion of DTC, see infra Sections II.C.3, III.B, IV.C.2.

<sup>49</sup> Rockwell Study, supra note 19.

<sup>50</sup> See, e.g., Rockwell Study, supra note 19, at 101.

agent rules in 1977 and 1983, independent registrars were still present in the marketplace and indeed were required by the NYSE until 1984.<sup>51</sup>

To reduce the physical movement of securities, the Rockwell Study recommended the establishment of individual transfer agent depositories (“TADs”), which was, at the time, a theoretical proposal that had not been implemented in any market.<sup>52</sup> As proposed, the TAD model would have established a national clearing system together with a decentralized network of individual transfer agent depositories. Securityholders would immobilize their certificated securities by depositing them for custody with the transfer agent for the issuer, effectively making each transfer agent an independent depository for its respective issuers. The transfer agent would maintain the issuer’s register, or records of registered shareholders, in electronic form on behalf of the issuer and would settle transactions by debiting and crediting the securities accounts of the respective parties to the transaction on the issuer’s register instead of delivering physical certificates.<sup>53</sup> Thus, the account on which transfers took place would also be the issuer’s register, which would allow transfers to be effected by simply removing the seller’s name from the register (i.e., debiting the seller’s securities account) and adding the buyer’s name (i.e., crediting the buyer’s securities account). The national clearing system proposed under the TAD model would settle all securities transactions, both exchange and OTC trades, by receiving

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<sup>51</sup> However, at that time, the American Stock Exchange did not require an independent registrar. Rockwell Study, supra note 19, at 101. In 1984, the Commission issued an order that approved an NYSE rule change that eliminated the requirement to use a separate transfer agent and registrar, subject to certain conditions. Securities Exchange Act Release No. 21499 (Nov. 19, 1984) (File No. SR-NYSE-84-33).

<sup>52</sup> Rockwell Study, supra note 19, at 3, 9, 14, 31, 39, 43, 77, 98.

<sup>53</sup> Rockwell Study, supra note 19, at 39-43.

the compared trades<sup>54</sup> directly from the floor of the exchange and receiving OTC trades by messenger or other delivery service.<sup>55</sup> Compared trades would then be transmitted to the appropriate TAD, where, as noted above, the respective accounts of the parties would be credited and debited.<sup>56</sup> As with the CCS system established by the NYSE, the movement of certificates would be eliminated, resulting in their immobilization.

#### Arthur Little Study (1969)

From July 1968 to April 1969, Arthur D. Little & Co. conducted a study for the National Association of Securities Dealers (“NASD”) on the problem of settlement fails,<sup>57</sup> titled, “The Multiple Causes of Fails in Stock Clearing in the United States With Particular Emphasis in Over-The-Counter Securities” (“Arthur Little Study”). Among other things, the Arthur Little Study compared the performance of two different types of clearing systems: (a) the “balance order system” used by the New York, American, and National OTC Clearing Corporations, and (b) the “net by net” or “continuous netting system” used by the Pacific Coast Stock Clearing Corporation and the Midwest Stock Exchange Clearing Corporation.<sup>58</sup> The study showed that

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<sup>54</sup> Trade comparison, resulting in a compared trade, is the post-execution act of matching the two sides of a trade and confirming the existence of a contract and the trade’s exact terms (security, parties, time of trade, number of units, and price), usually by the exchange. It is generally regarded as the first step in the clearance and settlement process. See The October 1987 Market Break, A Report by the Division of Market Regulation, 10-2, 10-4 (1988) (“October 1987 Market Break Report”).

<sup>55</sup> Unsafe Practices Study, supra note 17, at 180.

<sup>56</sup> Id.

<sup>57</sup> A settlement fail occurs if a seller does not deliver securities or a buyer does not deliver funds owed by the settlement date.

<sup>58</sup> See Arthur D. Little, Inc., The Multiple Causes of Fails in Stock Clearing in the United States 2414, 21-22 (“Arthur Little Study”). In the balance order system, after comparing the trades completed for the day by each clearing corporation participant, the clearing corporation would net each participant’s trades in each security and issue orders for the net sellers to deliver, and the net buyers to receive, specific amounts of securities at the established settlement price directly from other participants. The duty to deliver and the

the balance order system could reduce securities movement by approximately 25 percent and the continuous netting system could result in a 50 percent reduction.<sup>59</sup> The Arthur Little Study, along with the NASD, concluded that the best nationwide clearance and settlement system would be one consisting of interconnected regional clearing centers, each using the net by net (or continuous net settlement) system.<sup>60</sup>

#### Formation of the National Clearing Corporation (1969)

In December 1969, the NASD formed the National Clearing Corporation (“NCC”) as the vehicle for developing and implementing a nationwide system of interconnected regional clearinghouses that would form a national OTC clearing system utilizing continuous net settlement. NCC took over the operations of the National Over-the-Counter Clearing Corporation and eventually grew to include OTC transactions in all issues listed on exchanges or included on the NASDAQ system.<sup>61</sup> In 1977, NCC merged with the clearing facilities of both the NYSE and the American Stock Exchange to form the National Securities Clearing

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duty to receive would be allocated in such a way that, for each issue traded, the net seller would have to make only one delivery and the net buyer would receive only one delivery, which could result in participants receiving from or delivering to other participants with whom they did not transact that day. In the net by net (or continuous net settlement system), each of the participant’s trades in every security were netted for that day, so that each participant would be either a net seller or a net buyer for a particular security, and the duty to deliver the net sales or receive the net purchase would be added to any outstanding deliver or receive obligations of that participant in that security. In addition, all deliveries and receipts would be made to or from the clearing corporation, rather than between other participants, as in the balance order system. Unsafe Practices Study, supra note 17, at 167 n.6.

<sup>59</sup> Unsafe Practices Study, supra note 17, at 167 n.6, 172.

<sup>60</sup> Id. at 174-5.

<sup>61</sup> NASDAQ stands for National Association of Securities Dealers Automated Quotations and was founded in 1971 by the NASD as an electronic quotation system. It later developed into an electronic stock market, primarily focused on the OTC market and today is registered with the Commission as a national securities exchange under Section 6 of the Exchange Act. See Exchange Act Section 6, 15 U.S.C. 78f; Teweles, supra note 8, at 4-5, 371-2.



Corporation (“NSCC”). The new entity provided clearing, settlement, risk management, and other services, including continuous net settlement of trades and payments, to its participants.

### BASIC Study (1970)

In early 1970, around the same time that CCS extended its services to the American Stock Exchange, the Banking and Securities Industry Committee (“BASIC”) was formed by banking and securities industry participants to find solutions to problems affecting both those industries.<sup>62</sup> After more than a year of review and analysis, BASIC advocated the immobilization of securities certificates through a “Central Securities Depository System for the entire securities industry comprised of regional depositories with an inter-connection between the depositories.”<sup>63</sup> There was also agreement that “the certificate must be eliminated, but that this will take time.”<sup>64</sup>

## 2. *Regulatory and Industry Responses (1971-1975)*

### Unsafe Practices Study (1971)

In 1970, Congress enacted the Securities Investor Protection Act of 1970 which established the Securities Investor Protection Corporation for the broad purpose of affording financial protection for the customers of registered brokers and dealers.<sup>65</sup> The act also directed the Commission to conduct a study into the causes and potential responses to the Paperwork

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<sup>62</sup> BASIC was formed in March 1970 as an outgrowth of a joint committee established between representatives of the securities and banking industries in 1968. BASIC was sponsored by the NYSE and American Stock Exchange, the NASD, and the 11 New York Clearing House banks. Securities Industry Study, H.R. Rep. No. 92-1519, 64 (1972) (“Securities Industry Study”).

<sup>63</sup> Unsafe Practices Study, *supra* note 17, at 171. *See also id.* at 184-188.

<sup>64</sup> *Id.* at 173.

<sup>65</sup> The Securities Investor Protection Act of 1970, Pub. L. No. 91-598, 84 Stat. 1636 (Dec. 30, 1970), 15 U.S.C. 78aaa; S. Rep. No. 91-1218 (1970) (Report to Accompany S. 2348).

Crisis.<sup>66</sup> In response, the Commission held meetings, a conference, and hearings that included participation by market participants and federal bank regulators to identify and correct operational and financial problems in the securities industry, and then produced the Unsafe Practices Study.<sup>67</sup> The Unsafe Practices Study in part concluded that the inherent inefficiencies and risks associated with the processing of physical securities certificates contributed to the Paperwork Crisis, and it was therefore necessary to reduce the amount of paperwork connected with securities transfers.<sup>68</sup> There was disagreement, however, regarding the best way to accomplish this goal.

Although it was generally recognized at the time that the complete elimination of certificated securities, known as “dematerialization,” was the best approach to eliminating the risks associated with the processing of physical securities, due to technological and legal impediments, dematerialization was viewed as a “utopian solution” that “would require very extensive legal work and lead time to implement.”<sup>69</sup> Indeed, as noted above, two of the leading proposed securities settlement models designed to reduce the amount of paperwork being discussed at that time – the central depository system represented by CCS and the TAD system – would have resulted in the immobilization of securities rather than dematerialization, and

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<sup>66</sup> 15 U.S.C. 78kkk(g). See also Unsafe Practices Study, supra note 17, at 11.

<sup>67</sup> See Unsafe Practices Study, supra note 17, at 31 (discussing a meeting of major SROs to discuss operational capacity in the securities industry, a conference on the stock certificate, a series of meetings with federal bank regulators regarding the regulation and performance of transfer agents, and hearings concerning restructuring of the securities markets).

<sup>68</sup> Id. at 28.

<sup>69</sup> Id. at 173, 194-95. For example, Delaware did not permit the issuance of “certificateless stock” until Section 158 of the Delaware General Corporation Law was amended in 1983. See Welch, Turezyn, and Saunders, *Folk on the Delaware General Corporation Law* §158.4 (5th ed. 2013).

therefore were viewed as “interim measures for efficient operations” that could be taken immediately but would also “serve as building blocks for that ultimate objective” of dematerialization.<sup>70</sup>

While there was widespread industry support for the TAD model, there were legal and technological impediments to its immediate implementation.<sup>71</sup> In contrast, the central depository system model had already been established on a limited basis as the CCS established by NYSE, although it had not been implemented on a national basis. The proposal being discussed at the time would use CCS as a starting point and gradually expand it into a New York central securities depository that would link to similar regional depositories of other major financial centers, thus resulting in each depository having an account at the others.<sup>72</sup> This would allow members of one depository to transact with members of, and effect the delivery of securities via, the other depositories.<sup>73</sup> Under this approach, no one depository would be restricted solely to the specific members or securities listed on a particular exchange. Like the TAD, this approach resulted in immobilization rather than dematerialization, but instead of a decentralized network of transfer agents acting as individual depositories for issuers, all paper securities certificates for all issuers would be deposited into one or more central pools and kept in custody by such central depositories. Under this model, the more certificates deposited into a central depository, the more efficient the system would be.

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<sup>70</sup> Unsafe Practices Study, supra note 17, at 173.

<sup>71</sup> Unsafe Practices Study, supra note 17, at 173, 183-4, 194-5.

<sup>72</sup> Unsafe Practices Study, supra note 17, at 184-5.

<sup>73</sup> Id. at 185.

### Securities Industry Study (1973)

Following publication of the Commission's Unsafe Practices Study, the Senate Subcommittee on Securities conducted its own 18-month study, which resulted in the Securities Industry Study of 1973 Report ("Securities Industry Study").<sup>74</sup> The Securities Industry Study found "two primary functional causes" for the Paperwork Crisis: (i) the securities industry had failed to develop a nationwide system for clearance and settlement of securities transactions; and (ii) there existed a lack of uniformity and coordination among the various methods of clearing and settlement in use. The Securities Industry Study's recommendations included the following: (i) that the Securities Exchange Act of 1934 ("Exchange Act") be amended to "make it clear" that the Commission has the "power and the responsibility to direct the evolution of clearance and settlement methods employed by the national securities associations and by broker-dealers engaged in interstate commerce;" (ii) that legislation should "requir[e] clearing agencies and depositories to register with and report to the SEC and empower the Commission to review and amend the rules of such entities;" (iii) that "the Commission be directed to proceed with dispatch toward elimination of the stock certificate as a means of settlement between broker-dealers..."; and (iv) that "the Commission be directed to consider the practice of registering securities in 'street name....'"<sup>75</sup>

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<sup>74</sup> Securities Industry Study, supra note 62.

<sup>75</sup> Id. at 40.

## 1975 Amendments

The Securities Industry Study ultimately led to Congress enacting the Securities Act Amendments of 1975 (“1975 Amendments”),<sup>76</sup> which made sweeping changes to the federal securities laws, implemented many of the principal recommendations from the Securities Industry Study, and established both the national market system<sup>77</sup> and the National C&S System as they exist today.<sup>78</sup> In particular, in the new statute, Congress directed the Commission to, among other things: (i) “facilitate the establishment of a national system for the prompt and accurate clearance and settlement of transactions in securities;”<sup>79</sup> (ii) “end the physical movement of securities certificates in connection with the settlement among brokers and dealers of transactions in securities;”<sup>80</sup> and (iii) establish a system for reporting missing, lost, counterfeit, and stolen securities.<sup>81</sup>

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<sup>76</sup> Securities Acts Amendments of 1975, Pub. L. No. 94-29, 89 Stat. 97 (1975). See also S. Rep. No. 75, at 7 (1975).

<sup>77</sup> Section 11A of the Exchange Act directed the Commission to facilitate the establishment of a national market system to link together the multiple individual markets that trade securities and achieve the objectives of efficient, competitive, fair, and orderly markets, that are in the public interest, and protect investors. See Exchange Act Section 11A(a)(2), 15 U.S.C. 78k-1(a)(2).

<sup>78</sup> See Exchange Act Section 17A(a)(2), 15 U.S.C. 78q-1(a)(2). For legislative history concerning Section 17A, see, e.g., S. Rep. No. 75, at 4 (1975); H.R. Rep. No. 229, at 102 (1975).

<sup>79</sup> Exchange Act Section 17A(a)(2)(A)(1), 15 U.S.C. 78q-1(a)(2)(A)(1). For legislative history concerning Section 17A, see supra note 80.

<sup>80</sup> Exchange Act Section 17A(e), 15 U.S.C. 78q-1(e).

<sup>81</sup> Exchange Act Section 17(f)(1), 15 U.S.C. 78q(f)(1).

### 3. Advent of the Modern Clearance and Settlement System (1975-present)

#### Early Proliferation of Clearing Agencies

Between 1968 and 1975, in addition to CCS (now known as DTC), several other securities depositories were established, including by the Midwest Stock Exchange, Inc., the Pacific Stock Exchange, and TAD Depository Corporation. The number of shares evidenced by certificates immobilized in depositories increased between 1968 and 1976 from approximately 400 million to over 4 billion.<sup>82</sup> On November 3, 1975, pursuant to its new authority and directives under the 1975 Amendments, the Commission adopted Rule 17Ab2-1(c)(1) and Form CA-1 for the registration of clearing agencies, including central securities depositories.<sup>83</sup> Later in 1975, the Commission granted temporary registrations as clearing agencies to nine entities, that were either clearing corporations or securities depositories.<sup>84</sup> Shortly after NSCC was formed in 1977 through the merger of NCC and the clearing facilities of the NYSE and American Stock Exchange, NSCC also sought, and was granted, temporary registration as a clearing corporation. The Commission also granted temporary registrations as a clearing

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<sup>82</sup> Final Report of the Securities and Exchange Commission on the Practice of Recording the Ownership of Securities in the Records of the Issuer in Other than the Name of the Beneficial Owner of Such Securities 55 (Dec. 3, 1976) (“Final Street Name Study”).

<sup>83</sup> See Exchange Act Rule 17Ab2-1(c)(1), 17 CFR 240.17Ab2-1(c)(1); Exchange Act Form CA-1, 17 CFR 249b.200.

<sup>84</sup> The nine entities granted temporary registrations as clearing agencies were: (i) DTC; (ii) Bradford Securities Processing Services; (iii) Stock Clearing Corporation of Philadelphia; (iv) Midwest Securities Trust Company; (v) Options Clearing Corporation; (vi) Midwest Clearing Corporation; (vii) Pacific Securities Depository Trust Company; (viii) Boston Stock Exchange Clearing Corporation; and (ix) TAD Depository.

corporation to the New England Securities Depository Trust Company and the Philadelphia Depository Trust Company in 1976 and 1979, respectively.<sup>85</sup>

Advances in Technology (1976-present)

Over the next several decades, factors such as technology enhancements and regulatory changes led to the increased prevalence of securities depositories, and many of them substantially expanded their services and participant base, especially DTC. Of particular note, in 1975, DTC introduced the Fast Automated Securities Transfer (“FAST”) Program, which was approved by the Commission in 1976.<sup>86</sup> Among other things, it reduced the costs and risks associated with moving street name securities between DTC and participants.

Prior to FAST, transferring securities to or from DTC on behalf of its participants required moving certificated securities back and forth between DTC and transfer agents. For securities being deposited with DTC, participants would send certificates to DTC, which would then send the certificates to the transfer agent for re-registration into the name of DTC’s partnership nominee, Cede & Co.,<sup>87</sup> before returning the reregistered certificates to DTC. For securities being withdrawn from DTC, DTC would send the certificates registered in the name of

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<sup>85</sup> For more information regarding clearing agency registration standards and the history of those standards, see Regulation of Clearing Agencies, Exchange Act Release No. 16900 (June 17, 1980), 45 FR 41920 (June 23, 1980).

<sup>86</sup> Securities Exchange Act Release No. 12353 (Apr. 20, 1976), 41 FR 17823 (Apr. 28, 1976) (File No. SR-DTC-76-3). The FAST Program was introduced in 1976 with ten transfer agents and 400 securities issues. See Securities Exchange Act Release No. 55816, 3 n.5 (May 25, 2007), 71 FR 30648 (June 1, 2007) (File No. SR-DTC-2006-16). By the end of 1984, 64 transfer agents held balance certificates valued at \$580 billion in 11,442 securities issues. See The Depository Trust Company Annual Report 1984, at 16 (“DTC Annual Report”).

<sup>87</sup> The name Cede & Co. was drawn from the term “certificate depository” and it was formed as a partnership partly because it was considered simpler to effect a transfer of securities registered in the name of a partnership nominee than in the name of a corporation. For more information about Cede & Co., including regarding the terms of its partnership agreement, see S. Rep. No. 93-62 (1974) (“Disclosure of Corporate Ownership”).

Cede & Co. to the transfer agent for re-registration into the name designated by the withdrawing participant, and the transfer agent then returned to DTC both the reregistered certificate (which DTC would then deliver to the withdrawing participant or other entity designated by the participant) and a separate certificate registered in the name of Cede & Co. representing the remainder of DTC's position.<sup>88</sup>

The FAST Program substantially reduced the movement of paper certificates by permitting transfer agents to become custodians for balance certificates registered in the name of Cede & Co. The balance certificate represents on the transfer agent's books the sum total of shares for that issue held by all of DTC's participants.<sup>89</sup> Participants maintain corresponding books representing their securityholder accounts held in street name. Then, when securities are deposited into or withdrawn from DTC, FAST transfer agents adjust the denomination of the balance certificates and electronically confirm the changes with DTC on a daily basis, with the corresponding participant accounts adjusted accordingly by DTC.<sup>90</sup>

In 1983, DTC adopted technological enhancements to its Participant Terminal System which allowed participants to automatically match book-entry receive notifications and facilitate redelivery to other participants.<sup>91</sup> DTC also partnered with NSCC to provide an Institutional

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<sup>88</sup> Securities Exchange Act Release No. 60196 (June 30, 2009), 74 FR 33496 (July 13, 2009) (File No. SR-DTC-2006-16).

<sup>89</sup> Id. at 2-3.

<sup>90</sup> Id. For a description of early DTC rules relating to FAST, see Securities Exchange Act Release No. 13342 (Mar. 8, 1977) (File No. SR-DTC-76-3); Securities Exchange Act Release No. 14997 (July 26, 1978) (File No. SR-DTC-84-4); Securities Exchange Act Release No. 21401 (Oct. 16, 1984) (File No. SR-DTC-84-8); Securities Exchange Act Release No. 31941 (Mar. 3, 1993) (File No. SR-DTC-92-15); Securities Exchange Act Release No. 46956 (Dec. 6, 2002) (File No. SR-DTC-2002-15).

<sup>91</sup> For discussion of "Dual Host PTS," see DTC Annual Report, supra note 86, at 24-5.



Delivery System which, through an interface with NSCC's continuous net settlement system ("CNS"), allowed brokers to net the often very large trades made for institutional customers instead of settling trade-for-trade at DTC. In 1996, the Direct Registration System ("DRS") was implemented, which allowed investors to hold uncertificated securities in registered form directly on the books of the issuer's transfer agent.<sup>92</sup> DRS also allowed investors to transfer the shares to and from a brokerage account through FAST when they choose to sell or transfer the stock.<sup>93</sup>

A number of legal and regulatory changes also led to increased participation at securities depositories among banks and broker-dealers. For example, in 1978, the UCC was revised to substitute the concept of delivery of securities specific to the physical delivery of certificated securities with the concept of "transfer" by book-entry on the books of a central depository.<sup>94</sup> As a result, the only book-entry transfers that qualified the transferee for protected purchaser rights under the UCC, as discussed above in Section II.A, were those made on the books of a clearing corporation.

In 1982 and 1983, the NASD and five stock exchanges, including the NYSE and American Stock Exchange, amended their rules to require their members to use a Commission-registered securities depository for the confirmation, affirmation and settlement of transactions in

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<sup>92</sup> See, e.g., Securities Exchange Act Release No. 37931 (Nov. 7, 1996), 61 FR 58600 (Nov. 15, 1996) (File No. SR-DTC-96-15) (approving establishment of DRS). Prior to the advent of DRS, unless they were held on a transfer agent's books through a direct stock purchase plan or dividend reinvestment plan, book-entry shares generally could only be held by beneficial owners in street name through FAST. For more detail on DRS, see *infra* Section IV.C.2. See also *infra* note 144 (dividend reinvestment plan).

<sup>93</sup> If the securityholder wants to sell the shares, they are transferred into a broker's account by means of an "Electronic Participant Instruction" through DTC's proprietary communication network, the Profile Modification System ("Profile"), through which the shares are re-registered in the name of Cede & Co. See Securities Exchange Act Release No. 60304 (June 30, 2009), 74 FR 33496 (July 13, 2009) (File No. SR-DTC-2009-11). For additional information, see *infra* note 309.

<sup>94</sup> See U.C.C. 8-320.

depository eligible securities if the member provides its customer with delivery-versus-payment privileges.<sup>95</sup> Delivery versus payment privileges allow payments to be made prior to or simultaneously with delivery of the securities. Because customers typically wanted those privileges, the rules had the effect of requiring the use of a registered securities depository to clear and settle institutional trades. As a result, DTC participation soared. In 1995 and 1996, several exchanges adopted uniform depository eligibility requirements, paving the way for an industry standard for depository eligibility determinations.<sup>96</sup> Finally, 1997 revisions to UCC Article 8 modernized securities holding rules by allowing depositories to make eligible additional foreign securities that are held through foreign custodians as well as other financial instruments.<sup>97</sup> New York's adoption of these revisions enabled DTC to use foreign banks as custodians. This increased DTC's ability to maintain custody of securities abroad,<sup>98</sup> which resulted in additional foreign securities and other financial products and instruments becoming depository eligible.<sup>99</sup>

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<sup>95</sup> Securities Exchange Act Release No. 25120 (Nov. 13, 1987), 52 FR 44506 (Nov. 19, 1987) (File No. SR-NYSE-87-04).

<sup>96</sup> See, e.g., Securities Exchange Act Release No. 35798 (June 1, 1995), 60 FR 30909 (June 12, 1995) (File Nos. SR-Amex-95-17, SR-BSE-95-09, SR-CHX-95-12, SR-NASD-95-24, SR-NYSE-95-19, SR-PSE-95-14, SR-PHLX-95-34); Securities Exchange Act Release No. 36788 (Jan. 26, 1996), 61 FR 3741 (Feb. 1, 1996) (File No. SR-CBOE-95-62).

<sup>97</sup> See, e.g., U.C.C. 8-102(a)(7), (9), (17), 501, 506.

<sup>98</sup> See The Depository Trust Company 1998 Annual Report, available at [http://www.sechistorical.org/collection/papers/1990/1998\\_0101\\_DTCAR\\_1.pdf](http://www.sechistorical.org/collection/papers/1990/1998_0101_DTCAR_1.pdf).

<sup>99</sup> For example, DTC was able to expand eligible issues to include State of Israel bonds and Bankers' Acceptances, short-term debt instruments that are guaranteed by commercial banks. See The Depository Trust Company 1997 Annual Report, available at [http://www.sechistorical.org/collection/papers/1990/1997\\_0101\\_DTCAR.pdf](http://www.sechistorical.org/collection/papers/1990/1997_0101_DTCAR.pdf).

### Clearing Agency Consolidation (1980s-present)

Throughout the late 1980s and mid-1990s, DTC merged with or absorbed business from several other depositories, leading to its further growth. First, in April 1987, the Pacific Stock Exchange Board of Governors closed the Pacific Securities Depository Trust Company. Virtually all eligible securities in its custody were moved to DTC. Then, in 1995, DTC and NSCC worked together to absorb the business of Midwest Securities Trust Company and Midwest Clearing Corporation in light of the Chicago Stock Exchange's decision to exit the clearing and settlement business.

By the late 1990s, DTC had become the largest depository in the United States, and NSCC was the largest clearing agency.<sup>100</sup> On June 15, 1999, the Commission issued an order approving DTC's integration with NSCC.<sup>101</sup> The Commission's order authorized DTC and NSCC to restructure their boards of directors so that one board served both corporations.<sup>102</sup> The Depository Trust & Clearing Corporation ("DTCC"), a holding company, was subsequently formed with DTC and NSCC as its subsidiaries.

Today, DTC provides depository and book-entry settlement services for substantially all corporate and municipal debt, equity securities, asset-backed securities, and money market instruments available for trading in the United States.<sup>103</sup> It provides custody and asset services

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<sup>100</sup> SEC Annual Report, 1997, tbl.3 (Clearing Agencies), at 179 and tbl.9 (Depositories), at 180.

<sup>101</sup> Securities Exchange Act Release No. 41800 (Aug. 27, 1999), 64 FR 48694 (Sept. 7, 1999) (File No. SR-NSCC-99-10).

<sup>102</sup> Id.

<sup>103</sup> See DTCC: Settlement & Asset Services, available at <http://www.dtcc.com/asset-services.aspx> (last visited December 11, 2015). See also DTCC, Our Capabilities 17 (2014), available at [http://www.dtcc.com/~media/Files/Downloads/About/DTCC\\_Capabilities.pdf](http://www.dtcc.com/~media/Files/Downloads/About/DTCC_Capabilities.pdf).

for securities valued at over \$37 trillion.<sup>104</sup> Approximately 1.4 million settlement-related transactions, with a value of approximately \$600 billion, are completed at DTC each day.<sup>105</sup>

DTC provides three primary services: (i) custody services; (ii) asset services, such as dividend and interest payment, reorganizations, and proxy services; and (iii) settlement services (through its interface with NSCC), all of which help facilitate the National C&S System mandated by the 1975 Amendments.

### **III. TRANSFER AGENT ROLE IN CLEARANCE AND SETTLEMENT PROCESSES**

Because transfer agents operate within the National C&S System, it is important to understand that system, especially concerning the services transfer agents provide by maintaining accurate ownership records on behalf of issuers, facilitating the issuance or cancellation of securities, and distributing dividends within that system. Accordingly, this section provides a general overview of transfer agents' operations and processes within the National C&S System.

#### **A. Types of Security Ownership**

Under the current centralized depository model in the United States, there are two types of securities owners: (a) registered and (b) beneficial.

##### *1. Registered Securityholders*

Under state corporation law, certain securityholder rights commonly accrue only to those registered on the securityholder list and not to persons who may have an ultimate economic interest in the shares but who are not registered securityholders.<sup>106</sup> Registered securityholders

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<sup>104</sup> Id.

<sup>105</sup> Id.

<sup>106</sup> See, e.g., Del. Code Ann. tit. 8, § 219(c) (right to examine the stockholder list or to vote in person or by proxy at any meeting of stockholders limited to registered securityholders).

(who may also be referred to as “holders of record”)<sup>107</sup> own and hold securities in “registered form.”<sup>108</sup> The UCC provides that an “issuer...may treat the registered owner as the person exclusively entitled to vote, receive notifications, and otherwise exercise all the rights and powers of an owner.”<sup>109</sup> Registered securityholders are listed directly on the records of the issuer or the issuer’s transfer agent under their own names.<sup>110</sup> The issuer or its transfer agent may have direct contact with the registered securityholder, keep the records that reflect the ownership interest of the registered securityholder, and provide services directly to the registered securityholder. These services may include issuing, cancelling and transferring shares, making distributions, providing communications and mailings from the issuer, and answering securityholder inquiries. Registered owners can hold their securities either in certificated form or in uncertificated (i.e., book-entry) form, such as uncertificated securities held through DRS.<sup>111</sup>

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<sup>107</sup> See Exchange Act Rule 17Ad-9(a)(3), 17 CFR 240.17Ad-9(a)(3) (referring to “securityholder’s registration”); Exchange Act Rule 17Ad-9(a)(4), 17 CFR 240.17Ad-9(a)(4) (referring to “registered securityholder”); Exchange Act Rule 12g5-1, 17 CFR 240.12g5-1 (“securities shall be deemed to be ‘held of record’ by each person who is identified as the owner of such securities on records of security holders maintained by or on behalf of the issuer”).

<sup>108</sup> See U.C.C. 8-102(a)(13). (“‘Registered form,’ as applied to a certificated security, means a form in which: (i) the security certificate specifies a person entitled to the security; and (ii) a transfer of the security may be registered upon books maintained for that purpose by or on behalf of the issuer, or the security certificate so states.”)

<sup>109</sup> U.C.C. 8-207.

<sup>110</sup> Because a registered securityholder may be either a natural person or a legal entity, such as a partnership, trust, or corporation, transfer agents generally are familiar with issues that may arise with respect to a registered securityholder’s legal status in connection with securities processing transactions. See Guttman, supra note 6, at § 5:19-5:28 (discussing different “aggregate” and corporate types of registered securityholders).

<sup>111</sup> A registered securityholder’s options for holding uncertificated securities, through DRS or otherwise, will be subject to the issuer’s governing documents and the law of its jurisdiction of organization, as well as to other legal requirements that may apply to the issuer, such as rules of SROs such as DTC and national securities exchanges. For additional discussion of DRS, see supra note 92 and infra Section IV.

## 2. *Beneficial Owners*

The vast majority of securityholders in the U.S. are beneficial owners rather than registered owners.<sup>112</sup> Beneficial owners do not own the securities directly but generally have purchased them through an intermediary, such as a broker or a bank, and determined to hold them in street name through a book-entry account with that intermediary. The intermediary, rather than the transfer agent, maintains and updates the securityholder records, facilitates or executes transfers, and provides other services for the securityholder.<sup>113</sup>

When securities are held in street name, there is a legal distinction between the nominee, who has legal status as the registered securityholder, and the person with economic or beneficial ownership of the security.<sup>114</sup> Securities held in street name are legally owned by and registered in the name of the depository's nominee (most often DTC's nominee, Cede & Co.). The individual investor's broker (or other intermediary) who is a member or participant of the depository will be identified on the books of the depository as having a "securities entitlement"<sup>115</sup> to a pro rata share of the fungible bulk of that security held by the depository.<sup>116</sup>

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<sup>112</sup> For more information regarding beneficial ownership, *see, e.g.*, Final Street Name Study, *supra* note 82; Concept Release On The U.S. Proxy System, Exchange Act Release No. 62495 (July 14, 2010), 75 FR 42982 (July 22, 2010) ("Proxy Concept Release"); Holding Your Securities—Get the Facts, SEC, [available at http://www.sec.gov/investor/pubs/holdsec.htm](http://www.sec.gov/investor/pubs/holdsec.htm).

<sup>113</sup> These transfer and recordkeeping services provided to beneficial owners by intermediaries may be referred to as "sub-transfer agent" services. For more information, *see infra* Section VII.B.

<sup>114</sup> For additional detail concerning aspects of beneficial ownership, *see* Preliminary Street Name Study, *supra* note 45, at 9-11. For an example of reference in a rule of the Commission to "beneficial owner[s]," *see, e.g.*, Exchange Act Rule 13d-3, 17 CFR 240.13d-3 (determination of beneficial owner).

<sup>115</sup> *See* U.C.C. 8-102(a)(7) (defining "entitlement holder" as a person identified in the records of a securities intermediary as the person having a security entitlement against the securities intermediary); U.C.C. 8-102(a)(17) (defining "security entitlement"); U.C.C. 8-102(a)(14) (defining "securities intermediary" as (i) a clearing corporation or (ii) a person, including a bank or broker, that in the ordinary course of its business maintains securities accounts for others and is acting in that capacity); U.C.C. 8-503(b) (providing that an

Correspondingly, the individual investor will be identified on the books of the depository participant (his or her broker or other intermediary) as having a securities entitlement to a pro rata share of the securities in which the participant has an interest. At each level, the intermediary will be obligated to provide the entitlement holder with payments and distributions with respect to the financial asset and to exercise rights as directed by the entitlement holder.<sup>117</sup> A securities intermediary satisfies such duties where the intermediary acts as required by any agreement between the intermediary and entitlement holder.<sup>118</sup> The entitlement holder will be permitted to look only to the intermediary for performance of the obligations.<sup>119</sup> Other rights and interests that a beneficial owner has against a securities intermediary's property are created by agreements between the beneficial owner and the securities intermediary.

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entitlement holder's property interest with respect to a particular financial asset under [U.C.C. 8-503(a)] is a pro rata property interest in all interests in that financial asset held by the securities intermediary).

<sup>116</sup> For securities held in "fungible bulk," there are no specifically identifiable shares directly owned by DTC participants. Rather, each participant owns a pro rata interest in the aggregate number of shares of a particular issuer held at DTC. In turn, each customer, such as an individual investor of a DTC participant, owns a pro rata interest in the shares in which the DTC participant has an interest. See Processing of Tender Offers Within the National Clearance and Settlement System, Exchange Act Release No. 19678, n.5 (Apr. 15, 1983), 48 FR 17603, 17605, n.5 (Apr. 25, 1983) (describing fungible bulk) ("Rule 17Ad-14 Proposing Release"); Office of Investor Education and Advocacy, Investor Bulletin: DTC Chills and Freezes, SEC (May 2012), available at <https://www.sec.gov/investor/alerts/dtcfreezes.pdf> (discussing fungible bulk).

<sup>117</sup> U.C.C. 8-505, 506.

<sup>118</sup> U.C.C. 8-505(a)(1), 506(1). In the absence of an agreement covering payments and distributions, the securities intermediary must exercise due care in accordance with reasonable commercial standards. In the absence of an agreement with respect to the exercise of rights as directed by the entitlement holder, the securities intermediary either must place the entitlement holder in a position to exercise the rights directly or exercise due care in accordance with reasonable commercial standards to follow the direction of the entitlement holder. U.C.C. 8-505(a)(2), 506(2).

<sup>119</sup> U.C.C. 8-503(c) (referring only to "securities intermediar[ies]" with respect to enforcement rights that may be exercised by an entitlement holder).

## B. Clearance and Settlement Process

The clearance and settlement process differs depending on the type of security being traded, how the security is held by the investor (i.e., registered or beneficial form), the market or exchange on which it is traded, and the specific entities and institutions involved. Yet, regardless of the specific variables involved, the basic clearance and settlement processes are substantially similar. For illustration purposes, this section describes generally the clearance and settlement process for exchange-based equity trades held in street name.

All securities trades involve a legally binding agreement that sets forth the terms of the trade. In general, the “clearing” of those trades is the process of comparing and confirming the material terms of the agreement: (i) the identity of the buyer and seller; (ii) the identity and quantity of the securities being traded; and (iii) the price, date, and other material details of the trade.<sup>120</sup> Clearing can be “bilateral,” where the parties to the transaction work directly with each other to take the steps necessary to clear the transaction, or “central,” where a third party, such as a clearing agency, undertakes the steps necessary to clear the transaction.<sup>121</sup>

Settlement is the fulfillment by the parties to the transaction of their respective obligations for the trade, usually by exchanging funds for the delivery of securities. For equities,

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<sup>120</sup> October 1987 Market Break Report, supra note 54, at 10-2 through 10-5; Teweles, supra note 8, at 302-3.

<sup>121</sup> Prior to the 1980s, central clearing predominantly involved a two-sided matching process conducted mainly by the exchanges, where an exchange collected trade data and passed that information to the clearing agency. After the October 1987 Market Break led to significant numbers of unmatched trades, the Commission recommended that automated systems should be used to facilitate comparison at or near the time of trade execution. See Securities and Exchange Commission Recommendations regarding the October 1987 Market Break, contained in Testimony delivered by David S. Ruder, Chairman, Securities and Exchange Commission, before the Senate Committee on Banking, Housing and Urban Affairs, p. 23 (Feb. 3, 1988). The recommendation was subsequently adopted in stages. See, e.g., New York Stock Exchange, Inc. “Overnight Trade Comparison,” adopted Aug. 14, 1989, Exchange Act Release No. 27096 (Aug. 3, 1989), 54 FR 33299 (Aug. 14, 1989).



settlement generally occurs three business days after the trade date (i.e., “T+3”),<sup>122</sup> although other arrangements may be available by private agreement.<sup>123</sup> Delivery currently is far more likely to be by book-entry than by exchange of physical certificates. As previously discussed, the brokers’ certificates in DTC’s depository are held in fungible bulk and registered in the name of Cede & Co. to facilitate book-entry transactions involving electronic debits (on the seller’s side) and credits (on the buyer’s side) to the brokers’ securities accounts at the depository rather than the movement of physical securities certificates. Because these shares are held in street name, DTC knows the names of the brokers who are DTC participants (often referred to as clearing brokers) but not the names of brokers who are not DTC participants (often referred to as introducing brokers) or either type of brokers’ customers.<sup>124</sup> The brokers track the holdings of their customers who are the ultimate beneficial owners of the securities. For securities held in fungible bulk, rights are passed from record owner Cede & Co. through securities intermediaries to the ultimate beneficial owner.

Equity trades that are cleared and settled through DTC’s facilities are generally processed in NSCC’s CNS system, with final settlement on the third business day after the trade is executed. NSCC has approximately 1,000 members, made up of brokers, dealers, banks, and other intermediaries. Using CNS, NSCC nets multilaterally all of the clearing participants’

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<sup>122</sup> See Exchange Act Rule 15c6-1, 17 CFR 240.15c6-1. T (or T+0) is the day the trade is executed. The first business day following the trade date is T+1, and so on. Thus, assuming there are no non-business days in the week, a trade that is executed on a Monday (T or T+0) would settle on Thursday (T+3). A trade executed on Friday would settle on the following Wednesday (Saturday and Sunday are not business days, so T+1 is Monday, T+2 is Tuesday, etc.).

<sup>123</sup> See, e.g., NYSE Rule 64 (2009).

<sup>124</sup> For further information on introducing and clearing brokers, see fig.1 and accompanying text, infra.

purchases and sales in each security to one security position per participant per day in order to arrive at a daily net settlement obligation for each participant. NSCC then makes deliveries only on the remaining net positions through settlement accounts that the participants hold with DTC (for securities) and the Federal Reserve System (for cash).<sup>125</sup> Because NSCC interposes itself between trading brokers on each trade and guarantees the settlement as each broker's counterparty,<sup>126</sup> each broker's settlement is with NSCC and DTC, not with the other clearing participant, which reduces the brokers' exposure to risk of default by other brokers (i.e., counterparty risk). A broker can either settle each day or carry open commitments forward to net against the next business day's settlement (hence the continuous nature of CNS).<sup>127</sup> On the cash side of the trade, all money owed to or from a particular DTC participant will be netted down each day by NSCC to a single dollar amount, which reduces the amount of money firms need to have on hand to settle their obligations.

The goal of netting is to minimize the number and value of transactions required for buyers and sellers (or the firms acting on their behalf) to settle their transactions. For example, if a broker purchases 100 shares of XYZ stock for a customer and sold 50 shares of XYZ stock for another customer, at the end of the day the broker's securities account at DTC would be credited with 50 shares of XYZ (the net difference between buying 100 shares and selling 50 shares). If

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<sup>125</sup> NSCC Rule 11, 68-74 (May 4, 2015), available at [www.NSCC.com](http://www.NSCC.com) (“Continuous Net Settlement”). The Federal Reserve System refers to the central bank of the United States, and is commonly referred to as the “Federal Reserve.” The Federal Reserve Board is the governing body for the Federal Reserve System. See generally, Federal Reserve, <http://www.federalreserve.gov/aboutthefed/default.htm>.

<sup>126</sup> NSCC Rule 11,68-74 (May 4, 2015), available at [www.dtcc.com](http://www.dtcc.com); see also Becker and Etter, *International Clearance and Settlement*, 14 Brook. J. Int'l L. 275, note 15 (1988); David M. Weiss, *After the Trade is Made – Processing Securities Transactions* 245-49 (2006) (“After the Trade is Made”).

<sup>127</sup> See October 1987 Market Break Report, *supra* note 54, at ch. 10, 1-12; Teweles, *supra* note 8, at 312-26.

the broker paid \$25 per share to buy the 100 shares of XYZ and sold the 50 shares for the same price on the same day, at the end of the day the broker's cash account would be debited \$1,250. The vast majority of equity trades handled by DTC clear and settle through NSCC's CNS, which, on average, results in an reduction of the volume of settlement transactions by approximately 98%.<sup>128</sup> As a result, on average, 99% of all trade obligations that occur in U.S. equity markets do not require the exchange of money.<sup>129</sup>

For illustration purposes only, Figure 1 below depicts one possible example of how an equity trade effected on a national securities exchange is cleared and settled, beginning with the buyer conveying an order to an executing broker. If the executing broker is a member of NSCC it may be referred to as a "clearing broker." If it is not a member of NSCC, it may be referred to as an "introducing broker" or "correspondent broker," depending on whether the broker carries and is responsible for the customer's account. Where the executing broker is a member of NSCC (i.e., a clearing broker) it routes the order for execution to a national securities exchange. Where the executing broker is not a member of NSCC (i.e., an introducing or correspondent broker) it routes the order to a clearing broker who will then route the order for execution to a national securities exchange. The national securities exchange matches the order with a corresponding sell order and then sends matched trade data to NSCC. NSCC nets these orders using its CNS system. If the securities are held in street name, there will be no change to the

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<sup>128</sup> See DTCC's overview of NSCC, stating that NSCC's netting system results in "reducing the value of securities and payments that need to be exchanged by an average of 98% each day," available at <http://www.dtcc.com/about/businesses-and-subsidiaries/nscc>.

<sup>129</sup> Virginia B. Morris and Stuart Z. Goldstein, *Guide to Clearance and Settlement: An Introduction to DTCC*, 8 (2009).

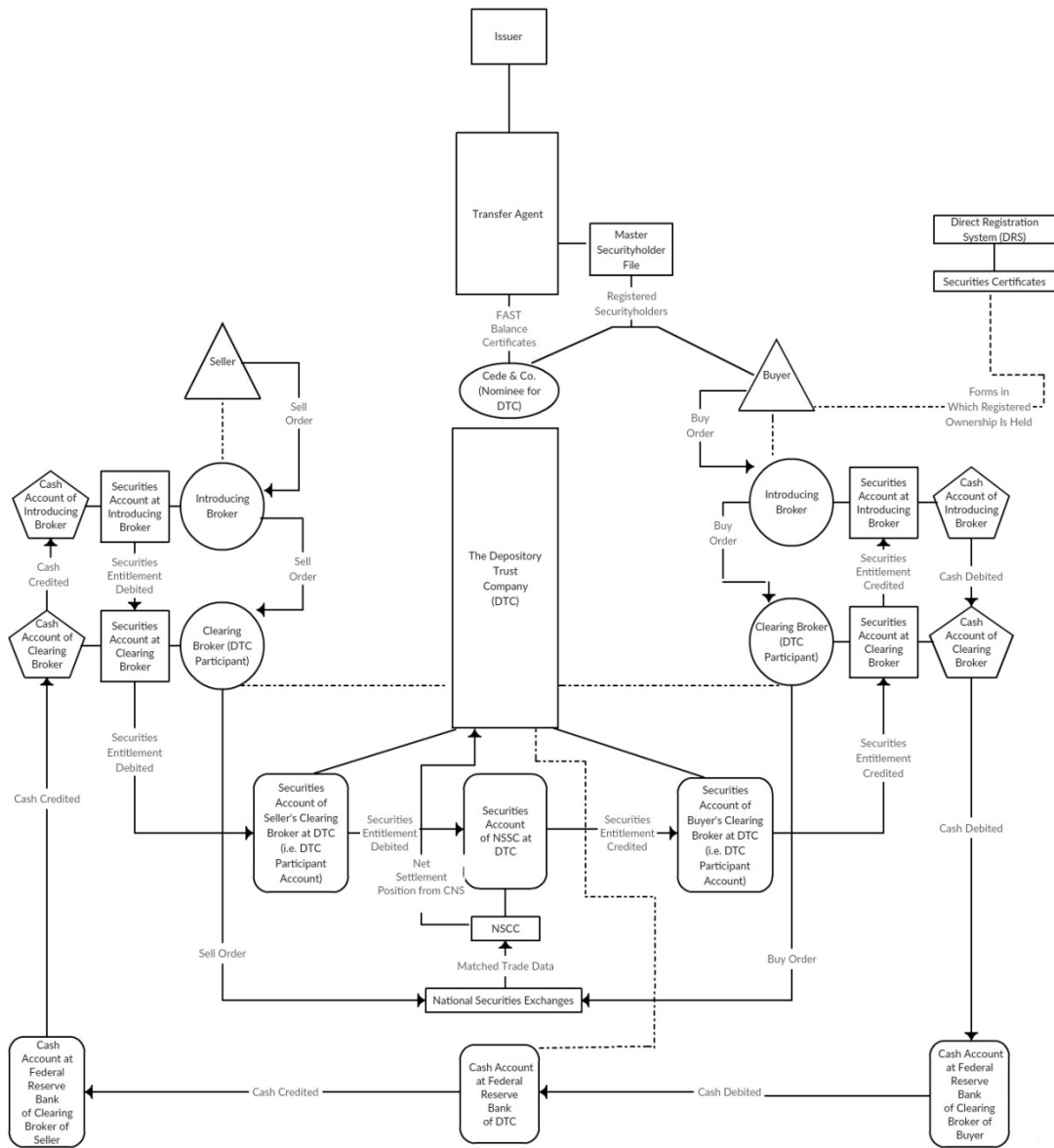
master securityholder file<sup>130</sup> maintained by the transfer agent and settlement will be effected by crediting and debiting the securities entitlement accounts of the buyer and seller, respectively.

Thus, final settlement of the securities leg of the transaction will involve the following sequential steps: (i) the DTC securities account of the seller's clearing broker will be debited with the securities being purchased; (ii) NSCC's securities account at DTC will be credited with the securities purchased; (iii) the DTC securities account of the buyer's clearing broker will also be credited; and (iv) each broker will credit or debit their respective customers' securities accounts held with the broker. On the cash side, final settlement will involve the following sequential steps: (i) the Federal Reserve bank account of the buyer's clearing broker will be debited for the sale price of the securities; (ii) DTC's Federal Reserve bank account will be credited for the sale price of the securities; (iii) DTC will transfer this cash to the Federal Reserve bank account of the seller's Clearing Broker; and (iv) each broker will credit or debit its respective customers' cash accounts held with the broker.

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<sup>130</sup> See infra Sections IV.A.3 and V.A. for additional description and discussion of transfer agents' role and responsibilities with respect to the master securityholder file.

Figure 1:



#### IV. TRANSFER AGENT REGULATION: ORIGINS AND CURRENT STATUS

This section provides a general overview of the federal and state law and other requirements, such as those of self-regulatory organizations (“SRO”), that apply to transfer agents and their activities. We begin with a review and discussion of each of the Commission’s

current transfer agent rules, then briefly discuss banking regulations and taxation-related requirements that may apply to transfer agents.<sup>131</sup> We then review the requirements of SROs that apply to transfer agents, particularly DTC and NYSE rules. Finally, we discuss the regulation of transfer agents under state law. Later, in Sections V, VI, and VII of the release, we discuss issues and concerns related to modern transfer agent activities and seek comment on the best approach to addressing them.

A. Federal Transfer Agent Rules

Prior to 1975, most transfer agents were banks or trusts.<sup>132</sup> There was no federal regulation of transfer agents and transfer agents were subject to state law, generally pursuant to UCC provisions.<sup>133</sup> Transfer agents were also subject to stock exchange requirements regarding securities processing. For example, in 1869, the NYSE adopted a requirement that all shares of NYSE-listed companies must be registered at a bank or other agency.<sup>134</sup> As another example, the “Chambers Street Rule” of the NYSE required transfer agents to maintain offices for transfer south of Chambers Street in New York City.<sup>135</sup> The American Stock Exchange had similar requirements in its Rule 891.<sup>136</sup>

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<sup>131</sup> See Section IV.B, supra, for discussion of bank transfer agents. Transfer agents that are not banks may be referred to as non-bank transfer agents.

<sup>132</sup> Unsafe Practices Study, supra note 17, at 38.

<sup>133</sup> For a discussion of state law requirements impacting transfer agent processes, see supra Sections II and III.

<sup>134</sup> See Facts and Figures, Historical, Chronology of New York Stock Exchange (1792-1929), available at [http://www.nyxdata.com/nysedata/asp/factbook/viewer\\_edition.asp?mode=table&key=2169&category=4](http://www.nyxdata.com/nysedata/asp/factbook/viewer_edition.asp?mode=table&key=2169&category=4).

<sup>135</sup> See Jerry W. Markham, A Financial History of the United States: From Christopher Columbus to the Robber Barons (1492-1900) 288 (2002).

<sup>136</sup> See, e.g., Securities Exchange Act Release No. 37562 (Apr. 25, 1996), 61 FR 43283 (Aug. 13, 1996) (File No. SR-DTC-96-09) (mentioning American Stock Exchange Rule 891 requirements). These requirements were criticized by non-New York banks providing transfer agent services as many banks viewed providing

The 1975 Amendments gave the Commission regulatory authority for the first time over transfer agents.<sup>137</sup> Section 3(a)(25) of the Exchange Act defines a “transfer agent” as any person who engages on behalf of an issuer of securities or on behalf of itself as an issuer of securities in:

- (A) countersigning such securities upon issuance;
- (B) monitoring the issuance of such securities with a view to preventing unauthorized issuance (i.e., a registrar);<sup>138</sup>
- (C) registering the transfer of such securities;
- (D) exchanging or converting such securities; or
- (E) transferring record ownership of securities by bookkeeping entry without the physical issuance of securities certificates.<sup>139</sup>

Section 17A(c)(1) of the Exchange Act requires any person performing any of these functions with respect to any security registered pursuant to Section 12 of the Exchange Act or with respect to any security which would be required to be registered except for the exemption contained in subsection (g)(2)(B) or (g)(2)(G) of Section 12 (“Qualifying Security”) to register

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transfer agent services as an important part of providing the full-service relationship it was believed was desired by corporate borrower clients. See Charles Welles, The Great Paper Fight: Who Will Control the Machinery?, Institutional Investor (May 1973), Hearings on S.2058 before S. Comm. on Banking, Hous. and Urban Affairs, Subcomm. on Securities, 93rd Cong. 334 (1973). The NYSE amended the Chambers Street Rule in 1971, permitting out-of-town transfer agents to act as listed company transfer agents, subject to certain conditions including that they maintain a “drop” office in lower Manhattan. In 2005, the Commission issued an order that approved an NYSE rule change that eliminated the Chambers Street Rule. Securities Exchange Act Release No. 51973 (July 5, 2005), 70 FR 40094 (July 12, 2015) (File No. SR-NYSE-2004-62).

<sup>137</sup> See S. Rep. No. 75, 57-58 (1975) (to accompany report S. 249). S. 249 is the principal legislative history of the Securities Acts Amendments of 1975 of which the transfer agent legislation was a part.

<sup>138</sup> For additional information regarding “registrars,” see supra note 51 and Sections II.B and II.C.1 and infra notes 298, 299, 320, 341 and Section IV.C.1.

<sup>139</sup> Exchange Act Section 3(a)(25), 15 U.S.C. 78c(a)(25). Note that any insurance company or separate account which performs such functions solely with respect to variable annuity contracts or variable life policies which it issues or any registered clearing agency which performs such functions solely with respect to options contracts which it issues is excluded from the definition of “transfer agent” under the Exchange Act. Id.

with the Commission or other Appropriate Regulatory Agency (“ARA”).<sup>140</sup> With respect to any transfer agent so registered, Section 17A(d)(1) of the Exchange Act authorizes the Commission to prescribe such rules and regulations as may be necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act.<sup>141</sup> Once a transfer agent is registered, either compulsorily or voluntarily,<sup>142</sup> the Commission “is empowered with broad rulemaking authority over *all* aspects of a transfer agent’s activities as a transfer agent.”<sup>143</sup>

Beginning in the late 1970s and early 1980s, the Commission adopted a series of transfer agent rules designed to regulate the basic recordkeeping and processing functions performed by transfer agents. The rules primarily related to routine transfers of certificated equity and debt securities and generally covered three areas: (i) registration and annual reporting requirements; (ii) timing and certain notice and reporting requirements related to securities transaction processing (referred to as “turnaround rules”); and (iii) recordkeeping and record retention rules and safeguarding requirements for securities and funds.

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<sup>140</sup> Exchange Act Section 17A(c)(1), 15 U.S.C. 78q-1(c)(1). Additionally, see infra Section IV.B for discussion of bank ARAs.

<sup>141</sup> As noted in the Committee Report which accompanied Section 17A(d)(1) of S.249, the precursor to Section 17A(d)(1) of the 1975 Amendments, Congress intended to “. . . empower[] [the Commission] with broad rulemaking authority over all aspects of a transfer agents’ activities as transfer agent.” Senate Report on Securities Act Amendments of 1975, supra note 44, at 57.

<sup>142</sup> There is no statutory or other prohibition on voluntary registration as a transfer agent, although it is relatively uncommon. See generally, Exchange Act Section 17A(c), 15 U.S.C. 78q-1(c). See also infra Section VII.B.1, discussing the practice of voluntary registration as transfer agents by certain third party administrators (“TPA”).

<sup>143</sup> See Senate Report on Securities Act Amendments of 1975, supra note 44. The Committee Report elaborated that it expected the Commission’s regulations “to include, among other matters, minimum standards of performance, the prompt and accurate processing of securities transactions, and operational compatibility of and cooperation by transfer agents with other facilities and participants in the securities handling process.” Id.



As discussed more fully below, processing obligations related to mutual funds, dividend reinvestment plans (“DRIPs”),<sup>144</sup> and limited partnerships were expressly exempted from most of the processing and recordkeeping rules because at the time, the Commission believed that the activities required for the redemption of investment company shares and shares purchased or sold through a DRIP were significantly different from those required for the transfer of stocks and bonds.<sup>145</sup> Although the Commission has made modest revisions to the initial transfer agent rules and has added several new rules since the adoption of those earlier rules, the core registration, processing, recordkeeping, and safeguarding rules remain substantially unchanged, and the exemptions for mutual funds, DRIPs, and limited partnerships have not been revisited.

*1. Registration and Annual Reporting Requirements*

The rules setting forth the registration, annual reporting, and withdrawal requirements for transfer agents are found in Exchange Act Rules 17Ac2-1 (application for registration), 17Ac2-2 (annual reporting), and 17Ac3-1 (withdrawal from registration).

Rule 17Ac2-1 and Form TA-1

Before a transfer agent may perform any of the statutory transfer agent functions defined in Section 3(a)(25) of the Exchange Act for a Qualifying Security, it must apply for registration by submitting Form TA-1 (Uniform Form of Registration as a Transfer Agent and for Amendment to Registration) to its ARA and its registration as a transfer agent with its ARA must

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<sup>144</sup> DRIPs allow investors who already own an issuer’s stock to reinvest their cash dividends by purchasing additional shares or fractional shares directly from the issuer or the issuer’s transfer agent, without going through a broker. Most DRIPs require the investor to become a registered securityholder, as opposed to a street name holder.

<sup>145</sup> See Regulation of Transfer Agents, Exchange Act Release No. 13636 (June 16, 1977), 42 FR 32404, 32408 (June 24, 1977) (“Rule 17Ad-1 through 17Ad-7 Adopting Release”).

have become effective.<sup>146</sup> Form TA-1 requires a transfer agent seeking to register to disclose information including the following: (a) general identification information<sup>147</sup> about the transfer agent and whether it is part of any service company arrangements;<sup>148</sup> (b) the identity of its direct and indirect owners and other control persons;<sup>149</sup> and (c) whether it or any of its control affiliates has been subject to investment-related criminal prosecutions, regulatory actions, or civil actions.<sup>150</sup> The registration automatically becomes effective 30 days after the Form TA-1 is filed, unless the ARA takes affirmative action to accelerate, deny, or postpone registration in accordance with the provisions of Section 17A(c) of the Exchange Act.<sup>151</sup> A registrant must amend its Form TA-1 within 60 days following the date on which information reported therein

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<sup>146</sup> Exchange Act Section 17A(c)(1), 15 U.S.C. 78q-1(c)(1); 17 CFR 240.17Ac2-1; SEC Form TA-1, 17 CFR 249b.100. Once registration has become effective, a transfer agent may be subject to censure, suspension, limitation, or revocation of its registration if the transfer agent or any person associated with the transfer agent fails to obey Commission rules or violates certain of the securities laws. Exchange Act Section 17A(c)(3), 15 U.S.C. 78q-1(c)(3); Exchange Act Section 17A(c)(4)(C), 15 U.S.C. 78q-1(c)(4)(C).

<sup>147</sup> SEC Form TA-1, Items 1-7 (concerning basic identification information (such as name, contact person, phone number, address and email address), identification numbers including the transfer agent's file number and FINS number, and information concerning service company arrangements in which the registrant may be involved). The file number for a transfer agent registered with the Commission would be the file number assigned by the Commission. A FINS number, short for Financial Industry Number Standard, is a unique five digit number issued by DTC and used by the securities industry as a means of identifying financial institutions in automated data processing systems. See Notice of Assumption or Termination of Transfer Agent Services, Exchange Act Release No. 35039 n.12 (Dec. 1, 1994), 59 FR 63656 (Dec. 8, 1994) ("Adopting Release for Rule 17Ad-16"); See Becoming a DTC-Eligible Agent, DTCC, <http://www.dtcc.com/asset-services/agent-services/dtc-eligible-agent> (information provided by DTCC, the parent company of DTC, including a form for authorizing DTC to issue a FINS number).

<sup>148</sup> For definition of "service company," see *infra* note 241 and accompanying text.

<sup>149</sup> SEC Form TA-1, Items 8 and 9, 17 CFR 249b.100.

<sup>150</sup> SEC Form TA-1, Item 10, 17 CFR 249b.100.

<sup>151</sup> Exchange Act Rule 17Ac2-1(a), 17 CFR 240.17Ac2-1(a); SEC Form TA-1, General Instruction G, 17 CFR 249b.100. Note that the 30-day time period in Exchange Act Rule 17Ac2-1(a), 17 CFR 240.17Ac2-1(a), is shorter than the Exchange Act's 45-day time period for applications to be effective. Exchange Act Section 17A(c)(2), 15 U.S.C. 78q-1(c)(2).

becomes inaccurate, incomplete, or misleading.<sup>152</sup> For transfer agents for whom the Commission is their ARA, they must file Form TA-1 and amendments thereto electronically on the Commission's EDGAR system and each answer provided by the transfer agent is required to be formatted as an XML data tag.<sup>153</sup>

#### Rule 17Ac2-2 and Form TA-2

All registered transfer agents, regardless of their ARA, must file an annual report with the Commission using Form TA-2 (Form for Reporting Activities of Transfer Agents Registered Pursuant to Section 17A of the Securities Exchange Act of 1934).<sup>154</sup> Form TA-2 covers a calendar year reporting period that ends on December 31<sup>155</sup> and must be filed by March 31 of the year following the end of the reporting period. Form TA-2 must be filed electronically on the Commission's EDGAR system and each answer provided by the transfer agent is required to be formatted as an XML data tag.<sup>156</sup>

Form TA-2 requires transfer agents to identify and report on the use of service companies, or other transfer agents, in connection with their transfer agent activities. It also requires transfer agents to provide annual data regarding the transfer agent's compliance with the

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<sup>152</sup> Exchange Act Rule 17Ac2-1(c), 17 CFR 240.17Ac2-1(c); SEC Form TA-1, General Instruction H, 17 CFR 249b.100.

<sup>153</sup> Exchange Act Rule 17Ac2-1(d), 17 CFR 240.17Ac2-1(d); Electronic Filing of Transfer Agent Forms, Exchange Act Release No. 54864, 5 (Dec. 4, 2006), 71 FR 74698 (Dec. 12, 2006) ("Electronic Filing of Transfer Agent Forms Release").

<sup>154</sup> Exchange Act Rule 17Ac2-2(a), 17 CFR 240.17Ac2-2(a); SEC Form TA-2, 17 CFR 249b.102 (Form for Reporting Activities of Transfer Agents Registered Pursuant to Section 17A of the Securities Exchange Act of 1934).

<sup>155</sup> Exchange Act Rule 17Ac2-2(b), 17 CFR 240.17Ac2-2(b).

<sup>156</sup> Exchange Act Rule 17Ac2-2(c), 17 CFR 240.17Ac2-2(c); Electronic Filing of Transfer Agent Forms Release, supra note 153, at 5.

turnaround rules. Additionally, the form requires transfer agents to provide the Commission with updated information about their business activities, including accounts administered, items received,<sup>157</sup> turnaround performance, total amounts of funds distributed, and lost securityholder accounts.<sup>158</sup>

Rule 17Ac2-2 provides exemptions from completing certain sections of Form TA-2 for small transfer agents and for transfer agents that outsource their work completely to service companies. If a registered transfer agent received fewer than 1,000 items for transfer in the reporting period and did not maintain master securityholder files for more than 1,000 individual securityholder accounts as of December 31 of the reporting period, it is only required to complete Questions 1 through 5, 11, and the signature section of Form TA-2.<sup>159</sup> A named transfer agent that engaged a service company to perform all of its transfer agent functions during the reporting period is only required to complete Questions 1 through 3 and the signature section of Form TA-2.<sup>160</sup>

The Commission, other ARAs and members of the public (including issuers and investors) use information on Forms TA-1 and TA-2. The Commission's EDGAR database provides a means through which information on these forms can be searched and retrieved. The Commission uses the information on Form TA-1 to review an entity's application for registration as a transfer agent and to maintain current information about transfer agents. The Commission

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<sup>157</sup> See generally, Section IV.A.2 for discussion of "item."

<sup>158</sup> See generally, SEC Form TA-2, 17 CFR 249b.102.

<sup>159</sup> Exchange Act Rule 17Ac2-2(a)(1), 17 CFR 240.17Ac2-2(a)(1).

<sup>160</sup> Exchange Act Rule 17 Ac2-2(a)(2), 17 CFR 240.17Ac2-2(a)(2).

uses information on Form TA-2, as well as information on Form TA-1 and amendments thereto, for several purposes, including: (i) to determine the nature of the business conducted by a transfer agent, (ii) to monitor transfer agent activities and to evaluate compliance with Commission rules, and (iii) to inform Commission transfer agent policymaking.<sup>161</sup> In connection with monitoring of and checking regulatory compliance by transfer agents, the Commission's examination and inspections program may use the information on Forms TA-1 and TA-2 to plan their site visits in connection with an exam. The examination staff of the Commission may also use the information on Forms TA-1 and TA-2 to identify particular issues to focus on during an exam or to analyze industry trends and to provide basic census information concerning registered transfer agents. In addition, Form TA-1 and TA-2 data provide the Commission with information about securities processing issues that may need to be addressed by Commission rulemaking. Form TA-1 and TA-2 data is also used by the Commission to assist it in evaluating the costs and benefits of potential rulemaking.

#### Rule 17Ac3-1 and Form TA-W

Pursuant to Rule 17Ac3-1, a registered transfer agent may voluntarily withdraw its registration by filing Form TA-W (Notice of Withdrawal from Registration as a Transfer Agent) with the relevant ARA, disclosing, among other things, any actual or potential claims or legal proceedings against the transfer agent, its reasons for withdrawing or ceasing to function as a transfer agent, and whether one or more successor transfer agents will take over the maintenance

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<sup>161</sup> See Adoption of Revised Transfer Agent Forms and Related Rules, Exchange Act Release No. 23084 (Mar. 27, 1986), 51 FR 12124 (Apr. 9, 1986) ("Revised Transfer Agent Forms and Related Rules"); Electronic Filing of Transfer Agent Forms Release, supra note 153, at 5.

of its transfer books.<sup>162</sup> Withdrawal from registration automatically becomes effective 60 days after filing Form TA-W, unless the Commission or applicable ARA finds it in the public interest to take affirmative action to accelerate, deny, or postpone the request.<sup>163</sup>

2. *Processing, Reporting, Recordkeeping, and Exemptions: Rules 17Ad-1 Through 17Ad-7 and Rules 17f-1 and 17f-2*

On June 16, 1977, the Commission adopted Rules 17Ad-1 through 17Ad-7 as a set of performance standards for transfer agents.<sup>164</sup> These turnaround and processing rules were “designed to protect investors . . . and to contribute to the establishment of the national system for the prompt and accurate clearance and settlement of transactions in securities by,” among other things, “assuring that the transfer agent community performs its functions in a prompt, accurate and more predictable manner.” The rules primarily focused on establishing minimum performance and recordkeeping standards for routine transfers of certificated equity and debt securities and the prompt and accurate cancellation and issuance of certificated securities.<sup>165</sup> The rules were also designed to provide an early warning system to alert issuers and regulatory agencies when the performance standards are not being met, prohibit under-performing transfer agents from expanding their operations, require transfer agents to respond promptly to certain written inquiries regarding items presented for transfer, and require the maintenance and preservation of certain records necessary for regulatory authorities to monitor and enforce

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<sup>162</sup> Exchange Act Rule 17Ac3-1, 17 CFR 240.17Ac3-1; Exchange Act Section 17A(c)(3)(a), 15 U.S.C. 78q-1(c)(3)(A); SEC Form TA-W, 17 CFR 249b.101 (Notice of Withdrawal from Registration as a Transfer Agent).

<sup>163</sup> Exchange Act Rule 17Ac3-1(b), 17 CFR 240.17Ac3-1(b).

<sup>164</sup> Exchange Act Rules 17Ad1-7, 17 CFR 240.17Ad-1-7.

<sup>165</sup> See Rule 17Ad-1 through 17Ad-7 Adopting Release, *supra* note 145, at 32404.

transfer agent compliance with the turnaround rules.<sup>166</sup> The specific processing, reporting, and retention requirements were metrics-based and, at the time, considered to be those necessary to ensure that transfer agents adequately performed their functions and that the Commission and other ARAs would be able to monitor transfer agents' compliance with the turnaround rules.<sup>167</sup> Further, the new transfer agent rules established by the Commission were designed not only to ensure that transfer agents meet prescribed performance standards for their core recordkeeping and transfer activities, but to ensure they would be regulated appropriately in the context of the National C&S System and that any problems meeting these performance standards would not negatively impact individual investors or the clearance and settlement system as a whole.<sup>168</sup> Each rule is discussed in detail below.

Rule 17Ad-1 defines the relevant terms used throughout the rules. One of the most important is “item,” which is defined as the certificates of a single issue of securities presented under one ticket,<sup>169</sup> and is the basic unit for which the turnaround and other processing requirements apply.<sup>170</sup> The other key definitions in Rule 17Ad-1 are “transfer” and “turnaround.” “Transfer” of a certificated security (where an outside registrar is not involved) is the completion of all acts necessary to cancel the certificate, issue a new one, and make it

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<sup>166</sup> Id. See also Exchange Act Rules 17Ad-1-7, 17 CFR 240.17Ad-1-7.

<sup>167</sup> Rule 17Ad-1 through 17Ad-7 Adopting Release, supra note 145, at 32410.

<sup>168</sup> Rule 17Ad-1 through 17Ad-7 Adopting Release, supra note 145, at 32407 (noting the importance of avoiding impediments to “the Commission’s efforts to provide necessary or appropriate regulations for transfer agents in the broader context of the establishment of a national system for the prompt and accurate clearance and settlement of securities transactions.”).

<sup>169</sup> Exchange Act Rule 17Ad-1(a)(1), 17 CFR 240.17Ad-1(a)(1) (definition of “item”). See supra note 17 (describing tickets).

<sup>170</sup> Rule 17Ad-1 through 17Ad-7 Adopting Release, supra note 145, at 32404.

available to the presenter, and “turnaround” for an item (where an outside registrar is not involved) is completed when transfer is accomplished.<sup>171</sup>

Rule 17Ad-2 sets the basic performance standards for transfer agents.<sup>172</sup> Transfer agents who are not acting as a registrar must turnaround within three business days of receipt at least 90% of all “routine items”<sup>173</sup> received by the transfer agent during any month.<sup>174</sup> Non-routine items must receive “diligent and continuous attention” and must be “turned around as soon as possible.”<sup>175</sup> Routine items that are not turned around within three business days nevertheless must be “turned around promptly.”<sup>176</sup> Registered transfer agents acting as a registrar must “process” at least 90% of all items received during any given month no later than noon of the next business day for any item received after noon and no later than the opening of business on the next business day for those items received at or before noon.<sup>177</sup> If a transfer agent fails to meet the performance standards for turnaround set forth in Rule 17Ad-2 with respect to any month, it must notify the Commission and the transfer agent’s ARA if it is not the Commission

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<sup>171</sup> Exchange Act Rule 17Ad-1(d), (e), 17 CFR 240.17Ad-1(d), (e).

<sup>172</sup> As discussed in more detail infra in Section IV.C.1, the NYSE imposes a 48 hour turnaround requirement.

<sup>173</sup> Routine items are defined by Rule 17Ad-1(i), 17 CFR 240.17Ad-1(i). They are generally defined in the negative such that most items are considered routine so long as they do not require the requisition of a new certificate that the transfer agent does not have on hand, are not subject to a stop order, adverse claim, or other restriction on transfer, do not require certain additional documentation or review to complete the transfer, do not involve a transfer in connection with certain types of corporate actions, do not include a security of an issue which within the previous 15 business days was offered to the public pursuant to a Securities Act registration statement in an offering of a non-continuing nature, and do not include a warrant, right or convertible security either presented for transfer within five business days before rights expire or change or presented for exercise or conversion.

<sup>174</sup> Exchange Act Rule 17Ad-2(a), 17 CFR 240.17Ad-2(a). We note that with automation, these standards are substantially easier to meet than when the rule was adopted in 1977.

<sup>175</sup> Exchange Act Rule 17Ad-2(e), 17 CFR 240.17Ad-2(e).

<sup>176</sup> Id.

<sup>177</sup> Exchange Act Rule 17Ad-2(e), 17 CFR 240.17Ad-2(b).



within 10 business days of the end of the month, provide certain turnaround data regarding specific numbers and percentages of items, explain the reasons for the failure, identify what steps have been taken to prevent future failures, and provide certain data regarding routine items that have not been turned around and have been in the transfer agent's possession for "more than four business days."<sup>178</sup> Similar notification requirements apply where a transfer agent acting as a registrar fails to meet the processing performance standards.<sup>179</sup>

Rule 17Ad-3 provides limitations on the expansion of transfer agent activities if a transfer agent is unable to meet the minimum performance standards established by Rule 17Ad-2. Any transfer agent that is required pursuant to Rule 17Ad-2 to provide notice for failure to meet the performance standards for three consecutive months is prohibited from taking on new issues or providing new services for existing issues.<sup>180</sup> Further, if a transfer agent fails to turnaround or process at least 75% of all routine items, it must notify the chief executive officer of each issuer for which the transfer agent acts.<sup>181</sup> Thus, Rules 17Ad-2 and 17Ad-3, taken together, provide an early warning system to alert issuers, the Commission and other ARAs of untimely performance and potential problems.

Rule 17Ad-4 provides certain exemptions from the turnaround, processing, and recordkeeping rules.<sup>182</sup> Rule 17Ad-4(a) creates an exemption from Rules 17Ad-2, 17Ad-3, and

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<sup>178</sup> Exchange Act Rule 17Ad-2(c), 17 CFR 240.17Ad-2(c).

<sup>179</sup> Exchange Act Rule 17Ad-2(d), 17 CFR 240.17Ad-2(d).

<sup>180</sup> Exchange Act Rule 17Ad-3(a), 17 CFR 240.17Ad-3(a). Such limitations on the business of the transfer agent continue until there has been a period of three successive months in which no notices have been required.

<sup>181</sup> Exchange Act Rule 17Ad-3(b), 17 CFR 240.17Ad-3(b).

<sup>182</sup> Exchange Act Rule 17Ad-4, 17 CFR 240.17Ad-4.

17Ad-6(a)(1)-(7) for the processing of interests in limited partnerships, DRIPs, and redeemable securities issued by investment companies registered under Section 8 of the Investment Company Act of 1940 (“Investment Company Act”), which are also known as open-end funds.<sup>183</sup> In 1977, the rationale for providing the exemption for interests in limited partnerships was “the low volume of transfers of such interests,”<sup>184</sup> while the rationale for providing the exemption for DRIPs was the Commission’s view at the time that transfer agents’ processing for DRIPs “require[s] procedures significantly different from the procedures required to transfer ownership of stocks and bonds.”<sup>185</sup>

The Commission expressed the same rationale with respect to redeemable securities of registered investment companies, stating that transactions in these securities were “significantly different from the transfer of ownership of stocks and bonds on issuer’s records.”<sup>186</sup> In addition, the Commission noted that such activity “is subject to Section 22(e) of the Investment Company

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<sup>183</sup> Investment Company Act Section 8, 15 U.S.C. 80a-8. See generally, Section VII.C for discussion of transfer agents for investment companies and the handling of redeemable securities issued by investment companies.

<sup>184</sup> Regulation of Transfer Agents, Exchange Act Release No. 13293 (Feb. 24, 1977) (“Rule 17Ad-1 through 17Ad-7 Re-Proposing Release”) (“From the information provided in SEC Form TA-1, 17 CFR 249b.100, the low volume of transfers of such [limited partnership] interests suggests that they may appropriately be exempted from revised [Rules 17Ad-2, 17Ad-3, and 17Ad-6(a)(1) through (a)(7)].”).

<sup>185</sup> Rule 17Ad-1 through 17Ad-7 Adopting Release, supra note 45 (“Lastly, the exemptions of paragraph 17Ad-4(a) have been expanded to include the transfers and withdrawals of shares from dividend reinvestment plans which...require procedures significantly different from the procedures required to transfer ownership of stocks and bonds.”)

<sup>186</sup> Rule 17Ad-1 through 17Ad-7 Adopting Release, supra note 145, at n.13. As originally proposed, the exemption would have been for “securities of open-end investment companies,” rather than “redeemable securities of investment companies.” See Rule 17Ad-1 through 17Ad-7 Re-Proposing Release, supra note 184. By adding the word “redeemable,” redeemable securities of registered unit investment trusts (“UIT”) were included within the exemption. However, because closed-end investment companies do not issue redeemable securities, transfer agents servicing closed-end fund securities are not within the exemption. Rule 17Ad-1 through 17Ad-7 Adopting Release, supra note 145, at n.14 (“The turnaround rules do apply to registered transfer agents performing transfer agent functions for securities issued by closed-end investment companies.”) (emphasis added).

Act of 1940, 15 U.S.C. 80a-22(e),”<sup>187</sup> and that “[t]he amount of certificated fund shares is relatively small, and the amount of transfer agent activity in connection with transferring ownership of certificated shares represents a very small part of a transfer agent’s activity with regard to an open-end investment company.”<sup>188</sup> For these reasons, the Commission believed at the time that “it would be desirable to study further the need for, and the nature of, minimum performance standards for the transfer of securities effected by open-end investment companies registered under Section 8 of the Investment Company Act, 15 U.S.C. 80a-8.”<sup>189</sup>

Rule 17Ad-4(b) provides a similar exemption for certain small transfer agents by exempting a registered transfer agent from the turnaround, processing, recordkeeping, and other provisions of Rules 17Ad-2(a), (b), (c), (d) and (h), 17Ad-3, and 17Ad-6(a)(2)-(7) and (11), provided the transfer agent has received fewer than 500 items for transfer and fewer than 500 items for processing within a consecutive six month period, and provided that the transfer agent has filed proper notice of its exempt status with its ARA or has prepared a document certifying that the transfer agent qualifies as exempt (with respect to those ARAs where filing is not required).<sup>190</sup> The rationale behind this exemption was that, because the number of transfers performed by these smaller transfer agents was relatively small and involved issues which are not traded actively, it was not necessary or appropriate at that time to require those smaller

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<sup>187</sup> Rule 17Ad-1 through 17Ad-7 Adopting Release, supra note 145, at 32408.

<sup>188</sup> Rule 17Ad-1 through 17Ad-7 Adopting Release, supra note 145, at n.13.

<sup>189</sup> Rule 17Ad-1 through 17Ad-7 Re-Proposing Release, supra note 184.

<sup>190</sup> The filing of notices of exempt status for these small transfer agents is required where the ARA is the Federal Deposit Insurance Corporation (“FDIC”) or the Federal Reserve. Where the ARA is the Commission or the Office of the Comptroller of the Currency, the exempt transfer agent is not required to file a notice but must prepare a document certifying that the transfer agent qualifies as exempt and retain it in its records. See Exchange Act Rule 17Ad-4(b)(3), 17 CFR 240.17Ad-4(b)(3).

transfer agents to comply with the minimum performance standards, recordkeeping provisions, and other requirements in those rules.<sup>191</sup>

Rule 17Ad-5 generally requires a registered transfer agent to respond within prescribed timeframes to certain types of written inquiries.<sup>192</sup> Rule 17Ad-5(a) requires a registered transfer agent to respond within five business days following the receipt of an inquiry from any “person” concerning the status of an item presented for transfer by such person or their agent during the preceding six months, provided the inquirer provides specific information concerning the item.<sup>193</sup> Rule 17Ad-5(b) requires a registered transfer agent to respond to any “broker-dealer” inquiry within five business days confirming or denying whether it has possession of a security presented for transfer and, if it has possession, acknowledging the transfer instructions or revalidating the window ticket,<sup>194</sup> provided the broker-dealer provides certain identifying information.<sup>195</sup> Rule 17Ad-5(c) requires a registered transfer agent to respond within 10 business days confirming or denying possession of a security where any person or their agent has requested that the transfer agent confirm possession as of a given date of a certificate presented by such person during the preceding 30 days<sup>196</sup> and provides information similar to that which is

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<sup>191</sup> Rule 17Ad-1 through 17Ad-7 Adopting Release, supra note 145, at 32408.

<sup>192</sup> Exchange Act Rule 17Ad-5, 17 CFR 240.17Ad-5. The response must generally be in writing, however, Rule 17Ad-5(f)(1) permits a telephone response if (i) the telephone response resolves the inquiry and (ii) the inquirer does not request a written response. Exchange Act Rule 17Ad-5(f)(1), 17 CFR 240.17Ad-5(f)(1).

<sup>193</sup> Exchange Act Rule 17Ad-5(a), 17 CFR 240.17Ad-5(a) (requiring inquirer to provide: (i) the issue, (ii) the number of shares or units (or principal amount of debt securities), (iii) the approximate date of presentation, and (iv) the name in which the item is registered).

<sup>194</sup> Exchange Act Rule 17Ad-5(b), 17 CFR 240.17Ad-5(b).

<sup>195</sup> Id. See also supra note 193 (concerning information to be provided by inquirers).

<sup>196</sup> Exchange Act Rule 17Ad-5(c), 17 CFR 240.17Ad-5(c).

required under Rules 17Ad-5(a) and (b).<sup>197</sup> If required by the transfer agent, the inquirer must also provide assurance of payment.<sup>198</sup> Rule 17Ad-5(d) requires a registered transfer agent to respond within 20 business days where any person requests a transcript of such person's account with respect to a particular securities issue as of a certain date not more than six months prior to the request.<sup>199</sup> If required by the transfer agent, the inquirer must provide the transfer agent assurance of payment of a reasonable fee for this service.<sup>200</sup>

Rules 17Ad-6 and 17Ad-7, taken together, address some of the basic aspects of the records that transfer agents must maintain and for how long.<sup>201</sup> Rule 17Ad-6 generally details what records every registered transfer agent shall make and keep. Rule 17Ad-6(a)(1) requires every registered transfer to make and keep receipts, tickets, logs, schedules, journals, and other records showing the number of routine and non-routine items received and made available each business day.<sup>202</sup> Rules 17Ad-6(a)(2) through (4) require maintenance of records that generally relate to the monitoring of performance standards for turnaround and for processing under Rule 17Ad-2 for each month and notices required to be filed under Rule 17Ad-2<sup>203</sup> and any written inquiries or requests, including those inquiries to transfer agents where the inquiries were not subject to Rule 17Ad-5 or inquiries which were answered orally or where no response was made. Rule 17Ad-6(a)(8) requires maintenance of any contracts and certain related documentation

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<sup>197</sup> Id. See also supra note 193 (concerning information to be provided by inquirers).

<sup>198</sup> Id.

<sup>199</sup> Exchange Act Rule 17Ad-5(d), 17 CFR 240.17Ad-5(d).

<sup>200</sup> Id.

<sup>201</sup> Exchange Act Rule 17Ad-6, 17 CFR 240.17Ad-6.

<sup>202</sup> Exchange Act Rule 17Ad-6(a)(1), 17 CFR 240.17Ad-6(a)(1).

<sup>203</sup> Exchange Act Rule 17Ad-6(a)(2)-(4), 17 CFR 240.17Ad-6(a)(2)-(4).

showing the appointment or termination of the registered transfer agent to serve in any capacity on behalf of an issuer.<sup>204</sup> Rule 17Ad-6(a)(9) requires records of: (i) currently active stop orders;<sup>205</sup> (ii) adverse claims;<sup>206</sup> and (iii) restrictions on transfer.<sup>207</sup>

Rule 17Ad-7 specifies the particular lengths of time for which the various records described in Rule 17Ad-6 shall be maintained.<sup>208</sup> While the records listed in Paragraph (a)(1) of this rule were generally, at the time of its adoption in 1977, paper records such as receipts, tickets, schedules, they now are likely to be electronic records. Rule 17Ad-7(f), was updated in 2001 and 2003 to authorize the use of electronic recordkeeping, electronic storage media, and micrographic storage media, such as microfilm records.<sup>209</sup> Paragraph (g) of Rule 17Ad-7 regulates transfer agent records maintained by an outside service bureau, other recordkeeping service or the issuer.”<sup>210</sup> Paragraph (h) states that when a registered transfer agent ceases to perform transfer agent functions, its responsibilities under this provision “shall end upon the

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<sup>204</sup> Exchange Act Rule 17Ad-6(a)(8), 17 CFR 240.17Ad-6(a)(8).

<sup>205</sup> For discussion of stop orders as a general matter, see supra notes 25 and 26.

<sup>206</sup> For discussion of an adverse claim in connection with protected purchaser status under the UCC, see supra note 14 and accompanying text. Regarding the existence of an adverse claim as a factor resulting in classification of an item as non-routine under the Commission’s transfer agent rules, see supra note 173, Exchange Act Rule 17Ad-1(i), 17 CFR 240.17Ad-1(i).

<sup>207</sup> For discussion of securities subject to restrictions on transfer and of restrictive legends, see infra Section VI.D.

<sup>208</sup> Exchange Act Rule 17Ad-7, 17 CFR 240.17Ad-7.

<sup>209</sup> See Recordkeeping Requirements for Transfer Agents, Exchange Act Release No. 44227 (Apr. 27, 2001), 66 FR 21659 (May 1, 2001); Recordkeeping Requirements for Registered Transfer Agents, Exchange Act Release No. 48949 (Dec. 18, 2003), 68 FR 75050 (Dec. 29, 2003) (“Recordkeeping Requirements for Transfer Agents”).

<sup>210</sup> Exchange Act Rule 17Ad-7(g), 17 CFR 240.17Ad-7(g).

delivery of such records to the successor transfer agent,” a provision that was originally included to clarify when a transfer agent is relieved of such recordkeeping responsibilities.<sup>211</sup>

Rule 17f-1<sup>212</sup> was adopted in 1976 pursuant to Section 17(f)(1) of the Exchange Act in order to curtail trafficking in lost, stolen, missing, and counterfeit securities certificates.<sup>213</sup> It requires reporting institutions, which are defined as national securities exchanges, brokers, dealers, registered transfer agents, and others, to report missing, lost, counterfeit, or stolen securities to the Commission or its designee. This led to the Commission’s implementation in 1977 of the Lost and Stolen Securities Program and also led to subsequent Commission releases addressing in detail the structure of the program.<sup>214</sup> The program became fully operational on January 2, 1978 and consists mainly of an electronic database for securities certificates that have been reported lost, stolen, missing, or counterfeit.<sup>215</sup> The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank Act”) expanded Section 17(f)(1)’s statutory

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<sup>211</sup> Rule 17Ad-1 through 17Ad-7 Adopting Release, supra note 145, at 32411.

<sup>212</sup> Exchange Act Section 17(f)(1), 15 U.S.C. 78q(f)(1); Exchange Act Rule 17f-1, 17 CFR 240.17f-1. See also Adoption of Reporting and Inquiry Requirements with Respect to Missing, Lost, Stolen and Counterfeit Securities, Exchange Act Release No. 13053 (Dec. 15, 1976), 41 FR 54923 (Dec. 16, 1976) (order adopting Rule 17f-1).

<sup>213</sup> See Senate Report on Securities Act Amendments of 1975, supra note 44 at 103-4; see also Hearings before the Permanent Subcomm. on Investigations of the S. Comm. on Gov’t Operations, 93<sup>rd</sup> Cong., 1st Sess. (1973), 2nd Sess. (1974).

<sup>214</sup> See, e.g., Implementation of program for reporting and inquiry with respect to missing, lost counterfeit or stolen securities, Exchange Act Release No. 13832 (Aug. 5, 1977), 42 FR 41022 (Aug. 12, 1977) (order adopting Release implementing the Lost and Stolen Securities Program); U.C.C. 8-405 (“Replacement of Lost, Destroyed, or Wrongfully Taken Security Certificate”).

<sup>215</sup> See supra note 25. Lost and Stolen Securities Program Amendments, Exchange Act Release No. 15867 (May 23, 1979), 44 FR 31500 (May 31, 1979).

coverage to add securities certificates that are cancelled to the categories that must be reported to the Commission or its designee.<sup>216</sup>

Rule 17f-2 was adopted in 1976 and requires the fingerprinting of certain securities industry personnel.<sup>217</sup> In accordance with its governing statute, Section 17(f)(2) of the Exchange Act,<sup>218</sup> Rule 17f-2 requires, with certain exemptions, the fingerprinting of all partners, directors, officers, and employees of brokers, dealers, registered transfer agents, and registered clearing agencies. The Dodd-Frank Act expanded Section 17(f)(2)'s statutory coverage to include the personnel of national securities exchanges, national securities associations, and registered securities information processors.<sup>219</sup>

3. *Recordkeeping and Safeguarding Rules: Rules 17Ad-8 through 17Ad-13*

The new regulatory regime established by the turnaround rules provided the Commission with visibility into the transfer agent industry and a way to review and analyze it. The first six years of monitoring transfer agent performance under the new regulatory regime highlighted some of the significant adverse operational and financial consequences for the securities industry, securities markets, issuer community, and investing public that could occur when a transfer agent's operations collapse, when records maintained by a transfer agent contain significant inaccuracies, or when a transfer agent's internal accounting controls are

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<sup>216</sup> Pub. L. No. 111-203, 124 Stat. 1376, § 929D (2010).

<sup>217</sup> Exchange Act Rule 17f-2, 17 CFR 240.17f-2; Lost and Stolen Securities Program Amendments, Exchange Act Release No. 12214 (Mar. 16, 1976), 41 FR 13594 (Mar. 31, 1976) (order adopting Rule 17f-2).

<sup>218</sup> Exchange Act Rule 17(f)(2), 15 U.S.C.78q(f)(2).

<sup>219</sup> Pub. L. No. 111-203, 124 Stat. 1376, § 929S.



inadequate.<sup>220</sup> The Commission therefore determined that additional rulemaking was necessary and appropriate to supplement the turnaround rules.

The impetus for Rule 17Ad-8 was the recommendation in the Final Street Name Study that “each depository be required to transmit periodically to each issuer whose securities the depository holds of record a list of the persons on whose behalf the depository holds the securities.”<sup>221</sup> The rule, which was adopted in 1980, requires every registered clearing agency to provide promptly to each issuer or transfer agent acting on its behalf, upon request, a securities position listing which identifies the participants on whose behalf the clearing agency holds the issuer’s securities in the name of the clearing agency or its nominee and the respective positions in such securities as of a specified date.<sup>222</sup> The clearing agency may charge issuers who request this service with fees designed to recover its reasonable costs.<sup>223</sup>

On June 10, 1983, the Commission adopted Rules 17Ad-9 through 17Ad-13.<sup>224</sup> These new rules established various requirements and exemptions designed to ensure that transfer agents maintain appropriate internal controls, meet adequate levels of service and performance, and avoid adverse operational and financial problems that could harm investors, issuers, or other securities industry participants. Most notably, the new rules established additional minimum

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<sup>220</sup> See 17Ad-9 through 13 Proposing Release, *supra* note 2. In its release proposing Rules 17Ad-9 to 17Ad-13, the Commission cited examples of substandard transfer agent performance in the areas of recordkeeping and safeguarding and noted the significant adverse operational and financial problems caused by poor transfer agent performance or operations.

<sup>221</sup> Securities Position Listing Rule, Exchange Act Release No. 16443 (Dec. 20, 1979), 44 FR 76774, 76775 (Dec. 28, 1979) (“Adopting Release for Rule 17Ad-8”); Final Street Name Study, *supra* note 82, at 55.

<sup>222</sup> See Exchange Act Rule 17Ad-8, 17 CFR 240.17Ad-8; Adopting Release for Rule 17Ad-8, *supra* note 221.

<sup>223</sup> Exchange Act Rule 17Ad-8(b), 17 CFR 240.17Ad-8(b).

<sup>224</sup> Exchange Act Rules 17Ad-9-13, 17 CFR 240.17Ad-9-13

standards for recordkeeping and codified minimum requirements for the safeguarding of funds and securities.<sup>225</sup> The Commission believed that these additional minimum standards were critical to addressing seriously deficient transfer agent performance.<sup>226</sup>

Rule 17Ad-9<sup>227</sup> defines 12 principal terms with respect to transfer agents as used especially in Rules 17Ad-10 through 17Ad-13, consisting of the terms “certificate detail,” “master securityholder file,” “subsidiary file,” “control book,” “credit,” “debit,” “record difference,” “record keeping transfer agent,” “co-transfer agent,” “named transfer agent,” “service company transfer agent,” and “file.”<sup>228</sup>

Rule 17Ad-9’s certificate detail,<sup>229</sup> with respect to certificated securities, includes, at a minimum, all of the following (and with respect to uncertificated securities, includes only items (ii) through (viii)): (i) the certificate number, meaning the unique serial number of each certificate of an issue of securities, as distinct from the CUSIP number<sup>230</sup> which is the same number for all certificates of the same issue; (ii) the number of shares (for equity securities) or principal dollar amount (for debt securities) designated by the certificate; (iii) the securityholder’s registration, which is the name of the individual, partnership, or corporation in

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<sup>225</sup> See 17Ad-9 through 13 Proposing Release, supra note 2.

<sup>226</sup> Id. The Commission was particularly concerned with reducing the potential for transfer agent failure, which inevitably imposes substantial potential liabilities and costs on issuers, securities firms, and securityholders, as well as improving generally transfer agent performance, thereby reducing the broker-dealers’ costs associated with fails to settle and extended transfer delays.

<sup>227</sup> Exchange Act Rule 17Ad-9, 17 CFR 240.17Ad-9.

<sup>228</sup> See 17Ad-9 through 13 Proposing Release, supra note 2.

<sup>229</sup> For “certificate detail,” see also Exchange Act Rule 17f-1(c)(6), 17 CFR 240.17f-1(c)(6).

<sup>230</sup> CUSIP stands for Committee on Uniform Security Identification Procedures. A CUSIP number is assigned to most financial instruments. See CUSIP Number, SEC, <http://www.sec.gov/answers/cusip.htm>.

which a securities certificate is held and which registration appears on the face of the certificate; (iv) the address of the registered owner, which also appears on the face of the certificate; (v) the date the certificate was issued, which likewise appears on the face of the certificate; (vi) the “cancellation date of the securities certificate,” which, if and when the certificate is cancelled will appear on the face of a certificate along with the word “cancelled” to evidence that the certificate no longer has any market value and that it no longer represents a claim against the issuer; (vii) in the case of redeemable securities of investment companies (e.g., securities issued by open-end management companies and other investment companies registered under Section 8 of the Investment Company Act), an appropriate description of each debit and credit (i.e., designation indicating purchase, redemption, or transfer); and (viii) “[a]ny other identifiable information about securities and securityholders” that the transfer agent reasonably deems essential to its recordkeeping system for the efficient and effective research of record differences.<sup>231</sup>

“Master securityholder file” is defined as the official list of individual securityholder accounts. With respect to uncertificated securities of investment companies registered under the Investment Company Act, the master securityholder file may consist of multiple, but linked, automated files.<sup>232</sup>

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<sup>231</sup> Exchange Act Rule 17Ad-9(a), 17 CFR 240.17Ad-9(a).

<sup>232</sup> Exchange Act Rule 17Ad-9(b), 17 CFR 240.17Ad-9(b). In other contexts, the master securityholder file may be referred to as a “stockholder register,” “stockholder list,” “shareholder ledger,” or some other designation. As used throughout this release, we refer to it as the master securityholder file. See, e.g., Del. Code Ann. tit. 8 §220 (referring to a corporation’s “stock ledger” as well as its “list of its stockholders”).

A “subsidiary file” is any list of record of accounts, securityholders, or certificates that evidences debits or credits that have not been posted to the master securityholder file.<sup>233</sup>

A “control book” is the record or other document that shows the total number of shares (in the case of equity securities) or the principal dollar amount (in the case of debt securities) authorized and issued by the issuer.<sup>234</sup> The control book may be referred to in the industry as a registrar journal, and is one of the mechanisms transfer agents use to monitor against overissuance.<sup>235</sup>

A “credit” is an addition of appropriate certificate detail to the master securityholder file, and a “debit” is a cancellation of appropriate certificate detail to the master securityholder file.<sup>236</sup>

A “record difference” occurs when either: (i) the total number of shares or total principal dollar amount of securities in the master securityholder file does not equal the number of shares or principal dollar amount in the control book; or (ii) the security transferred or redeemed contains certificate detail different from the certificate detail currently on the master securityholder file, which difference cannot be immediately resolved.<sup>237</sup>

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<sup>233</sup> Exchange Act Rule 17Ad-9(c), 17 CFR 240.17Ad-9(c).

<sup>234</sup> Exchange Act Rule 17Ad-9(d), 17 CFR 240.17Ad-9(d).

<sup>235</sup> The Commission’s transfer agent rules do not provide a definition of “overissuance” or explicitly import a definition from other authorities that have defined this term. The UCC provides a definition of this term which has been amended over the years and currently provides: “In this section ‘overissue’ means the issue of securities in excess of the amount the issuer has corporate power to issue, but an overissue does not occur if appropriate action has cured the overissue.” U.C.C. 8-210(a). One way in which an overissue can occur is when a corporation issues more shares than are authorized under its charter, such as its articles of incorporation. Under state law, shares over issued in such a manner may be deemed void. See, e.g., Del. Gen. Corp. L. §§ 161, 242(a)(3). For more information concerning the general concept of “overissuances” and types of transactions in which overissuances can occur, see Guttman, supra note 6, at § 11:7; Rhodes, supra note 18, at § 22:3.

<sup>236</sup> Exchange Act Rule 17Ad-9(e), (f), 17 CFR 240.17Ad-9(e), (f).

<sup>237</sup> Exchange Act Rule 17Ad-9(g), 17 CFR 240.17Ad-9(g).

A “recordkeeping transfer agent” is the registered transfer agent that maintains and updates a security’s master securityholder file.<sup>238</sup> All other transfer agents associated with a given issue of securities are defined as “co-transfer agents,” which are registered transfer agents that transfer securities but do not maintain and update the master securityholder file.<sup>239</sup> A co-transfer agent may include an outside registrar that keeps only the control book as defined in Rule 17Ad-1(b). A “named transfer agent” is the registered transfer agent that is engaged by an issuer to perform transfer agent functions for an issue of securities but has engaged a service company to perform some or all of those functions.<sup>240</sup> And a “service company” is the registered transfer agent engaged by a named transfer agent to perform transfer agent functions for that named transfer agent.<sup>241</sup>

Finally, Rule 17Ad-9(l) clarifies that the term “file” includes both automated and manual records.<sup>242</sup>

Rule 17Ad-10<sup>243</sup> requires each recordkeeping transfer agent to post promptly certificate detail to its master securityholder file after a security is transferred, purchased, or redeemed. The meaning of the term “promptly” varies with the relevant transaction but generally is five business days, although for exempt transfer agents under Rule 17Ad-4(b) promptly means 30 calendar days and for transfer agents functioning solely for their own or their affiliated companies’

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<sup>238</sup> Exchange Act Rule 17Ad-9(h), 17 CFR 240.17Ad-9(h).

<sup>239</sup> Exchange Act Rule 17Ad-9(i), 17 CFR 240.17Ad-9(i).

<sup>240</sup> Exchange Act Rule 17Ad-9(j), 17 CFR 240.17Ad-9(j).

<sup>241</sup> Exchange Act Rule 17Ad-9(k), 17 CFR 240.17Ad-9(k).

<sup>242</sup> Exchange Act Rule 17Ad-9(l), 17 CFR 240.17Ad-9(l).

<sup>243</sup> Exchange Act Rule 17Ad-10, 17 CFR 240.17Ad-10.

securities and using batch processing promptly means ten business days.<sup>244</sup> Timely updating of the master securityholder file is required because delayed posting or the failure to post would promote the proliferation of record inaccuracies that could impede the accurate payment of dividends and the processing of proxy solicitations.<sup>245</sup> Rule 17Ad-10(g) requires, with certain exceptions, that any transfer agent that erroneously issues securities that result in an overissuance<sup>246</sup> must “buy-in” (i.e., purchase securities in the open market) securities equal to the number of shares (in the case of equity securities) or principal dollar amount (in the case of debt securities) of the overissuance.<sup>247</sup> The buy-in requirement is designed to deter transfer agents from permitting record differences to accrue and encourages them to maintain complete and accurate records that assure that securityholders will receive all appropriate corporate distributions and communications.<sup>248</sup>

Rule 17Ad-11<sup>249</sup> requires that within ten business days following the end of each month, registered recordkeeping transfer agents report to issuers and the ARA certain information regarding aged record differences<sup>250</sup> when the dollar amount or the number of shares regarding

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<sup>244</sup> See 17Ad-9 through 13 Proposing Release, supra note 2.

<sup>245</sup> See infra Section V.B. for further discussion of proxy services.

<sup>246</sup> See supra note 235.

<sup>247</sup> Exchange Act Rule 17Ad-10(g)(1), 17 CFR 240.17Ad-10(g)(1).

<sup>248</sup> See Maintenance of Accurate Securityholder Files and Safeguarding of Funds and Securities by Registered Transfer Agents, Exchange Act Release No. 19860 (June 10, 1983), 48 FR 28231 (June 21, 1983) (“Adopting Release for Rule 17Ad-10”).

<sup>249</sup> Exchange Act Rule 17Ad-11, 17 CFR 240.17Ad-11.

<sup>250</sup> Exchange Act Rule 17Ad-11(a)(2), 17 CFR 240.17Ad-11(a)(2). A record difference becomes an aged record difference if it exists for “more than thirty calendar days.”

those shares reach certain preset levels.<sup>251</sup> The reports required by 17Ad-11 must set forth the amount of aged record differences, the reasons for any difference, and the steps being taken to resolve any difference.

Rule 17Ad-12<sup>252</sup> requires registered transfer agents to safeguard funds and securities of which they have custody or possession in a manner reasonably free from theft, loss, destruction, or misuse, in light of all the facts and circumstances including the cost of particular safeguards and procedures that might be employed. A reasonable level of safeguarding is necessary due to various duties of transfer agents which may include, for example: (i) holding balance certificates as transfer agent custodians; (ii) administering DRIPs which involves the holding of funds and securities; (iii) making distributions, including of principal, interest and dividends, as paying agents of issuers;<sup>253</sup> and (iv) maintaining working inventories of unissued securities certificates.<sup>254</sup>

Rule 17Ad-13<sup>255</sup> requires registered transfer agents, with certain exceptions, to file annually with the Commission a report prepared by an independent accountant concerning the transfer agent's system of internal controls and related procedures for the transfer of record ownership and the safeguarding of related securities and funds based on an annual study and evaluation made in accordance with generally accepted auditing standards. The purpose of the

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<sup>251</sup> Exchange Act Rule 17Ad-11(b)(1), 17 CFR 240.17Ad-11(b)(1). The dollar amounts and share thresholds reflected in the table set forth in Rule 17Ad-11(b)(1) have not been modified since Rule 17Ad-11 was first adopted in 1983.

<sup>252</sup> Exchange Act Rule 17Ad-12, 17 CFR 240.17Ad-12.

<sup>253</sup> See generally, Section VI.C for discussion of paying agent services.

<sup>254</sup> Id.

<sup>255</sup> Exchange Act Rule 17Ad-13, 17 CFR 240.17Ad-13.

rule is to ensure that transfer agents have a system of internal controls adequate to provide reasonable assurances that securities and funds held by transfer agents – for example, when a transfer agent facilitates a dividend or interest payment for an issuer – are safeguarded against loss from unauthorized use or disposition and that transfer agent activities are performed promptly and accurately. The rule requires that the independent accountant’s report state whether the annual study and evaluation was made in accordance with generally accepted auditing standards using the criteria set forth in the rule and describe and comment upon any material inadequacies found to exist in the system of internal accounting control as of the date of the evaluation and any corrective action taken, or state that no material inadequacy exists.<sup>256</sup> An accountant preparing reports under this rule is expected to use the general standards established by the American Institute of Certified Public Accountants (“AICPA”).<sup>257</sup>

4. *Issue-Specific Rules: Rules 17Ad-14 Through 17Ad-21T.*

After the adoption of Rules 17Ad-8 through 17Ad-13, between 1983 and 2013 the Commission continued to adopt new rules to address specific issues. Specifically, Rules 17Ad-14 through 17Ad-20, as well as 17Ad-21T, address issues such as tender agent services, signature guarantee programs, notifications when transfer agents begin or cease acting for specific issues, lost shareholder searches, processes for cancelling certificates, transfer of restricted securities, and anticipated risks associated with Year 2000 compliance.

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<sup>256</sup> See Adopting Release for Rule 17Ad-10, supra note 248.

<sup>257</sup> Id.



Rule 17Ad-14<sup>258</sup> requires a registered transfer agent that acts as a tender agent or a depository for a party making a tender or exchange offer to establish and maintain special accounts with all qualified registered securities depositories that hold the subject company's securities, thereby enabling depository participants to move securities to and from the tender agent by book-entry.<sup>259</sup> Unless a bidder's depository establishes an account with a securities depository, all the subject securities must be tendered in physical certificate form, rather than by book-entry, which causes inefficiencies and other problems for securityholders, broker-dealers, bidders, tender agents, and others.<sup>260</sup> The purpose of this rule is to reduce the processing costs and trading inefficiencies that occur when tender offers are processed in a physical certificate environment and to make the benefits of processing tender offers by book-entry available to the investing public and the securities industry.<sup>261</sup>

For example, securityholders sometimes have difficulty obtaining properly denominated physical certificates for tender to the bidder's depository prior to the offer's expiration date. Also, instances where there is unavailability of book-entry settlement have resulted in a substantially higher number of fails-to-deliver between broker-dealers. As a result, broker-dealers who are unable to satisfy tender obligations may have to buy securities in the cash market for same-day delivery (i.e., delivery on the day of the contract), which may create significant price disparities between the cash market and the regular-way market (i.e., delivery on the third

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<sup>258</sup> Exchange Act Rule 17Ad-14, 17 CFR 240.17Ad-14.

<sup>259</sup> See discussion *infra* at p. 104 for definition of "tender agent."

<sup>260</sup> Processing of Tender Offers Within the National Clearance and Settlement System, Exchange Act Release No. 20581 (Jan. 19, 1984), 48 FR 17603 (Apr. 25, 1983).

<sup>261</sup> *Id.*

business day following the day of the contract).<sup>262</sup> Prior to the adoption of Rule 17Ad-14, bidders could insist upon the tender of physical securities certificates outside of securities depositories (such as to the bidder's broker or local bank), even if the delivering entities were depository participants and even if the securities themselves were depository eligible. Doing so not only increased the number of fails, but increased brokerage firms' financing expenses and made it more difficult to settle transactions in a timely way.<sup>263</sup>

Rule 17Ad-15<sup>264</sup> prohibits inequitable treatment of eligible guarantor institutions (e.g., banks, brokers, and other financial institutions) that provide signature guarantee programs. The rule implements Section 17A(d)(5) of the Exchange Act which expressly bars transfer agents from exercising inequitable treatment of financial institutions with respect to security guarantees.<sup>265</sup> The signature guarantee program requires that a securities certificate bear a signature by a guarantor institution with a medallion stamp backed by a surety bond before the transfer agent will accept the certificate for transfer. The guarantee program allows the high-speed processing of a large volume of securities certificates that would be impossible if transfer agents had to examine the creditworthiness of the person behind each certificate being presented. Specifically, the program establishes requirements for its members with respect to guaranteeing and accepting securities certificates. The indorsing signature on a securities certificate is

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<sup>262</sup> Regular way settlement generally refers to settlement that occurs on a T+3 basis as required pursuant to Exchange Act Rule 15c6-1. Exchange Act Rule 15c6-1, 17 CFR 240.15c6-1. For additional information on cash, regular way, and other delivery schedules, see NYSE Rule 64 (2009).

<sup>263</sup> For a discussion of tender offers and trade processing problems that arise when depository book-entry services are not used during tender offers, see Rule 17Ad-14 Proposing Release, supra note 116.

<sup>264</sup> Exchange Act Rule 17Ad-15, 17 CFR 240.17Ad-15.

<sup>265</sup> Exchange Act Section 17A(d)(5), 15 U.S.C. 17q-1(d)(5).

guaranteed, typically by a financial institution, by the placement of a signature of the guarantor or its representative and a medallion stamp backed by a surety bond which, in effect, states that in event of mishap, the surety will pay for any damages incurred as a result of a forged signature if the guarantor does not pay.<sup>266</sup> With these assurances of financial safety, a transfer agent is able to accept a securities certificate without further examination or delay, as is required by the terms of the program.<sup>267</sup> Rule 17Ad-15 requires transfer agents to establish written standards for the acceptance of signature guarantees, and it authorizes signature guarantee programs. It also enables transfer agents to reject a request for transfer where a securities certificate is not guaranteed and bears no medallion stamp or where the guarantor is neither a member nor a participant in a signature guarantee program.<sup>268</sup>

Rule 17Ad-16 requires a registered transfer agent to provide written notice to an “appropriate qualified registered security depository” (i.e., DTC)<sup>269</sup> when terminating or

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<sup>266</sup> The UCC provides: “A person who guarantees a signature of an indorser of a securities certificate warrants that at the time of signing: (1) the signature was genuine; (2) the signer was an appropriate person to indorse, or if the signature is by an agent, the agent had actual authority to act on behalf of the appropriate person; and (3) the signer had legal capacity to sign.” U.C.C. 8-306.

<sup>267</sup> There are currently three organizations that provide signature guarantee programs to their members: Securities Transfer Agent Medallion Program, Stock Exchange Medallion Program, and New York Stock Exchange Medallion Program. See, e.g., Signature Guarantees: Preventing the Unauthorized Transfer of Securities, SEC, <http://www.sec.gov/answers/sigguar.htm>.

<sup>268</sup> See Acceptance of Signature Guarantees from Eligible Guarantor Institutions, Exchange Act Release No. 30146 (Jan. 6, 1992), 57 FR 1082 (Jan. 10, 1992) (adopting release for Rule 17Ad-15).

<sup>269</sup> Rule 17Ad-16 defines an “appropriate qualified registered securities depository” as the “qualified registered securities depository” that the Commission so designates by order or, in the absence of such designation, the qualified registered securities depository that is the largest holder of record of all qualified registered securities depositories as of the most recent record date. In 1995, the Commission issued an order approving a DTC rule filing in which DTC was designated as the “appropriate qualified registered securities depository” to receive notices of transfer agent changes pursuant to Rule 17Ad-16 in order to eliminate uncertainty about where registered transfer agents should direct Rule 17Ad-16 notices, and to reduce unnecessary costs and administrative burdens for transfer agents and registered securities

assuming transfer agent services on behalf of an issuer or when changing its name or address.<sup>270</sup>

The rule is intended to address the problem of unannounced transfer agent changes that adversely affect the prompt transfer of securities certificates by causing needless delays, costs, and risks.<sup>271</sup>

Depositories and other entities in the marketplace must have the correct information in order to send transfer instructions to the appropriate transfer agent at the correct address. In addition to causing delay in execution of the instructions, certificates sent to the wrong address may result in a loss of certificates.

Rule 17Ad-17 is designed to ensure that the transfer agents, brokers, dealers, and other financial intermediaries make adequate efforts to find lost securityholders.<sup>272</sup> It was first adopted in 1997<sup>273</sup> and later amended at the beginning of 2013.<sup>274</sup> The rule defines “lost securityholder” as a securityholder for whom an item of correspondence sent to his or her last known address was “returned as undeliverable” and requires transfer agents, brokers, and dealers to conduct two database searches in their efforts to locate a lost securityholder. It defines “unresponsive payee” to mean a securityholder to whom a paying agent has sent a regularly scheduled check which was not cashed or otherwise negotiated before the earlier of either the paying agent’s sending the next regularly scheduled check or of 6 months after the sending of the not yet negotiated

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depositories. See Securities Exchange Act Release No. 35378 (Feb. 15, 1995), 60 FR 9875 (Feb. 22, 1995) (File No. SR-DTC-95-02).

<sup>270</sup> Exchange Act Rule 17Ad-16, 17 CFR 240.17Ad-16.

<sup>271</sup> Adopting Release for Rule 17Ad-16, supra note 147.

<sup>272</sup> Exchange Act Rule 17Ad-17, 17 CFR 204.17Ad-17.

<sup>273</sup> Lost Securityholders, Exchange Act Release No. 39176 (Oct. 1, 1997), 62 FR 52229 (Oct. 7, 1997).

<sup>274</sup> Lost Securityholders and Unresponsive Payees, Exchange Act Release No. 68668 (Jan. 16, 2013), 78 FR 4768 (Jan. 23, 2013) (“Adopting Release for 17Ad-17 Amendments”).

check.<sup>275</sup> Any “paying agent,” defined for purposes of Rule 17Ad-17 as “any broker, dealer, investment advisor, indenture trustee, custodian, or any other person that accepts payments from the issuer of a security and distributes the payments to the holders of the security,” shall provide to each unresponsive payee not less than one written notice stating that such payee has been sent a check that has not yet been negotiated.

Rule 17Ad-19 was adopted in 2003 and requires every transfer agent to establish and implement written procedures for the cancellation, storage, transportation, destruction, or other disposition of securities certificates.<sup>276</sup> Specifically, it requires transfer agents to mark each cancelled securities certificate with the word “cancelled,” to maintain a secure storage area for cancelled certificates, to maintain a retrievable data base for of all its cancelled, destroyed, or otherwise disposed of certificates, and to have specific procedures for the destruction of cancelled certificates. The rule was adopted in response to a series of major thefts of cancelled certificates from transfer agent facilities, after which the stolen certificates were recirculated into the marketplace on a massive scale and fraudulently sold or used as loan collateral.<sup>277</sup>

Rule 17Ad-20 prohibits registered transfer agents from effecting the transfer of any equity security registered pursuant to Section 12 or that subjects an issuer to reporting under Section 15(d) of the Exchange Act if such security is subject to any restriction or prohibition on

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<sup>275</sup> Id.

<sup>276</sup> Exchange Act Rule 17Ad-19, 17 CFR 240.17Ad-19.

<sup>277</sup> See 17Ad-19 Adopting Release, supra note 2. We note that in more than a decade since the adoption of Rule 17Ad-19, we are not aware of any major thefts of cancelled securities certificates or their unlawful recirculation back into the marketplace.

transfer to or from a securities intermediary in its capacity as such.<sup>278</sup> In the 2004 adopting release for the rule, the Commission observed that issuers imposing such restrictions on transfer to intermediaries believe that “precluding ownership by certain securities intermediaries forces broker-dealers to deliver certificates on each transaction and eliminates the ability of naked short sellers to maintain a naked short sale position.”<sup>279</sup> The Commission believed Rule 17Ad-20 was necessary to prevent transfer agent facilitation of the transfer of securities subject to such restrictions, because these types of restrictions disrupted prompt and efficient clearing and settlement in the U.S. securities markets.

Two rules relate to Year 2000 compliance. Rule 17Ad-18 (Year 2000 Reports to be Made by Certain Transfer Agents) was adopted by the Commission on July 13, 1998 and required non-bank transfer agents to, among other things, file a report attesting to the Y2K compliance of their mission critical computer systems by August 31, 1998.<sup>280</sup> The rule also required non-bank transfer agents to notify the SEC of any material Y2K problems that would affect the millennium transition. Similarly, Rule 17Ad-21T required non-bank transfer agents to ensure that their mission critical computer systems were Year 2000 compliant by August 31, 1999 or to fix any non-compliant systems by November 5, 1999.<sup>281</sup> The purpose was to reduce risk to investors and the securities markets that were posed by non-bank transfer agents that had not adequately prepared their computer systems for millennium transition.

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<sup>278</sup> Exchange Act Rule 17Ad-20, 17 CFR 240.17Ad-20.

<sup>279</sup> See Issuer Restrictions or Prohibitions on Ownership by Securities Intermediaries, Exchange Act Release No. 50758, text following n.41 (Nov. 30, 2004), 70 FR 70852 (Dec. 9, 2004) (adopting release for Rule 17Ad-20). See also U.C.C. 8-501 et seq.

<sup>280</sup> Exchange Act Rule 17Ad-18, 17 CFR 240.17Ad-18.

<sup>281</sup> Exchange Act Rule 17Ad-21T, 17 CFR 240.17Ad-21T.

B. Bank and Internal Revenue Service Regulations

There are approximately 95 registered transfer agents that are banks or subsidiaries of banks. For national banks and banks operating under the Code of Law for the District of Columbia, the ARA is the Office of the Comptroller of the Currency (“OCC”); for State member banks, subsidiaries thereof, bank holding companies, and bank subsidiaries thereof the ARA is the Federal Reserve Board; and for banks insured by the FDIC (non-members of the Federal Reserve), the ARA is the FDIC. Collectively, we refer to transfer agents registered with the OCC, FDIC, or Federal Reserve Board as “bank transfer agents.” For non-bank transfer agents (i.e., all other transfer agents), the ARA is the Commission.<sup>282</sup>

Prior to the 1975 Amendments and the adoption of the Commission’s transfer agent rules discussed in Section IV.A above, many of the organizations performing transfer agent services were banks or trust companies regulated by bank regulators. As noted in the Unsafe Practices Study, at that time, “[t]he power of the bank regulatory officials over the transfer function [was] not specific. Rather their concern [was] whether the performance of the transfer function may endanger the financial stability of the bank.”<sup>283</sup> Today, pursuant to the 1975 Amendments and the Commission’s transfer agent rules enacted thereunder, bank transfer agents must comply with both the Commission’s transfer agent rules and any applicable rules promulgated by their ARA. Accordingly, bank transfer agents who are required to register as a transfer agent under

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<sup>282</sup> Exchange Act Section 3(a)(34), 15 U.S.C. 78c(a)(34).

<sup>283</sup> See Unsafe Practices Study, *supra* note 17, at 38. In contrast, the Exchange Act and the rules and regulations promulgated thereunder, including the Commission’s transfer agent rules, are focused on protecting investors and the securities markets. See Rule 17Ad-1 through 17Ad-7 Adopting Release, *supra* note 145 (noting the importance of avoiding impediments to “the Commission’s efforts to provide necessary or appropriate regulations for transfer agents in the broader context of the establishment of a national system for the prompt and accurate clearance and settlement of securities transactions.”).

the Exchange Act initially register with their appropriate ARA, but must file an annual Form TA-2 with the Commission.<sup>284</sup> The bank ARAs have not promulgated separate rules designed to address specifically the transfer functions of bank transfer agents, but instead generally require bank transfer agents to comply with the Commission’s transfer agent rules. OCC, for example, explicitly applies the Commission’s transfer agent rules to the “domestic activities of registered national bank transfer agents.”<sup>285</sup> Similarly, the Federal Reserve Board’s rules provide that the Commission’s transfer agent rules “apply to member bank transfer agents.”<sup>286</sup> The FDIC has stand-alone registration requirements for transfer agents and may examine transfer agents for both safety and soundness considerations under applicable banking regulations and for compliance with the Commission’s transfer agent rules.<sup>287</sup>

With respect to examination and enforcement, both the ARA and the Commission have examinations powers over bank transfer agents, however, the Commission must provide notice to the appropriate ARA prior to conducting an examination and to arrange for a joint examination where desired.<sup>288</sup> In addition, both the Commission and the ARA have enforcement authority over bank transfer agents.<sup>289</sup>

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<sup>284</sup> See supra Section IV.A.1.

<sup>285</sup> 12 CFR 9.20.

<sup>286</sup> 12 CFR 208.31.

<sup>287</sup> See FDIC Trust Examination Manual, sec. 11.B.1.b (Statutory Framework), available at [https://www.fdic.gov/regulations/examinations/trustmanual/section\\_11/section11toc.html](https://www.fdic.gov/regulations/examinations/trustmanual/section_11/section11toc.html) (“Registered Transfer Agent Examination Manual”).

<sup>288</sup> See Exchange Act Section 17(b), 15 U.S.C. 78q(b).

<sup>289</sup> See generally, Exchange Act Section 17A(d), 15 U.S.C. 78q-1(d).



In addition to complying with the Commission’s transfer agent rules, bank transfer agents must also comply with their ARA’s rules and standards. Those may supplement or exceed the Commission’s rules. In part, this may be due to the fact that a bank transfer agent’s activities could impact the proper functioning of the bank itself. As the FDIC explains in Section 11 of its Trust Examination Manual, one rationale for its transfer agent examination program is to “to detect and prevent situations which might threaten the viability of banks through diminution of their capital accounts.”<sup>290</sup> It further notes that “to the extent that a registered transfer agent fails to conduct transfer agent operations in a safe and efficient manner . . . the transfer agent function could incur contingent liabilities or estimated losses which could adversely impact the bank’s capital accounts.”<sup>291</sup>

As a result, for example, the FDIC examines its transfer agents for internal control and risk management policies and procedures that are similar to what is required for banks.<sup>292</sup> With respect to internal controls, the FDIC specifies not only what it expects from the agent in order to demonstrate compliance with the Commission’s rules, but additional standards as well. These standards apply whether the transfer agent is housed within the bank’s trust department, is its own operating unit, or if the transfer agent activities are outsourced. The FDIC specifies suggested means for ensuring control over physical security, such as controlled access, secure safes and cabinets, and maintenance of access logs, and generally expects to see management oversight of operations consistent with bank management oversight. Supervision of the transfer

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<sup>290</sup> See Registered Transfer Agent Examination Manual, supra note 287, at sec. 11.B (Introduction discussing the rationale for transfer agent examinations).

<sup>291</sup> Id. at sec. 11.B.1.b (The Statutory Framework).

<sup>292</sup> Id. at sec. 11.G (Management), sec. 11.H (Internal Controls).

agent operations may be delegated, but ultimately rests with the bank’s Board and senior management.<sup>293</sup>

Separately, depending on its duties, an OCC-registered transfer agent also may have to comply with statutory requirements for the treatment of “assets held in any fiduciary capacity.”<sup>294</sup> For example, entities servicing in a fiduciary capacity may be required to segregate the fiduciary funds from the “general assets” of the bank and have a separate accounting for transactions involving the segregated funds.<sup>295</sup>

In addition, depending on the nature and scope of the services that transfer agents provide, they must comply with certain regulations and other guidance issued by the U.S. Department of the Treasury (“Treasury”) and the Internal Revenue Service. For example, transfer agents track and report to the Internal Revenue Service the dividend income and share sale activity they facilitate on behalf of issuers via Form 1099 reporting,<sup>296</sup> and follow federal law requirements concerning tax withholding, where appropriate.<sup>297</sup>

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<sup>293</sup> Id.

<sup>294</sup> 12 U.S.C. 92a(c). See also 12 CFR 9.2 (“Fiduciary capacity” includes transfer agents and registrars of stocks and bonds).

<sup>295</sup> 12 U.S.C. 92a(c).

<sup>296</sup> See 2016 Instructions for Form 1099-DIV, available at <http://www.irs.gov/pub/irs-pdf/i1099div.pdf> (last visited November 20, 2015) (generally for information regarding disclosure of dividend payments).

<sup>297</sup> For example, the Foreign Account Tax Compliance Act (“FATCA”), enacted in 2010, is intended to reduce tax evasion by U.S. individuals with respect to income from financial assets held outside the United States by requiring foreign financial institutions to, among other things, report directly to the Internal Revenue Service certain information about financial accounts held by U.S. taxpayers, or by foreign entities in which U.S. taxpayers hold a substantial ownership interest. See Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, §§501-541 (1986). Under FATCA, foreign financial institutions such as investment funds domiciled outside the United States are permitted to contract with their transfer agents or other agents to perform certain due diligence and other FATCA obligations on their behalf. A transfer agent’s service agreement may take into account these new responsibilities, under which the transfer agent may be required to perform due diligence on all investors listed in the investor record, report on U.S. individuals and

### C. SRO Rules and Requirements Applicable to Transfer Agents

This section discusses some of the SRO rules and requirements applicable to transfer agents. While we focus here on NYSE and DTC requirements, we do so by way of example only. Other SROs may have additional rules which could apply to transfer agents in different contexts.

#### *1. NYSE Requirements*

Transfer agents for NYSE listed securities are also subject to NYSE requirements. The requirements focus on (i) dual registrars and transfer agents; (ii) turnaround times; (iii) capitalization; and (iv) insurance coverage. The requirements also address transfer agent personnel, safeguarding, and co-transfer agents.

First, the NYSE Listed Company Manual (“NYSE LCM”), Section 601.01(B), provides that one person may serve as both registrar and transfer agent subject to compliance with the following conditions: (i) meeting insurance and net capital requirements (discussed in more detail below); (ii) maintaining the functions separately and distinctly with appropriate internal controls; (iii) annual review of such internal controls by the transfer agent's independent auditors; (iv) submitting financial statements to the exchange; and (v) obtaining a certification from the transfer agent’s insurer that NSYE insurance requirements have been met. This provision is less restrictive than stock exchange prohibitions on serving as a dual registrar and transfer agent that

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institutions investing in the fund, and apply FATCA withholding to certain payments. For more information on regulations, rulings, notices, announcements, and other FATCA-related guidance or requirements for financial institutions, *see, e.g.*, FATCA- Regulations and Other Guidance, IRS, <http://www.irs.gov/Businesses/Corporations/FATCA-Regulations-and-Other-Guidance>.

existed in earlier eras.<sup>298</sup> It is the understanding of the Commission staff that outside or independent registrars are rarely used today.<sup>299</sup>

Second, as noted above, NYSE also imposes turnaround time requirements. NYSE LCM Section 601.01(A)(2) requires that routine transfers (as defined in Exchange Act Rule 17Ad-1) “must be processed under normal conditions within 48 hours of receipt of the securities by the transfer agent at its address designated for registration of transfers.” The 48 hour turnaround requirement was adopted by the NYSE in 1971 (originally as Rule 496) in the immediate wake of the transfer agent problems during the Paperwork Crisis.<sup>300</sup> The Commission adopted its Rule 17Ad-2 turnaround requirement (providing for three day turnaround) approximately six years later in 1977. In the adopting release for Rule 17Ad-2, the Commission stated “The adopted rules are not intended to and do not supersede any rules of self-regulatory organizations which impose more stringent performance standards.”<sup>301</sup>

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<sup>298</sup> See Rockwell Study, *supra* note 19, at 101 (1969 study discussing NYSE prohibition on serving as dual registrar and transfer agent); Securities Exchange Act Release No. 21499, File No. SR-NYSE-84-33 (Nov. 19, 1984) (discussing prior 1971 NYSE rule change permitting banks and trusts to serve as dual registrar and transfer agent and approving NYSE rule change to eliminate prohibition on acting as dual transfer agent and registrar that had applied to transfer agents other than banks and trusts, subject to certain conditions).

<sup>299</sup> Separate registrars and transfer agents still were common between 1977 and 1983, when the Commission adopted the majority of its transfer agent rules. Although even by that point, stock exchanges had relaxed certain prohibitions on serving as dual transfer agent and registrar, the practice often was followed because many securities industry participants believed that the independent registrar served an audit function that protected investors. See Study of the Securities Industry: Hearings Before the Subcomm. on Commerce and Fin. of the H. Comm. on Interstate and Foreign Commerce, 92nd Cong. app. DD 2391 (1971) (“1971 Study of the Securities Industry Hearings”) (Statement of Herman W. Bevis, Executive Director of BASIC).

<sup>300</sup> See Securities Exchange Act Release No. 21499, File No. SR-NYSE-84-33 n.16 (Nov. 19, 1984) (noting the NYSE adopted the 48 hour turnaround policy in 1971); 2011 NYSE Rule Archives, Rule 496.

<sup>301</sup> Rule 17Ad-1 through 17Ad-7 Adopting Release, *supra* note 145, at 32404 n.4.

Third, NYSE LCM Section 601.01(A)(1)(i) requires that a transfer agent must have at least \$10 million in “capital, surplus (both capital and earned), undivided profits, and capital reserves.” Where a transfer agent is unable to meet this capital requirement, NYSE LCM Section 601.01(A)(12) provides for a lower alternative capital standard of \$2 million that the transfer agent may meet if it maintains certain additional insurance coverage.<sup>302</sup> The requirements may also be satisfied by a parent company.<sup>303</sup> Fourth, NYSE LCM Section 601.01(A)(1)(ii) requires that a transfer agent maintain insurance coverage of at least \$25 million “to protect securities while in process.”<sup>304</sup>

The NYSE also requires transfer agents to be staffed with “experienced personnel qualified to handle so-called ‘legal terms’ and to advise on and handle other transfer problems.”<sup>305</sup> A transfer agent is also required to assume responsibility and liability for securities in its possession and must “provide adequate facilities for the safekeeping of securities in its possession or under its control.”<sup>306</sup> Additional provisions address other items specific to the NYSE, co-transfer agents, and independent registrars.<sup>307</sup>

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<sup>302</sup> See NYSE Listed Co. Manual §601.01(A)(12) (2013) (making the lower capital standard conditional on the maintenance by the transfer agent of “errors and omissions insurance coverage in an amount which, taken together with its capital, surplus (both capital and earned), undivided profits, and capital reserves, equals at least \$10,000,000 and, provided further, that such transfer agent maintains the insurance required by Para.601.01(A)(1)(ii).”)

<sup>303</sup> NYSE Listed Co. Manual §601.01(A)(10) (2013).

<sup>304</sup> NYSE Listed Co. Manual §601.01(A)(1) (2013).

<sup>305</sup> NYSE Listed Co. Manual §601.01(A)(6) (2013).

<sup>306</sup> NYSE Listed Co. Manual §601.01(A)(4),(7) (2013).

<sup>307</sup> See generally, NYSE Listed Co. Manual §601.01(A)-(D) (2013).

## 2. *DTC Requirements*

Transfer agents who participate in DRS must comply with DTC rules and regulations. Many transfer agents participate in DRS, especially because national U.S. securities exchanges, including NYSE and NASDAQ, require newly listed securities to be DRS eligible.<sup>308</sup>

DTC requires transfer agents to satisfy four primary requirements before being eligible to process DRS transactions, including the following:

- Because DRS is integrated for communication purposes into DTC's Profile system, transfer agents must become "Limited Participants" in DTC by submitting an application to the DRS Program Administration for DTC approval.<sup>309</sup>
- Participate in DTC's FAST program by becoming a FAST agent and agreeing to DTC's Operational Criteria for FAST Transfer Agent Processing ("FAST criteria"). The FAST criteria outline rules for securities transfers through FAST, DTC's Operational Arrangements, and DTC's Balance Certificate Agreement. The Operational Arrangements include, among other things, DTC's requirements for issues to be DTC-eligible, additional transfer requirements for FAST agents, record date requirements, and dividend and income notification procedures. By signing the Balance Certificate Agreement with DTC, transfer agents agree to maintain DTC-eligible inventory in the form of jumbo certificates registered in

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<sup>308</sup> See NYSE Listed Co. Manual §501.00 (2013) (requiring "all securities listed on the Exchange [to] be eligible for a direct registration system operated by a securities depository"); NASDAQ Rule 5210(c) (requiring "all securities initially listing on Nasdaq, except securities which are book-entry only, [to] be eligible for a Direct Registration Program operated by a clearing agency registered under Section 17A of the [Exchange] Act.").

<sup>309</sup> Profile was implemented by DTC in 2000 to "electronically convey an investor's request to move from one form of securities ownership to another. Profile takes the place of the paper transaction advice for electronic movement of securities positions between street-name positions and direct registration book-entry positions. Profile includes all the data fields listed on the paper transaction advice, including the investor's broker-dealer account number, investor's DRS account number, Tax I.D./Social Security number, full registration, and CUSIP." DTC, An Overview, available at <http://www.dtc.org/dtcpublic/html/lob2/prod6/drsdetail.htm>. In addition, since 2001, the Profile Surety Program has provided for a surety bond to help mitigate the risks for parties using DRS and Profile, similar to a medallion stamp on a certificated security.

the name of DTC's nominee, Cede & Co., and that they will electronically reconcile DTC participants' daily deposit and withdrawal activities.

- Establish and maintain electronic communication links with DTC through Profile so that DTC participants (e.g., broker-dealers) and limited participants (e.g., transfer agents) can communicate investors' instructions electronically. DTC requires transfer agents to complete DRS and Profile training before using Profile. Profile includes data fields that would be included in a traditional paper transaction, including the investor's broker-dealer account number, investor's DRS account number, Tax I.D./Social Security number, and CUSIP numbers of the securities. Once those instructions are transmitted, the actual movement of securities ownership takes place in DRS.
- Participate in DTC's Profile Surety Program, which functions similarly to the medallion guarantee programs for paper based transactions by providing for a surety bond to back the representations made by the transacting parties.<sup>310</sup>

Additionally, DTC criteria that must be met by a securities issuer to ensure its securities are eligible for DRS and Profile may indirectly apply to transfer agents acting on behalf of the issuer. For example, DTC requires issuers to mail DRS book-entry statements to registered owners evidencing their holdings at least once a year.<sup>311</sup> Transfer agents acting on behalf of issuers wishing to participate in DRS may therefore be asked by their issuer clients to handle this statement mailing function.

#### D. Regulation of Transfer Agents Under State Law

Transfer agents are subject indirectly to state corporation law when acting as agents of corporate issuers, and they are directly subject to state commercial law, principal-agent law, and other laws, many of which are focused on corporate governance and the rights and obligations of

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<sup>310</sup> See Securities Exchange Act Release No. 41862 (Sept. 10, 1999), 64 FR 51162, 51163 (Sept. 21, 1999) (File No. SR-DTC-99-16). See also supra note 86 (regarding FAST requirements).

<sup>311</sup> DTC requirements for DRS and Profile eligible transfer agents and issuers are discussed in greater detail at Direct Registration System, DTCC, <http://www.dtc.org/dtcpublic/html/lob2/prod6/drsdetail.htm> (last visited November 20, 2015).

issuers and securityholders.<sup>312</sup> While a full discussion of all state laws applicable to transfer agents is beyond the scope of this release, the transfer of investment securities is primarily governed by UCC Article 8, which has been adopted by the legislatures of all 50 states,<sup>313</sup> the District of Columbia, Puerto Rico, and the Virgin Islands. Article 8 was most recently revised in 1994 to introduce the concept of a securities entitlement as a way to simplify and clarify the rules for the modern street name system.<sup>314</sup> Although UCC Article 8 is intended to provide a uniform and practical definition of the responsibilities of issuers and their agents in issuing and transferring securities, it does not encompass or preempt the complete body of state laws that may relate to transfer agent activity.<sup>315</sup> Transfer agents may also be subject to the laws of the states of incorporation for both issuers and their securityholders that apply to specific services provided by the transfer agent, such as data privacy.<sup>316</sup>

## **V. EVOLUTION OF RECORDKEEPING, TRANSFER, AND RELATED TRANSFER AGENT ACTIVITIES**

This section discusses some of the core recordkeeping, transfer, and other activities that transfer agents engage in, the manner in which the current transfer agent rules apply to those

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<sup>312</sup> See, e.g., Del. Code Ann. tit. 8 (Delaware General Corporation Law), Del. Code Ann. tit. 6, art. 8 (Investment Securities), Restatement (Third) of Agency (2006).

<sup>313</sup> Louisiana has enacted the provisions of Article 8 into the body of its law, among others, but has not adopted the UCC as a whole.

<sup>314</sup> U.C.C. 8-501 et seq. (1994).

<sup>315</sup> For example, in addition to UCC Article 8, various state laws relating to contracts, principal agent relationships, estoppel, fraud, bankruptcy, escheatment (or abandoned property) and other areas may apply to a specific transaction or situation.

<sup>316</sup> For example, California's privacy statute which became effective in 2003, was the first significant effort by a state to assert substantive regulation of privacy of customer data. See Cal. Civ. Code §§ 1798.80–1798.84. While state regulations vary across jurisdictions, other states have followed suit with similar regulatory initiatives. See, e.g., Minn. Stat. § 325E.61, Neb. Rev. Stat. §§ 87-801–807.



activities, and how those activities have evolved over time. The world looks very different today than it did in 1977, when the first transfer agent rules were adopted. Since then, the increased use and decreased cost of technology, the expansion of corporate actions to bring securities into the public market, the continued dematerialization of securities, and other changes have resulted in significant evolution and changes to the types of services transfer agents provide and the manner in which they provide them. At the same time, with limited exceptions, the Commission's transfer agent rules have not been updated. As a result, there may be divergence between modern transfer agents' activities and the activities that the Commission's rules are designed to regulate.

A. Recordkeeping, Transfer, Issuance, and Corporate Actions

All transfer agents perform a number of core recordkeeping, transfer, and other services related to their primary function of facilitating the transfer of securities. This section discusses some of the activities transfer agents engage in with respect to these services and the relevant transfer agent rules applicable to them.

1. *Recordkeeping: Rules 17Ad-9, 10, and 11*

Transfer agents have direct responsibility for maintaining on behalf of the issuer the currency and integrity of the official list of the registered owners of an issuer's stocks and bonds, how those stocks and bonds are held, and how many shares or bonds each investor owns. This list is defined by Rule 17Ad-9(b) as the master securityholder file.<sup>317</sup> Without the master securityholder file, registered owners of an issuer's securities cannot be assured that they are

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<sup>317</sup> See Exchange Act Rule 17Ad-9(b), 17 CFR 240.17Ad-9(b).

recognized as such by the issuer and that they will receive corporate distributions, communications, and the other rights of security ownership to which they are entitled.<sup>318</sup>

Transfer agents also maintain and keep current the control book which is defined by Rule 17Ad-9(d) as the record of the total number of shares of equity securities or the principal dollar amount of debt securities authorized and issued by the issuer for each issue the transfer agent services.<sup>319</sup> As discussed above in Section IV.A.3, one of the main purposes of the control book is to allow the transfer agent to monitor the number of securities outstanding to prevent overissuance because the total number of shares reflected in the aggregate on the master securityholder file should match the number of shares authorized in the control book.<sup>320</sup>

Finally, pursuant to Rule 17Ad-6, transfer agents maintain the transfer journal.<sup>321</sup> The transfer journal can be a useful tool for transfer agents and issuers. For example, when reviewed in conjunction with the master securityholder file, the transfer journal may provide historical information regarding the issuance and transfer of a specific security or the holdings of a specific securityholder. The transfer agent rules do not define transfer journal nor codify requirements with respect to the transfer journal.

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<sup>318</sup> See generally, e.g., Del. Code Ann. tit. 8 §§ 170, 173 (authorizing a corporation to pay cash and stock dividends under certain circumstances); Exchange Act Rule 14c-3, 17 CFR 240.14c-3 (requirement to furnish an annual report to securityholders); Del. Code Ann. tit. 8 §212 (providing for voting rights of stockholders and permitting them to vote by proxy); Del. Code Ann. tit. 8 §222 (requirement to send stockholder notice in advance of stockholder meeting).

<sup>319</sup> Exchange Act Rule 17Ad-9(d), 17 CFR 240.17Ad-9(d).

<sup>320</sup> When acting in this capacity, a transfer agent may be referred to as a “registrar.” See Exchange Act Section 3(a)(25), 15 U.S.C. 78c(a)(25).

<sup>321</sup> Exchange Act Rule 17Ad-6, 17 CFR 240.17Ad-6.

The primary recordkeeping rules that apply to the core records discussed above include Rules 17Ad-9, 17Ad-10, and 17Ad-11. These recordkeeping requirements are supplemented and reinforced by the recordkeeping and record retention and preservation requirements found in Rules 17Ad-6 and 17Ad-7. Rules 17Ad-9 and 17Ad-10 define the term master securityholder file, provide the specific information regarding a securityholder that must be maintained on the master securityholder file, defined in the rules as certificate detail,<sup>322</sup> and set specific timing deadlines for recording this information.<sup>323</sup> In addition, Rule 17Ad-10 imposes obligations on transfer agents to carry over any existing certificate detail where they succeed to the maintenance of a master securityholder file that was maintained in an earlier format or by a predecessor transfer agent.<sup>324</sup>

The Commission’s transfer agent rules seek to promote accurate recordkeeping by transfer agents by establishing specific requirements when a transfer agent identifies a specific type of discrepancy in its records referred to in Rule 17Ad-9(g) as a record difference.<sup>325</sup> Rule 17Ad-10(b) requires transfer agents to “exercise diligent and continuous attention to resolve all

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<sup>322</sup> See supra Section IV.A.3. We note that the “certificate detail” requirements in Rule 17Ad-9 apply to both certificated securities and book-entry positions. Further, while we focus here on Rule 17Ad-9’s certificate detail requirements, Rule 17Ad-9(a)(4) is relevant to other rules that depend on obtaining securityholders’ address information such as Rules 17Ad-12 and 17Ad-17. We also note that Rule 17Ad-9(b) permits registered investment companies to maintain multiple, but linked, automated files with respect to book-entry securities.

<sup>323</sup> With certain exceptions, certificate details must be posted within five business days, unless a transfer agent is an “exempt transfer agent” under Rule 17Ad-4(b) or an issuer acting as its own transfer agent for its own securities. Exchange Act Rule 17Ad-10(a)(2)(i)-(ii), 17 CFR 240.17Ad-10(a)(2)(i)-(ii).

<sup>324</sup> See Exchange Act Rule 17Ad-10(h), 17 CFR 240.17Ad-10(h). As discussed below in Section VI.B, the rule does not require predecessor transfer agents to turn over such information to the issuer or to a successor transfer agent.

<sup>325</sup> Exchange Act Rule 17Ad-9(g), 17 CFR 240.17Ad-9(g). For additional discussion of the goals and objectives of the Commission’s transfer agent rules, see supra Section IV.

record differences.” Further, Rule 17Ad-10(b) requires that every recordkeeping transfer agent maintain and keep current an accurate master securityholder file and subsidiary files, and if a record difference is identified, then both the master securityholder file and subsidiary files must accurately represent all relevant debits and credits until the record difference is resolved.<sup>326</sup>

As discussed above, if a record difference exists for “more than thirty calendar days,” it becomes an aged record difference under Rule 17Ad-11(a)(2).<sup>327</sup> Depending upon the aggregate market value of the aged record differences for a particular issuer and the capitalization of the issuer, Rule 17Ad-11(b) may require the transfer agent to send a monthly report to the affected issuer.<sup>328</sup> Depending on the total number of issuers serviced and the aggregate market value of all record differences across all issuers serviced, the transfer agent may also need to make reports to its ARA pursuant to Rule 17Ad-11(c).<sup>329</sup>

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<sup>326</sup> Exchange Act Rule 17Ad-10(b), 17 CFR 240.17Ad-10(b). We also note that, as part of a transfer agent’s obligation to monitor against overissuances, Rule 17Ad-10(g) imposes buy-in obligations when an actual physical overissuance has occurred that was caused by the transfer agent. Exchange Act Rule 17Ad-10(g), 17 CFR 240.17Ad-10(g). There are limited exceptions to this requirement. See Exchange Act Rules 17Ad-10(g)(2)-(3), 17 CFR 240.17Ad-10(g)(2)-(3).

<sup>327</sup> Exchange Act Rule 17Ad-11(a)(2), 17 CFR 240.17Ad-11(a)(2).

<sup>328</sup> Exchange Act Rule 17Ad-11(b), 17 CFR 240.17Ad-11(b). Rule 17Ad-11(b) also requires, without imposing any minimum threshold as with the amount of aged record differences, that the transfer agent report to issuers concerning any securities bought-in pursuant to Rule 17Ad-10(g) or reported as bought-in pursuant to Rule 17Ad-10(c) during the preceding month.

<sup>329</sup> Exchange Act Rule 17Ad-11(c), 17 CFR 240.17Ad-11(c). The report to the ARA must also include information concerning buy-ins required by Rule 17Ad-10 (g) when the aggregate market value of all buy-ins during a calendar quarter exceeds \$100,000. Id.

2. *Securities Transfers, Exchanges, and Conversions: Rules 17Ad-9, 10, 12, and 19*

Transfer agents are integrally involved in effecting transfers of ownership of securities, as well as exchanging and converting securities.<sup>330</sup> For example, an equity sale would usually involve a transfer. In contrast, a stock-for-stock merger, where the equity security of Company A is exchanged for an equity security of Company B (and Company B is the disappearing company) would involve an exchange. Finally, a securityholder's election to convert a convertible debt security into an equity security would usually involve a conversion. While these transfer agent services vary in terms of definition, the transfer agent rules apply to all of them in substantially similar ways. Therefore, for the purposes of describing all of these services in the discussion that follows, we will focus on the activities and rules applicable to transfers.

In connection with transfers of certificated securities, the first steps in the transfer process are to match the certificate detail with the master securityholder file, verify the signature guarantee, and then cancel the negotiable certificate that has been presented for transfer. With respect to verifying the signature, presentation by the transferor typically involves providing the transfer agent an indorsed security certificate bearing a medallion stamp. In some cases, the indorsement and assignment may be made not on the certificate itself but by an executed power of attorney authorizing the transfer of ownership on the books of the issuer.<sup>331</sup>

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<sup>330</sup> The terms “exchange” and “conversion” are used in Exchange Act Section 3(a)(25) and in the Commission’s transfer agent rules but are not defined in the Commission’s transfer agent rules. The term “exchange” is commonly used to refer to the trading of specific securities for another asset, usually without an accompanying change in ownership. The term “conversion” is commonly used to refer to the changing into or substitution of one security for another security or asset under specific conditions, also without an accompanying change in ownership.

<sup>331</sup> See supra note 18 (regarding powers of attorney).

Rule 17Ad-19 governs certificate cancellation and requires that “every transfer agent involved in the handling, processing, or storage of securities certificates shall establish and implement written procedures for the cancellation, storage, transportation, destruction, or other disposition of securities certificates.”<sup>332</sup> The rule grants transfer agents flexibility to develop their own procedures, but depending on which procedures they adopt (i.e., cancellation, destruction, or other disposition), they must comply with minimum requirements regarding three general areas: (i) the manner of cancellation and destruction of certificates; (ii) the storage and transport of cancelled certificates; and (iii) recordkeeping with respect to cancelled certificates.<sup>333</sup>

Rule 17Ad-12 governs the safeguarding of cancelled certificates. First, certificates that are cancelled generally must be stamped or perforated with the word “CANCELLED” and, for any cancelled certificate that is subsequently destroyed, the destruction of certificates must be witnessed by authorized personnel of the transfer agent or its designee.<sup>334</sup> Second, transfer agents must control access to the location where cancelled certificates are kept and transport of cancelled certificates must be made in a “secure manner.”<sup>335</sup> If cancelled certificates are not

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<sup>332</sup> Exchange Act Rule 17Ad-19(b), 17 CFR 240.17Ad-19(b).

<sup>333</sup> Id.

<sup>334</sup> Exchange Act Rules 17Ad-19(c)(2), (6), 17 CFR 17.24017Ad-19(c)(2), (6). The requirement to stamp or perforate the certificate as cancelled does not apply where “the transfer agent has procedures adopted pursuant to this rule for the destruction of cancelled certificates within three business days of their cancellation.” In addition, a certificate may be marked “cancelled” and stored for a period of time before being destroyed.

<sup>335</sup> Exchange Act Rules 17Ad-19(c)(1), (5), 17 CFR 240.17Ad-19(c)(1), (5).

destroyed, they must be retained for six years pursuant to Rule 17Ad-7(d).<sup>336</sup> Furthermore, Rule 17Ad-12 requires that cancelled certificates be “held in safekeeping and...handled, in light of all facts and circumstances, in a manner reasonably free from risk of theft, loss or destruction (other than by a transfer agent's certificate destruction procedures pursuant to § 240.17Ad-19).” Third, transfer agents must keep a record regarding each cancelled certificate that is in transit and records for each cancelled certificate and destroyed certificate that in both cases are “indexed and retrievable by CUSIP and certificate number.”<sup>337</sup> These records must be kept for three years.

Once the old certificate has been cancelled, the next step in the transfer of a certificated security will generally involve recording the change of record ownership of the relevant securities on the master securityholder file. In the context of certificated securities, this is done by debiting the securities account of the transferor. Rule 17Ad-9(f) defines the term “debit” as “a cancellation of appropriate certificate detail from the master securityholder file.” Because the cancellation date is one of the defined elements of certificate detail under Rule 17Ad-9, together

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<sup>336</sup> We note that when the Commission adopted Rule 17Ad-19 in 2003 addressing among other things the destruction of certificates, it did not amend Rule 17Ad-7(d) to delete the requirement to retain cancelled security certificates for six years. But concurrently in 2003, the Commission amended Rule 17Ad-7(f) such that “the records required to be maintained pursuant to § 240.17Ad-6 may be retained using electronic or micrographic media...” See Exchange Act Rule 17Ad-7(f), 17 CFR 240.17Ad-7(f); Recordkeeping Requirements for Transfer Agents, *supra* note 215. We understand that many transfer agents today follow a practice of destroying certificates after a period of time in accordance with their individual policies and in compliance with Rule 17Ad-19 but keep electronic copies of the cancelled certificate by imaging it to comply with Rule 17Ad-7 as well as keeping the records required by Rule 17Ad-19(c)(4) for destroyed certificates.

<sup>337</sup> Exchange Act Rule 17Ad-9(c)(5), 17 CFR 240.17Ad-9(c)(5). The record regarding cancelled certificates in transit must show the certificate numbers and CUSIP numbers. The records regarding both cancelled certificates and destroyed certificates must include “the CUSIP number, certificate number with any prefix or suffix, denomination, registration, issue date, and cancellation date.” Exchange Act Rules 17Ad-9(c)(3)-(4), 17 CFR 240.17Ad-9(c)(3)-(4).

Rules 17Ad-9(a)(6) and 17Ad-10 have the effect of requiring that the cancellation date be posted to the master securityholder file, generally within five business days.<sup>338</sup>

The final step in the process of completing a transfer for a certificated security is for the transfer agent to issue (on behalf of the issuer) a new security to the transferee. The transfer agent's role in connection with the issuance stage of transfer is discussed in more detail in the next section below.

For uncertificated securities, transfer agents do not issue or cancel physical securities certificates when transferring securities. Instead, they effect book-entry transfers by registering the change in ownership on the master securityholder file, which does not involve the physical issuance and cancelling of securities certificates. The term "registering" means an official form of recording by a person charged with that function, which is accomplished under Exchange Act Rules 17Ad-9(h) and 17Ad-10(e) by updating the master securityholder file, as discussed above. Book-entry transfer may be accomplished through DTC's DRS using DTC's Profile system.<sup>339</sup> Once the transfer has been effected, the investor would receive from the transfer agent a statement of ownership that acknowledges his or her new DRS position.

### 3. *Securities Issuance: Rules 17Ad-1 and 2*

Transfer agents are also involved in the issuance of securities, which may be one of the final stages before completing a transfer, as discussed above, or could involve a primary offering

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<sup>338</sup> Exchange Act Rules 17Ad-9-10, 17 CFR 240.17Ad-9-10. Moreover, Congress in the Dodd-Frank Act has taken another step to tighten recordkeeping of cancelled securities by adding "cancelled" securities as a category of securities that must be reported to the Commission or its designee. See Exchange Act Section 17(f)(1), 78 U.S.C. 187(f)(1).

<sup>339</sup> See supra note 93.



of securities such as an initial public offering. Generally, from the perspective of the transfer agent facilitating a transfer, issuance will involve a credit to the transferee's securities account, as compared to the cancellation and transfer processes discussed above, which involve debiting the securities account of the transferor.

The clock for turnaround under Rules 17Ad-1 and 17Ad-2 begins when a transfer agent receives an item and ends when a transfer agent issues the new security. Thus, from the transfer agent's perspective, issuance is what stops the clock. Rule 17Ad-2(a) generally has the effect of imposing a three day deadline on turnaround of transfer of a routine item.<sup>340</sup> Rule 17Ad-1 provides in general terms that turnaround is achieved "when transfer is accomplished."<sup>341</sup> In turn, "transfer is accomplished" when "all acts necessary to cancel the certificate or certificates presented for transfer and to issue a new certificate or certificates...are completed and the item is made available to the presenter by the transfer agent..."<sup>342</sup> Thus, with certain exceptions, the "made available" standard<sup>343</sup> functions similar to a "mailbox" rule because the item is considered to have been made available when the transfer agent mails the new certificate to the transferee (or otherwise makes it available).

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<sup>340</sup> If a transfer agent fails to turnaround 90% of routine items received during a month within three business days of receipt, certain sanctions apply. See discussion supra Section IV.B for additional details on the turnaround requirements and requirements in the event of failure to meet the turnaround requirements.

<sup>341</sup> Rule 17Ad-1(c)(2) applies a different measurement of when turnaround is achieved when an outside registrar is involved: instead of the clock stopping when the new certificate is presented to the transferee, it stops when the item is "made available" to the outside registrar. Thus, turnaround will be accomplished when the transfer agent "completes all acts necessary to cancel the certificate or certificates presented for transfer and to issue a new certificate or certificates, and the item is made available to an outside registrar." Exchange Act Rule 17Ad-1(c)(2), 17 CFR 240.17Ad-1(c)(2).

<sup>342</sup> If the presenter has given special instructions, the timing is measured differently. See Exchange Act Rule 17Ad-1(d), 17 CFR 240.17Ad-1(d).

<sup>343</sup> See Exchange Act Rule 17Ad-1(c)(1), 17 CFR 240.17Ad-1(c)(1).

Upon issuing the new security to the transferee, the transfer agent must credit the securities account of the transferee receiving the new security. This is accomplished by posting to the master securityholder file all of the certificate detail information set forth in Rule 17Ad-9(a), generally within five business days.<sup>344</sup>

In the case of an uncertificated security, there is no certificate to cancel and no new certificate to be issued. Under Rule 17Ad-1(d), posting the new ownership information to the master securityholder file changes the ownership information of the securities account and “completes registration of change in ownership of all or a portion of those securities.”

Transfer agents are also responsible for countersigning securities upon issuance, which provides critical authentication of a security by an independent, outside actor. In general, “countersigning” means a signature added to a document previously signed by another person for authentication or confirmation. The second signature confirms the first signature, and the two signatures together are intended to show the certificate’s legitimacy. In the case of certificated securities, the first signer is typically an officer of the issuing corporation, and the countersigner is typically an independent officer of the issuer’s transfer agent. The procedures involved in countersignature of physical certificates are not mandated by the Exchange Act,<sup>345</sup> but are

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<sup>344</sup> See Exchange Act Rules 17Ad-9(a), 17Ad-10, 17 CFR 240.17Ad-9(a), 17Ad-10. We note that, in the case of a cancellation, which involves a “debit” to the master securityholder file under Rule 17Ad-9, the cancellation date would be the only portion of the “certificate detail” required to be posted to the master securityholder file. See Exchange Act Rule 17Ad-9, 17 CFR 240.17Ad-9.

<sup>345</sup> As discussed in Section IV.A, the Exchange Act, however, includes countersigning certificates as one element of the definition of transfer agent in Section 3(a)(25).

generally the product of other sources of law that either require them or otherwise address them in certain respects, such as by permitting them to be made by facsimile.<sup>346</sup>

In the case of DRS shares, where no certificate exists, an investor has the option of having his or her ownership of securities registered in book-entry form on the issuer's records or on the books of the issuer's transfer agent, and in either case the investor receives a "statement of ownership."<sup>347</sup> In either event, it is an important verification step in the issuance of a security and highlights the important role that transfer agents play as intermediaries for the public interest.

#### 4. *Corporate Actions and Related Services: Rules 17Ad-1, 6, 10, 12, and 13*

A corporate action is an event in the life of a security, typically instigated by the issuer, which affects a position in that security.<sup>348</sup> Examples of common corporate actions include changes that affect capital structure, such as a merger or acquisition, and distributions to securityholders, such as a dividend distribution or principal or interest payment on a debt security. Corporate actions may also include bankruptcy or liquidation proceedings, conversions, warrants, exchange offers, subscription rights, tender offers, and other events.<sup>349</sup> Generally, corporate actions can be divided into two broad categories: mandatory and voluntary (sometimes referred to as "elective.") Mandatory corporate actions usually affect all

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<sup>346</sup> See, e.g., Del. Code Ann. tit. 8 § 158 ("Any or all the signatures on the certificate may be a facsimile.").

<sup>347</sup> See Concept Release, Transfer Agents Operating Direct Registration System, Exchange Act Release No. 35038 (Dec. 1, 1994), 59 FR 63652 (Dec. 8, 1994) ("Investors who choose to participate in a direct registration system could have their securities registered in book-entry form directly on the books of the issuer and could receive a statement of ownership in lieu of a securities certificate.").

<sup>348</sup> Simmons and Dagleish, *Corporate Actions: A Guide to Securities Event Management* 3-5 (2006).

<sup>349</sup> See *id.* (categorizing major types of corporate actions).

securityholders equally and the securityholder does not have different options from which to choose; voluntary corporate actions usually allow securityholders to choose among one or more different elections they can make.

Transfer agents may perform a variety of roles and provide a variety of services, depending on the type and nature of the corporate action. For example, a transfer agent may take on the role of exchange agent in a mandatory corporate action, such as a stock-for-stock merger or a cash-for-stock merger. In a stock-for-stock merger the exchange agent might facilitate the surrender of outstanding securities for new securities, and in a cash-for-stock merger the exchange agent might facilitate the exchange of outstanding securities for cash.

In both of these examples, under Rule 17Ad-10, the transfer agent performing exchange agent services generally must update the master securityholder file with certificate details within five business days. But because the transfer associated with some of the most common corporate actions qualify as non-routine items under Rule 17Ad-1, including transfers “in connection with a reorganization, tender offer, exchange, redemption, or liquidation,”<sup>350</sup> the general three business day deadline for turnaround of routine items under Rule 17Ad-2 may not apply. However, if a transfer agent makes a determination that a transfer does fall within Rule 17Ad-1(i)(5) and therefore is non-routine, Rule 17Ad-6(a)(11) requires the transfer agent to maintain records documenting the basis for this determination.<sup>351</sup> Other aspects of the processing of the

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<sup>350</sup> Exchange Act Rule 17Ad-1(i)(5), 17 CFR 240.17Ad-1(i)(5).

<sup>351</sup> A large portion of specific records that transfer agents are required to maintain under Rule 17Ad-6 and to retain for different periods of time under Rule 17Ad-7 relate to: (i) the classification of an item as routine or non-routine; (ii) tracking the compliance of the transfer agent with the performance standards for turnaround of routine items under Rule 17Ad-2(a); and (iii) the performance standards for processing of all items pursuant to Rule 17Ad-2(b).

corporate action may cause the corporate action to be classified as non-routine as well. For example, if a transfer associated with a corporate action involves a need to review “explanations, or opinions of counsel before transfer may be effected,” requires “review of supporting documentation” other than routine documentation, or includes a warrant, right, or convertible security “presented for exercise or conversion” or “presented for transfer...within five business days” before expiry it will be considered non-routine under Rule 17Ad-1.<sup>352</sup>

Voluntary corporate actions, which permit securityholders to choose among different options, may result in the need for additional tasks and systems for transfer agents to process them. For example, in addition to the ordinary recordkeeping tasks, the transfer agent may be responsible for monitoring whether elections have been made by deadlines and for tracking such elections.

In addition to the examples discussed above, transfer agent roles in connection with corporate actions may also include serving as: (i) tender agent, when the transfer agent collects shares surrendered from securityholders and makes payments for the shares at a predetermined price; (ii) exchange agent, when the transfer agent collects shares surrendered from securityholders and issues, registers, and/or distributes shares of the bidding company’s securities as compensation for tendered securities of the subject company; (iii) subscription agent, when the transfer agent invites existing equity securityholders of an issuer to subscribe to a new issuance of additional debt or equity of the issuer; (iv) conversion agent, for example when the transfer agent converts debt securities into equity securities; and (v) escrow agent,

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<sup>352</sup> Exchange Act Rule 17Ad-1(i), 17 CFR 17Ad-1(i).

when the transfer agent holds an asset on behalf of one party for delivery to another party upon specified conditions or events.

Finally, transfer agents providing corporate action services may be subject to Rule 17Ad-12 and 17Ad-13, regarding safeguarding requirements for funds and securities and an annual audit of internal control of safeguarding procedures. As discussed above, corporate actions may involve transfer agents making distributions on behalf of issuers to securityholders of cash and stock dividends as well as principal and interest payments on debt securities. Rule 17Ad-12(a) requires that:

Any registered transfer agent that has custody or possession of any funds or securities related to its transfer agent activities shall assure that: (1) All such securities are held in safekeeping and are handled, in light of all facts and circumstances, in a manner reasonably free from risk of theft, loss or destruction...; and (2) All such funds are protected, in light of all facts and circumstances, against misuse.

Rule 17Ad-13 requires every registered transfer agent to file an annual report with the Commission and the transfer agent's ARA prepared by an independent accountant concerning the transfer agent's system of internal accounting controls and procedures for, among other things, safeguarding of securities and funds. Specifically, Rule 17Ad-13(a)(2)(iii) requires the report to cover “[t]ransferring record ownership as a result of corporate actions” and Rule 17Ad-13(a)(2)(iv) requires the report to cover “[d]ividend disbursement or interest paying-agent activities.”

B. Annual Meeting, Proxy-Related Services, and Securityholder Services and Communications

One of the key rights of securityholders is the right to vote their shares on important matters that affect the companies they own. Pursuant to state corporate law, registered

securityholders may either attend a meeting to vote shares in person or authorize an agent to act as their “proxy” at the meeting to vote their shares pursuant to their voting instructions.<sup>353</sup>

Because most securityholders do not physically attend public company securityholder meetings, the corporate proxy is the principal means by which they exercise their voting rights.

The process in the United States for distributing proxy materials and soliciting, tabulating, and verifying votes by securityholders is complex, especially with respect to beneficial securityholders.<sup>354</sup> Most corporate issuers and securities intermediaries such as banks and brokers rely on a proxy service firm to perform these functions, which may include distributing and forwarding the proxy materials and collecting and tabulating voting instructions. Alternatively, some issuers choose to engage their transfer agents for certain parts of the proxy distribution process, such as printing and distributing proxy materials either directly to registered securityholders or to intermediaries, which will then distribute them to beneficial owners either through the mail or electronically.<sup>355</sup> Providing these services may be a natural extension of a transfer agent’s core functions because most transfer agents will already possess and maintain the master securityholder file listing the issuer’s registered securityholders, will have the infrastructure in place to communicate with registered securityholders, and will be in a position

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<sup>353</sup> See Del. Code Ann. tit. 8, §212 (b), (c). A full discussion of the proxy system is beyond the scope. For more information on the proxy system, see Proxy Concept Release, supra note 112.

<sup>354</sup> Beneficial owners holding securities in street name are not technically entitled to vote shares or grant proxy authority. Rather, the voting rights reside with Cede & Co. as the record owner of all street name shares. However, because Cede & Co.’s role is only that of nominee for DTC as custodian and it has no beneficial interest in the shares, mechanisms have been developed in order to pass the legal rights it holds as the record owner to the beneficial owners, enabling them to vote. For a more comprehensive discussion of these and other issues relating to the U.S. proxy and indirect holding systems, see Proxy Concept Release, supra note 112.

<sup>355</sup> See, e.g., Broadridge Annual Report 2015 (2015), available at <http://www.broadridge-ir.com/~media/Files/B/Broadridge-IR/annual-reports/ar-2015.pdf>.

to reconcile the identity of registered voters and the number of votes against the official records of the issuer.<sup>356</sup> Typical transfer agent proxy services might include mailing or electronically transmitting notices of meetings,<sup>357</sup> proxy statements, and proxy cards<sup>358</sup> to securityholders.

In addition, under many state statutes, an issuer must appoint a vote tabulator (sometimes referred to as the “inspector of elections” or “proxy tabulator”) to collect and tabulate the proxy votes as well as ballot votes cast in person by registered owners at a securityholder meeting.<sup>359</sup> As with proxy distribution services, some issuers hire their transfer agent to create sophisticated voting platforms for securityholders or to act as the vote tabulator.<sup>360</sup> The vote tabulator is ultimately responsible for determining whether shares are represented at the meeting, the validity of proxies received, and tallying the votes.<sup>361</sup> The tabulator must determine that the correct

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<sup>356</sup> See Proxy Concept Release, *supra* note 112. See Proxy Tabulation and Solicitation, AST, [http://www.amstock.com/corporate/corporate\\_proxy.asp](http://www.amstock.com/corporate/corporate_proxy.asp) (last visited November 20, 2015).

<sup>357</sup> See, e.g., Del. Code Ann. tit. 8, § 222 (2001). See also Del. Code Ann. tit. 8, § 232 (2001).

<sup>358</sup> In cases where the issuer is relying upon the notice and access model of proxy statement distribution, the proxy card must be mailed even if the proxy statement is not mailed by the issuer. See Final Rule: Internet Availability of Proxy Materials, Exchange Act Release No. 55146, 10 (Jan. 22, 2007), 72 FR 4148 (Jan. 29, 2007).

<sup>359</sup> See, e.g., Del. Code Ann. tit. 8, § 231(a)-(c)(2001) (inspectors must be appointed in advance of all stockholder meetings of publicly held corporations and have responsibility for ascertaining the number of shares outstanding and the voting power of each, determining the shares represented at the meeting and the validity of proxies and ballots, counting all votes and ballots, creating and retaining a record of the disposition of any challenges made to any determination of the inspectors, and certifying their determination of the number of shares represented at the meeting and the count of all votes and ballots).

<sup>360</sup> Sometimes the issuer will hire an independent third party other than the transfer agent to perform the proxy tabulation function, such as to certify important votes. In such cases, the issuer or its transfer agent typically will provide the third party vote tabulator with the list of record owners so the vote tabulator can make this determination. Additionally, in contested votes, the issuer will commonly retain an independent inspector to count the proxies. See, e.g., [www.ivsassociates.com/html/index2.htm](http://www.ivsassociates.com/html/index2.htm).

<sup>361</sup> See, e.g., Del. Code Ann. tit. 8, § 231(2001); see also Marcel Kahan & Edward B. Rock, *The Hanging Chads of Corporate Voting*, 96 Geo. L.J. 1227, 1235 (2008) (“Where more than one valid proxy is given for a share, the later proxy revokes the earlier proxy. Determining the validity of proxies and the tally of votes is the responsibility of the inspector, appointed by the corporation.”), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1007065](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1007065).



number of votes has been submitted by each registered owner and determine that proxies submitted by securities intermediaries that are not registered owners are reconciled with DTC's securities position listing for that intermediary (i.e., determining that the number of nominee shares voted equals the number of shares that DTC indicates are held in nominee name).<sup>362</sup> Although the Commission does regulate transfer agents, which often serve as vote tabulators, it does not regulate the function of tabulating proxies by transfer agents.

All transfer agents also provide some level of securityholder communications services. The level of services may depend on the type or size of the issuer, but at a minimum, most transfer agents facilitate the mailing of quarterly and annual statements with details of holdings, transaction confirmations, and letters or communications confirming other transactions, such as address-change confirmations. Many transfer agents also provide tax reporting services, including sending tax forms such as W-9, W-8BEN, 1099-DIV, and 1099-B.

Most transfer agents also receive and respond to inquiries and requests by securityholders and non-securityholders,<sup>363</sup> often through interactive websites, call centers, and the like. Requests may involve a transfer (for example, a gift of fund shares from one family member to another) or a change in the securityholder's account, such as an address change or different election regarding dividend reinvestment. For transfer agents to open-end mutual funds, transfers may involve a purchase (i.e., a "subscription") or sale (i.e., a "redemption") of the

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<sup>362</sup> See Proxy Concept Release, *supra* note 112. See, e.g., [http://www.amstock.com/corporate/corporate\\_proxy.asp](http://www.amstock.com/corporate/corporate_proxy.asp).

<sup>363</sup> As discussed *supra* Section IV.A, several Commission rules address securityholder inquiries. See Exchange Act Rule 17Ad-5, 17 CFR 240.17Ad-5 (written inquiries and requests); Exchange Act Rules 17Ad-6, 7, 17 U.S.C. 240.17Ad-6, 7 (recordkeeping and retention requirements regarding inquiries and requests).

fund's shares.<sup>364</sup> Transfer agents may receive inquiries as well, which may not require processing a transaction or account change, but may involve merely answering questions about the securityholder's account or regarding the issuer generally.<sup>365</sup> Requests and inquiries are transmitted to transfer agents through various methods, including by telephone, mail, facsimile, email, internet, mobile communication device, and in-person. The predominance of telephone and other forms of electronic communication as favored methods for securityholders to communicate with issuers and their transfer agents, including the use of standardized protocols over the internet, means that managing sizable call centers and other customer service departments, with many representatives fielding calls and other message-traffic, has become a critical aspect of the transfer agent-issuer relationship.

One aspect of these securityholder services is lost certificate replacement. If a securityholder loses a certificate, the old certificate must be cancelled and new shares issued, either in certificated or book-entry form. Transfer agents facilitate this process by processing the request and replacing the lost or missing certificate. Generally, the securityholder will be required to fill out a declaration, affidavit, or other form with identifying information and a description of the circumstances giving rise to the loss and pay a fee to the transfer agent for processing the request. Most transfer agents will also require a surety bond to indemnify the issuer and transfer agent against any potential losses in connection with the missing or replacement certificate in the event it is later presented for transfer or conversion. The transfer

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<sup>364</sup> For additional discussion of "transfers," see supra Section IV.A.2.

<sup>365</sup> Inquiries about the securityholder's account may relate, for example, to matters such as dividend reinvestment or other account options.

agent will then report the lost or missing certificate to SIC pursuant to Rule 17f-1, as described above in Section II.B.

C. Regulatory Compliance and Reporting

Although not addressed directly in the transfer agent rules, most transfer agents today provide assistance with issuers' obligations to comply with various state and federal laws, including the federal securities laws, because many issuer compliance obligations fall directly into areas in which the transfer agent is already providing services to the issuer. For example, transfer agents may use their mailing and fulfillment services to help issuers meet their obligations to deliver certain documents to securityholders.<sup>366</sup> Transfer agents may also use their existing recordkeeping capabilities to help issuers meet obligations regarding disclosure of securityholders owning more than a certain threshold of ownership.<sup>367</sup> Further, investment company issuers subject to anti-money laundering responsibilities under federal law may rely on transfer agents to assist their compliance since this function is closely related to the new account processing services and securityholder recordkeeping services transfer agents provide to these issuers.

Finally, transfer agents spend a much greater amount of time and resources on assisting issuers with their escheatment obligations under state law than they have done historically.

Escheatment is the process of transferring abandoned property to the state or territory. All 50

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<sup>366</sup> See, e.g., Exchange Act Rule 14c-3, 17 CFR 240.14c-3 (annual report to be furnished securityholders); Investment Company Act Rule 30e-1, 17 CFR 270.30e-1 (reports to stockholders of management companies); Investment Company Act Rule 30e-2, 17 CFR 270.30e-2 (reports to shareholders of unit investment trusts).

<sup>367</sup> See, e.g., SEC Form N-1A, Item 18 (Control Persons and Principal Holders of Securities), SEC Form 10-K, Item 12 (Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters).

states, Washington, DC, Puerto Rico, and all U.S. territories have abandoned property laws which apply to any type of holding, including stock and associated payments made to securityholders, such as dividend payments. When a property owner fails to demonstrate ownership of property—for example, by not cashing dividend checks or responding to mailings—for a period of time, that property is deemed abandoned and is turned over to the state. The state then converts the property to cash within 30 days to two years. A securityholder who is holding securities that have been escheated will only be able to reclaim the sale price the state received, without interest, not the securities themselves.<sup>368</sup>

Pursuant to these abandoned property laws, issuers, through their transfer agents, are required to report when property is deemed to be abandoned based on the applicable abandoned property statute. Thus, issuers are required to file abandoned property reports annually with the individual states and U.S. territories, and to turn over abandoned property according to individual state laws. Failure to file on time can result in significant penalties and interest fees per year.

Transfer agents typically assist issuers with initial escheatment filings with the states in which securityholders have abandoned property, and then an annual filing every year after that with those states. In addition to fulfilling reporting requirements, typical activities may include attempted communications with the securityholder, maintaining up-to-date knowledge of federal and state escheatment requirements, proper accounting and handling of property prior to escheatment, and appropriate transfer of property.

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<sup>368</sup> See, e.g., Cal. Civ. Proc. Code §§ 1500 et. seq. (California’s requirements); Tex. Prop. Code Ann. §§ 72-76 (Texas’ requirements). We note also that Rule 17Ad-17 requires transfer agents to make certain efforts to locate lost securityholders.

## **VI. ADVANCE NOTICE OF PROPOSED RULEMAKING**

An advance notice of proposed rulemaking provides notice to the public that the agency is considering rulemaking in an area so that the public can participate in the formulation of potential future rules and can help shape a future notice of proposed rulemaking. Through this advance notice of proposed rulemaking, the Commission is requesting comment on specific areas and topics with respect to transfer agent regulation. As noted earlier, the Commission then intends to review comments and to then propose new rules, as soon as is practicable, either individually or in groups or phases to expedite the rulemaking process.

In particular, based on our current understanding of transfer agents and their functions, the Commission intends to propose new or amended rules to: (1) expand the scope of information collected by Forms TA-1 and TA-2 and capture all such information in a structured, electronic format as needed to enhance aggregation, comparison, and analysis; (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 addresses topics such as the transfer agent services to be provided, the fee schedule, and requirements for the handing over of transfer agent records to the successor transfer agent; (3) enhance transfer agents' requirements for the safeguarding of issuer and securityholder funds and securities; (4) apply an anti-fraud provision to specific activities of transfer agents; (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 scope of a transfer agent's business activities; and (8) conform and update various terms and definitions to reflect modern systems and usage, as well as the elimination of obsolete rules, such as those addressing Y2K issues.

In addition to the specific requests for comments in each section below, we also seek comment on the following:

1. For all regulatory issues discussed below, please comment on the need for revisions to the current regulatory framework, including the proposals described above, and the benefits they could provide for transfer agents, investors, issuers, and the capital markets. In particular, please comment on whether the proposals will increase the prompt and accurate clearance and settlement of securities transactions or have other benefits, such as reducing the potential for fraudulent activity. Please also comment on the potential effects on efficiency, competition, and capital formation of potential revisions to the current regulatory framework, if any. If you wish to comment on such potential benefits and effects, please explain the implications of any impact on competition, economic efficiency, capital formation, and the behavior of affected market participants, including transfer agents, issuers, and investors. For each benefit, effect and implication, provide supporting evidence and/or explain how such evidence may be obtained. Also please describe the current competitive landscape for each such affected transfer agent service. For example, to the extent possible, provide evidence on the identities of current providers, their market shares, their ease or cost of entry and exit, the cost to issuers of switching transfer agents, and the frequency of any such switching. Are there any other issues that are not discussed below but that should be addressed? If so, what are they and how should they be addressed?
2. For all regulatory issues discussed below, please comment on any potential interplay between applicable SRO rules and the potential revisions to the current regulatory framework for transfer agents discussed herein, including any potential conflicts that should be considered or resolved. Please provide a full explanation.
3. Are there specific areas where transfer agents need additional guidance or regulatory clarity regarding the applicability of current rules? How could such guidance best be provided? Would rule modification, staff guidance, or an industry roundtable be helpful?
4. Should the Commission prioritize certain of the proposed rule changes discussed in this Advance Notice of Proposed Rulemaking over others? If so, which ones and why? Are there other rule changes besides those discussed in this Advance Notice of Proposed Rulemaking that the Commission should prioritize? Please explain.
  - A. Registration and Annual Reporting Requirements

As discussed generally above in Section IV.A, Forms TA-1 and TA-2 are used to: (i) help regulators, issuers, investors, and other interested parties determine whether a transfer agent is

and will continue to be able to perform its functions properly; (ii) help regulators, issuers, investors, and other interested parties determine the nature of the business conducted by a particular transfer agent; (iii) permit the Commission to effectively target its transfer agent inspection program, including assisting examiners in preparing for and conducting transfer agent examinations; (iv) monitor transfer agent activity generally; (v) enable Commission staff to evaluate particular burdens and benefits that would be placed on the industry in potential rulemaking endeavors; and (vi) assist the Commission and Commission staff in assuring that rules are properly focused and refined.<sup>369</sup> Form TA-1 was developed and first adopted in 1975<sup>370</sup> and Form TA-2 was first adopted in 1986.<sup>371</sup> The information provided by these forms serves, among others, the vital regulatory goals of informing the Commission's oversight and examination programs and informing the public about the nature and scope of transfer agents' activities. The Commission believes the usefulness and utility of both forms in serving these important goals might be enhanced if they captured certain additional information, such as financial information, potential conflicts of interest, and detailed information about the types of services being provided and to whom.

To assure that Forms TA-1 and TA-2 continue to serve the regulatory goals described above, especially in light of the expanded scope of transfer agents' activities as discussed throughout this release, the Commission intends to propose amendments to the forms to include

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<sup>369</sup> See, e.g., Adoption of Revised Transfer Agent Forms and Related Rules, *supra* note 161.

<sup>370</sup> See Notice of Adoption of Rule 17Ac2-1 and Related Form TA-1 under the Securities Exchange Act of 1934 Providing for the Registration of Transfer Agents for which the Commission is the Appropriate Regulatory Agency, Exchange Act Release No. 11759 (Oct. 22, 1975), 40 FR 51181 (Nov. 4, 1975).

<sup>371</sup> See Adoption of Revised Transfer Agent Forms and Related Rules, *supra* note 161.

disclosure requirements with respect to certain financial information, such as the financial reports discussed below in Section VI.C (e.g., statements of financial condition, income, and cash flows), all direct or indirect conflicts of interest, the issuers and securities for which a transfer agent is providing transfer agent and other services, and the specific services being provided or expected to be provided for each issuer or security, regardless of the nature of those services. These anticipated amendments are intended to facilitate disclosure that is more closely targeted at risks associated with contemporary transfer agent activities.

A requirement that transfer agents and their officers and directors disclose any past or present affiliation with issuers serviced by, or broker-dealers affiliated with, the transfer agent could reveal instances where a transfer agent or its officers and directors have an ownership interest in such issuers and broker-dealers, including details about how the interest was obtained. Such disclosures could provide transparency about the existence of possible financial interests or other potential conflicts of interest that could incentivize a transfer agent to facilitate an improper transfer or engage in other improper conduct.

Financial disclosures may include annual financial statements using a data-tagged format, such as XBRL, broken out by the asset classes serviced by the transfer agent, such as equities, debt, and investment companies.

The Commission seeks comment on the following:

5. Should the Commission require any of the registration and disclosure items discussed above? Why or why not? Should the Commission consider other requirements? Please explain. What would be the benefits and costs associated with any such requirements? Please provide empirical data. If the Commission were to require transfer agents to disclose financial information, what information should be required, and why? Would requiring such information to be disclosed on Forms TA-1 and/or TA-2 be an effective and appropriate measure? What would be the benefits and costs associated with any such requirement?
6. Should the Commission consider amending the registration process to allow for



the issuance of an order approving a transfer agent's TA-1 application before that application becomes effective, rather than having such applications become effective automatically after 30 days? Should the Commission consider making certain findings before approving a transfer agent's application? If so, what should those findings be? Should the Commission impose threshold requirements that transfer agents must satisfy before their applications can become effective? If so, what would they be?

7. The Commission intends to propose to require transfer agents to submit annual financial statements. Should these statements be required to be audited? Why or why not?
8. Should the Commission require that annual financial statements be submitted using a data-tagged format such as XML or XBRL? Would such a requirement require changes to the U.S. GAAP Taxonomy in order to capture the information included in transfer agents' financial statements? Why or why not? Should some other electronic format be required or permitted?
9. Does the receipt of securities as payment for services create conflicts of interest for transfer agents, and if so, should the Commission require that such payments be disclosed? The Commission intends to propose to amend Forms TA-1 and/or TA-2 to require transfer agents to disclose all actual and potential conflicts of interest. Should it do so? Why or why not? Should the Commission provide any guidance as to what constitutes a conflict of interest? Why or why not? Has the proliferation of the types of services offered by transfer agents in recent years created new conflicts of interest? How might transfer agents' conflicts of interest differ depending upon whether the transfer agent is paid by the issuer, the shareholder, or some combination thereof? Is disclosure of conflicts of interest a sufficient safeguard for investors? Should the Commission ban certain conflicts of interest entirely? For example, should the Commission prohibit transfer agents from having certain affiliations with issuers or broker-dealers, or from providing certain services if they have such affiliations? Please provide a full explanation.
10. Should the Commission amend Forms TA-1 and/or TA-2 to require transfer agents to disclose information regarding the fees imposed or charged by the transfer agent for various services or activities? If so, what type of information or level of detail should be required? Should the Commission require that fee disclosures be standardized to facilitate comparison? Should fees charged to both issuers and directly to shareholders be required to be disclosed? Please provide a full explanation.
11. To increase the ability of the Commission to monitor trends, gather data and address emerging regulatory issues, should the Commission require registered transfer agents to file material contracts with the Commission as exhibits to Form TA-2? What costs, benefits and burdens, if any, would this create for issuers or transfer agents? Should the Commission establish a materiality threshold or

provide guidance on materiality were it to propose such a rule? Please provide a full explanation.

12. Should the Commission amend Forms TA-1 and/or TA-2 beyond any changes discussed above? If so, what amendments should the Commission consider in making that determination and why? Please provide a full explanation.
13. What costs, benefits, and burdens, if any, would the potential requirements discussed above create for issuers or transfer agents?

B. Written Agreements Between Transfer Agents and Issuers

Transfer agency agreements between transfer agents and issuers are mainly governed by state contract law.<sup>372</sup> It is the Commission staff's understanding, based on information collected during examination of registered transfer agents and review of a number of written agreements between transfer agents and issuers, that many transfer agents enter into written contracts with their issuers that cover some or all of the following subjects: (1) the services to be provided by the transfer agent and performance metrics and standards; (2) the responsibilities of the parties; (3) the duration of the agreement, including termination fees; (4) the fees and terms of payment; (5) the terms that govern termination of the agreement; (6) the disposition of securityholder records after the agreement's termination; (7) the use and protection of data, such as privacy and business continuity requirements; and (8) indemnification.

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<sup>372</sup> At present, no UCC or Commission rule requires that transfer agent service agreements with issuers be set down in writing or governs the terms of such agreements. Rule 17Ad-16 requires a registered transfer agent to notify an appropriate qualified registered securities depository under certain circumstances, including when the transfer agent assumes or ceases transfer agent services for an issuer, but does not address the terms of transfer agent service agreements with issuers nor require that they be set forth in writing. Exchange Act Rule 17Ad-16, 17 CFR 240.17Ad-16. See also Adopting Release for Rule 17Ad-16, supra note 147.

However, some transfer agents, often smaller transfer agents that may primarily service smaller issuers, may not document their arrangements with issuers in a written agreement or, even if they do enter into a written agreement, it may not cover all of the subjects identified above. Based on the Commission staff's experience administering the Commission's transfer agent rules and examination program, it appears that such undocumented or under-documented arrangements may be more likely than written agreements to lead to protracted disputes, especially with respect to: (1) the duration of the arrangement; (2) the conditions of the arrangement's termination; (3) the disposition of the securityholder records after termination or notice of termination; and (4) the fees charged by the transfer agent. Such disputes may interfere with the operations of the markets and the protection of investors by disrupting or otherwise hindering transfer agent processing, recordkeeping, and safeguarding. For example, it is the Commission staff's understanding that some transfer agents, after having been terminated by the issuer, have substantially delayed the handing over of securityholder records to successor transfer agents by demanding that the issuer pay a substantial "termination" fee before the transfer agent would agree to hand over the securityholder records it had been maintaining, even though the issuer claimed there was no written agreement in place or it had otherwise not agreed to such a fee.<sup>373</sup> In such cases, the issuer may be unable to retain a new transfer agent if the old transfer agent will not make the records available to the new transfer agent. The inability to retain a new transfer agent could lead to inaccuracies in the master securityholder file and other

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<sup>373</sup> It is the Commission staff's understanding that typical termination fees may range from about \$1,000 to \$5,000, though disputes like those described herein may involve a transfer agent's demand for fees as high as \$30,000.

records or impede trading in the issuer's securities. Commission staff is also aware of instances in which a termination dispute between an issuer and a transfer agent has resulted in two transfer agents each maintaining separate records, which could be inconsistent with each other.

The Commission believes that the existence of a written agreement that describes the ongoing relationship under which a transfer agent and an issuer will operate, including the terms under which the agreement between them may be terminated, could help to avoid such disputes, including disputes over agreed-upon fees, and could help ensure the timely and appropriate turnover of an issuer's shareholder records upon the termination of the written agreements. If the relationship between an issuer and a transfer agent is terminated and the issuer engages a new transfer agent, it is essential to the issuer, its securityholders, and the market participants who may seek to trade the issuer's securities, that the issuer's records are promptly delivered to the new transfer agent to provide an orderly continuity of services.

Among the issuer's records and related documents typically in the possession of its transfer agent are: (1) the master securityholder file with the names and addresses of current securityholders and the amount of securities owned by each holder;<sup>374</sup> (2) the control book showing the total units outstanding of each securities issue;<sup>375</sup> (3) the logs showing items transferred and processed for each issue; (4) the records of each issue's distributions (e.g., interest and dividends) to securityholders; (5) an inventory of blank (unissued) securities

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<sup>374</sup> See Exchange Act Rule 17Ad-9(b), 17 CFR 240.17Ad-9(b).

<sup>375</sup> See Exchange Act Rule 17Ad-9(d), 17 CFR 240.17Ad-9(d) (defining "control book").

certificates for each issue; and (6) the records of cancelled securities certificates for each issue.<sup>376</sup>

Such records are critical to issuers' routine operations as a stock corporation and to ensuring that investors' rights are protected. Without these records it would be challenging to: (1) establish the identities of its own securityholders or the number of units of securities each investor holds; (2) determine whether the number of its shares outstanding is within the bounds of its corporate charter or whether there has been an overissuance; (3) distribute interest and dividend payments to its investors; or (4) provide to investors periodic reports and proxy statements.

The Commission therefore intends to propose amendments to the transfer agent rules to 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 certain basic topics, such as the transfer agent services to be provided, the terms of payment and fees to be imposed, particularly any termination fees, and requirements for the turnover of transfer agent records to the successor transfer agent. The Commission further intends to propose new or amended rules requiring transfer agents to pass through certain records to newly appointed or successor transfer agents in a prompt, complete, and uniform manner.

The Commission seeks comment on the following:

14. Should the Commission require that any arrangement for transfer agent services between a registered transfer agent and an issuer be set forth in a written agreement? Why or why not? What are the alternative means of achieving similar objectives, and are they as effective or efficient? If the Commission were to require a written agreement, should it cover certain topics? If so, what topics? For any such provisions or topics, are there asymmetries in information or other

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<sup>376</sup> See Exchange Act Rule 17Ad-19, 17 CFR 240.17Ad-19 (cancellation of certificates); Exchange Act Rules 17Ad-6(c), 7(d), 17 C.F.R. 240.17Ad-6(c), 7(d) (requiring that such cancelled certificates "be maintained for a period of not less than six years.").

areas between transfer agents and issuers that the Commission should consider in connection with such contractual provisions? For what types of transfer agents, or in what types of such relationships, do these asymmetries most frequently arise, and where are they most acute? Please provide a full explanation and supporting evidence.

15. How are fees set out in transfer agent agreements today? Do issuers find it difficult to fully understand the fee structures offered by transfer agents, and how do those fee structures work in practice? Should the Commission require that all fee arrangements between an issuer and a transfer agent be set forth and specified in a written agreement? Why or why not? Should the Commission require that transfer agents disclose their fee arrangements in their filings with the Commission? If so, should transfer agents be required to utilize a standardized framework or terminology when disclosing their fee structures? Should the Commission exempt fees which may be negotiated on a case-by-case basis, such as corporate action fees? Why or why not? Would requiring disclosure of fees affect competition, or the form of competition, among transfer agents or between transfer agents and other entities? Please provide a full explanation and supporting evidence.
16. Currently, transfer agents are not required by rule to pass through specified records to successor transfer agents. Are issuers or transfer agents aware of instances where records have not been passed from one agent to the next, or agents have not done so in a prompt manner? Are commenters aware of disputes between transfer agents and their issuer clients or successor transfer agents with respect to the transfer of records to a successor transfer agent? How was the situation resolved? Have transfer agents demanded previously undisclosed termination fees, or fees inconsistent with what those parties previously agreed to, in exchange for turning over records to a successor? Would the anticipated proposed rules described above help avoid or resolve any disputes between transfer agents and issuers or successor-transfer agents with respect to the transfer of records? Please provide a full explanation and supporting evidence.
17. What costs, benefits, and burdens, if any, would a written agreement create for issuers or transfer agents?

C. Safeguarding Funds and Securities

Because transfer agents already facilitate securities transfers and maintain securityholder records, approximately one-third of them are engaged by issuers to provide administrative,

recordkeeping, and processing services related to the distribution of cash and stock dividends, bond principal and interest, mutual fund redemptions, and other payments to securityholders.<sup>377</sup> These services, which are generally referred to in this release as “paying agent” services,<sup>378</sup> often require the transfer agent to receive and accept funds or securities from issuers or securityholders and hold them for periods generally ranging from less than one day to 30 days before distributing the funds or securities to the intended recipients.<sup>379</sup> Transfer agents’ activities with respect to paying agent services are significant. In 2014, transfer agents distributed over \$2.4 trillion in securityholder dividends, bond principal and interest, and mutual fund redemption payments.<sup>380</sup>

Additionally, 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.<sup>381</sup> Residual funds or

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<sup>377</sup> This data is based on transfer agent annual reports filed with the Commission on Form TA-2 on or before March 31, 2015, which are publicly available once filed. See generally, Exchange Act Rule 17Ac2-2(a), 17 CFR 240.17Ac2-2(a); SEC Form TA-2, 17 CFR 249b.102.

<sup>378</sup> Entities other than transfer agents may also provide paying agent services. For example, recently amended Rule 17Ad-17(c)(2) defines “paying agent” to include “any issuer, transfer agent, broker, dealer, investment adviser, indenture trustee, custodian, or any other person that accepts payments from the issuer of a security and distributes the payments to the holders of the security.” 17 CFR 240.17Ad-17(c)(2). See supra Section IV.A.4 for additional discussion of Rule 17Ad-17.

<sup>379</sup> Certain corporate actions may require the transfer agent to hold funds for extended periods of time beyond 30 days. For example, where a tender offer is extended beyond 30 days, the transfer agent may maintain possession or control over investor funds until the offer expires. The Commission notes that when transfer agents have custody of funds or securities, they have a duty to safeguard that property. See Exchange Act Rule 17Ad-12, 17 CFR 240.17Ad-12.

<sup>380</sup> This figure is based on transfer agent annual reports filed with the Commission on Form TA-2 under the Exchange Act on or before Mar. 31, 2015, which are publicly available once filed. See generally, Exchange Act Rule 17Ac2-2(a), 17 CFR 240.17Ac2-2(a); SEC Form TA-2, 17 CFR 249b.102.

<sup>381</sup> As noted above in Section V.C, when a property owner fails to demonstrate ownership of property for a specified period of time by, for example, cashing a dividend check, that property will likely be deemed by the relevant state to be abandoned and will be escheated to the state’s unclaimed property administrator

securities include those which cannot be successfully delivered to the intended recipient because the transfer agent has lost contact with the intended recipient (e.g., lost securityholder funds),<sup>382</sup> as well as those which are transmitted or delivered, but the intended recipient nonetheless does not demonstrate ownership of the property (e.g., unresponsive payee funds, which may ultimately be escheated).<sup>383</sup>

As demonstrated by the Paperwork Crisis, the financial crisis of 2008, the 2012 flooding of the DTCC securities vault in New York during Superstorm Sandy,<sup>384</sup> and many other incidents, the safe, accurate, and efficient delivery of funds and securities, whether in certificated or uncertificated form, is vital to the integrity and smooth functioning of the National C&S System. Given their significant role in providing paying agent and custody services for funds and securities,<sup>385</sup> and the risk of loss from fraud, theft, or other misappropriation,<sup>386</sup> the funds

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pursuant to the state's applicable escheatment laws. See, e.g., Adopting Release for 17Ad-17 Amendments, supra note 274.

<sup>382</sup> See Exchange Act Rule 17Ad-17(b)(2), 17 CFR 240.17Ad-17(b)(2) (defining "lost securityholder"). As noted above in Section IV.A.4, the requirement to conduct database searches for lost securityholders has been extended to brokers and dealers. See Adopting Release for 17Ad-17 Amendments, supra note 274.

<sup>383</sup> See Exchange Act Rule 17Ad-17(c)(3), 17 CFR 240.17ad-17(c)(3) (defining "unresponsive payee"). Rule 17Ad-17(c)(1) generally requires paying agents to provide within certain time periods written notification to each unresponsive payee that the securityholder has been sent a check (or checks) that has not yet been negotiated. Exchange Act Rule 17Ad-17(c)(1), 17 CFR 240.17Ad-17(c)(1).

<sup>384</sup> See DTCC 2013 Annual Report (2013), available at <http://www.dtcc.com/annuals/2013/index.php> (discussing DTC vault flood and security certificate recovery process after Superstorm Sandy).

<sup>385</sup> See supra note 380 (data on distributions made in 2014 by registered transfer agents on behalf of issuers).

<sup>386</sup> See, e.g., SEC v. Robert G. Pearson and Illinois Stock Transfer Company, Civ. Action No. 1:14-cv-03875 (N.D. Ill. May 22, 2014); SEC Litigation Release No. 23007 (May 28, 2014) (announcing fraud charges against Illinois Stock Transfer Company and its owner, alleging misappropriation of money belonging to their corporate clients and the clients' securityholders in order to fund their own payroll and business); In the Matter of Securities Transfer Corporation and Kevin Halter, Jr., Exchange Act Release No. 64030 (Mar. 3, 2011) (settled action) (finding that transfer agent and its president failed to ensure that transfer agent had adequate supervisory procedures and a system for applying such procedures to safeguard client funds held in its custody or possession from internal employee abuse perpetrated by the transfer agent's former bookkeeper).



and securities held in a transfer agent's custody in either physical or electronic form could present significant custody or delivery risks to issuers, securityholders, and the financial system as a whole. In addition, funds and securities in custody of transfer agents could also be subject to risk of loss from recordkeeping errors (e.g., where the transfer agent is unable to reconcile the origin and ownership of funds or securities held), attachment (e.g., in the event of a judgment against the transfer agent), and insolvency (e.g., securityholder or issuer funds could be commingled with transfer agent funds and therefore, in the event of bankruptcy, treated as general assets of the transfer agent and not as separately identifiable investor or issuer funds).<sup>387</sup>

Further, even routine paying agent activity, such as dividend distribution processing, may be complex. For example, after determining record date eligibility, the paying agent (who may be a transfer agent) will calculate and balance the cash dividend amount or, in the case of a stock dividend, the equivalent number of shares, which the transfer agent will issue, register, and deliver, either in certificated or book-entry form. The paying agent may then handle the printing, posting, and distribution<sup>388</sup> of dividend payments to the issuer's registered securityholders,<sup>389</sup>

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<sup>387</sup> As noted in Section I, a transfer agent's failure to perform its recordkeeping duties can create significant risks. These risks may be heightened where a transfer agent maintains the only electronic record of ownership of an issuer's securities, such as when facilitating an issuer's DRS program whereby the transfer agent, not DTC, maintains electronic book-entry custody and records of shares.

<sup>388</sup> Disbursements may be by check, electronic deposit into a securityholder bank account, or reinvestment in additional shares of the company through a DRIP or a Direct Stock Purchase Plan ("DSPP"). Additionally, some larger transfer agents may provide currency exchange services to international investors, allowing them to select the currency in which they want their dividend payments or sale proceeds to be calculated and paid.

<sup>389</sup> Where securities are held in street name registered to DTC's nominee, Cede & Co., rather than issuing thousands of individual checks or securities directly to registered securityholders, the paying agent will deliver funds (or newly issued securities generated by certain corporate actions) to DTC. DTC then electronically credits the accounts of the appropriate banks and brokers, which in turn credit the payments and/or securities to the accounts of the beneficial owners. For additional information about DTC's

either directly or through a third-party service provider. The paying agent may also reconcile all checks and disbursements from the dividend account, and thereafter may also offer ancillary payment services to securityholders, such as: (i) corresponding with securityholders regarding uncashed or stale-dated distribution payments or distribution payments declared lost or stolen; (ii) placing stops on checks or certificates that are certified to be lost or stolen; (iii) reissuing replacement checks and securities where necessary; (iv) providing photocopies of paid checks; and (v) preparing and mailing dividend tax reporting forms required by the Internal Revenue Service.

Other distributions, like those arising from lawsuits or settlements, may require special attention. For example, to ensure that only investors who held shares between specific dates or meet other detailed tests are compensated for a specific settlement, transfer agents who are engaged to perform distribution activities must carefully review ownership records to determine who is entitled to receive a payment and in what amount. Any processing errors at any point in this complex process could present substantial risks for both issuers and securityholders. For example, if there is a substantial positive adjustment to the share price following the payment date, a transfer agent's failure to calculate or distribute the correct amounts to securityholders could create risk of loss of funds or securities for investors, as well as risk of liability for the issuer, transfer agent, and others involved in the processing. A transfer agent's inadvertent failure to reinvest a dividend payment or an erroneous distribution of a cash payment could create similar risks.

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Corporate Actions Processing Service for distributions, see Corporate Actions Processing, DTCC, <http://www.dtcc.com/asset-services/corporate-actions-processing.aspx>.

Despite the amounts involved and risks posed, only one of the existing transfer agent rules – recently amended Rule 17Ad-17 – specifically refers to and directly addresses certain limited conduct of paying agents.<sup>390</sup> Other Commission rules indirectly address activity implicated by the paying agent role, but do not specifically address the complex administrative, recordkeeping, and processing activities associated with transfer agents’ activities as paying agents, nor do they provide definitive standards to determine the adequacy of the transfer agent’s safeguards or prescribe specific requirements for how transfer agents in such instances should protect funds and securities from misappropriation, theft, or other risk of loss. In particular, Rule 17Ad-12 requires transfer agents to assure that funds and securities in their possession or control are “protected, in light of all facts and circumstances, against misuse,” and that all such securities “are held in safekeeping and are handled, in light of all facts and circumstances, in a manner reasonably free from risk of theft, loss or destruction.”<sup>391</sup> Rule 17Ad-13 requires transfer agents to file an annual report prepared by an independent accountant concerning the transfer agents’ systems of internal accounting control and related procedures for the safeguarding of related funds.

More specificity and a more robust set of standards against which paying agent activities can be measured may be necessary to better protect investors, facilitate the prompt and accurate clearance and settlement of securities transactions, and keep pace with the evolving roles transfer agents occupy in this space. We intend to propose new rules or rule amendments to address transfer agents’ expanded role in handling investor funds and securities, as well as the increase in

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<sup>390</sup> See supra Section IV.A.4 for additional discussion of Rule 17Ad-17.

<sup>391</sup> Exchange Act Rule 17Ad-12, 17 CFR 240.17Ad-12.

the number and types of transactions currently facilitated by transfer agents. In particular, the Commission intends to propose new rules or amend Rule 17Ad-12 to require transfer agents to comply with specific minimum best practices requirements 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 securityholder accounts and information; (iv) enhanced recordkeeping requirements; and (v) specific unclaimed property procedures. The Commission also intends to propose a rule requiring transfer agents to segregate client funds to ensure that bank accounts are appropriately designated to protect client funds from being counted as transfer agent funds in the event of insolvency, and to obtain written notification from banks holding the funds that the funds are for the exclusive benefit of the customers, not the transfer agent.

In addition, the Commission intends to propose new rules for transfer agents similar to those recently adopted for registered broker-dealers regarding amended annual reporting, independent audit, and notification requirements, which are designed to, among other things, increase broker-dealers' focus on compliance and internal controls.<sup>392</sup> In light of the activities and risks associated with their paying agent activities discussed above, the Commission preliminarily believes it would be appropriate to implement similar rules for transfer agents, including rules requiring transfer agents to prepare and file annual financial reports consisting of a statement of financial condition, a statement of income, a statement of cash flows, and certain other financial statements, similar to those discussed above in Section VI.A in connection with

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<sup>392</sup> For a discussion of the recent amendments to the requirements for broker-dealers, see Broker-Dealer Reports, Exchange Act Release No. 70073 (July 30, 2013), 78 FR 51910 (Aug. 21, 2013).

new registration and annual reporting requirements. The Commission intends to propose new rules to require transfer agents acting as paying agents or custodians 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. In connection with these proposals, the Commission also intends to propose certain amendments to Form TA-2 requiring transfer agents to disclose the number and/or dollar value of residual and unclaimed funds. Finally, the Commission intends to propose amendments to 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.

The Commission seeks comment on the following:

18. Would the anticipated proposals described immediately above appropriately strengthen practices and procedures involving the safeguarding of funds and securities by transfer agents? Are there other areas that the Commission should consider? If so, what regulatory or other action to address any areas of weakness or risk should the Commission consider? Please provide a full explanation.
19. Should the Commission require transfer agents to file on a periodic basis information disclosing whether and how a transfer agent maintains custody of issuer and securityholder funds and securities, similar to the information broker-dealers are required to report quarterly? Why or why not? What benefits, costs, and burdens would result? Please provide a full explanation.
20. In addition or as an alternative to the anticipated proposals described above, should the Commission provide specific guidelines or requirements for transfer agents' paying agent and custody services? Why or why not? What should those guidelines or requirements be? Do commenters believe the lack of such guidelines or requirements results in varying practices and standards among transfer agents, or specific areas of weakness or risk? Why or why not? Please provide a full explanation.
21. What are the current best practices with respect to the safeguarding of funds and securities (e.g., segregation of accounts, written procedures, specific internal controls, limits on employee access to physical items and records, and to computer systems, as well as other access controls)? Do commenters believe that Rules 17Ad-12, 17Ad-13, and 17Ad-17 are effective in encouraging those best practices? Are there differences in how funds are safeguarded between smaller

and larger transfer agent firms? Please provide a full explanation.

22. What are the current best practices with respect to the creation, maintenance, and reconciliation (or other use) of financial or other records that might bear upon the safety of customer funds and securities? Should the Commission require any such best practices, such as: (i) monitoring the financial position of the transfer agent by preparing, maintaining, and reconciling financial books and records, including a statement of financial condition, a statement of income, a statement of cash flows, and certain other financial statements; and (ii) adopting internal written procedures or specific internal controls requiring the monthly reconciliation of all bank accounts used in a transfer agent's business, and requiring audits of the effectiveness of these internal controls by independent public accountants? Why or why not? Please provide a full explanation.
23. Should the Commission require transfer agents to file certain additional reports prepared by an independent public accountant on the transfer agent's compliance and internal controls? Why or why not? In connection with any such requirement, should the Commission require transfer agents to allow representatives of the Commission or other ARA to review the documentation associated with certain reports of the transfer agent's independent public accountant and to allow the accountant to discuss with representatives of the Commission or ARA the accountant's findings associated with those reports when requested in connection with an examination of the transfer agent? Why or why not? Please provide a full explanation.
24. Do commenters believe that there are different risks associated with transfer agents maintaining issuer or securityholder funds at banks that are part of the same holding company structure as the transfer agent, as opposed to a wholly unaffiliated bank? Why or why not? If there are distinct risks, should the Commission act to mitigate those risks, and if so, how? Should the Commission prohibit a transfer agent from maintaining issuer and securityholder funds at a bank that is affiliated with the transfer agent? If so, how should "affiliated bank" be defined? Should transfer agents that are also custodian banks be required to maintain a segregated special account or accounts at an unaffiliated bank or other approved location? Why or why not? Please provide a full explanation.
25. If transfer agents were to be required to deposit or transmit issuer and securityholder funds into a special bank account, should the Commission also limit the amount of funds that could be deposited in special accounts at a bank to reasonably safe amounts, whether the bank is affiliated or non-affiliated? Why or why not? If so, what amounts should the Commission consider reasonably safe? Should such amounts be measured against the capitalization of the transfer agent and/or the bank? Why or why not? Please provide a full explanation.
26. What are the current insurance requirements and/or practices among transfer agents, and what is the source of those requirements and/or practices? Would

different or additional insurance requirements address current paying agent risks, such as loss or misuse of funds? Why or why not? If so, what types and amounts of insurance would be sufficient to address current paying agent risks? Why? If the Commission proposes specific insurance requirements for transfer agents, should it also require transfer agents to establish and maintain written policies and procedures describing their process for evaluating and procuring insurance (such as fidelity, professional indemnity, cybersecurity, errors and omissions and surety coverage) and for determining the coverage amounts? Should the transfer agent's annual accountant's report on internal controls required by Rule 17Ad-13 include verification that the transfer agent has fulfilled these requirements? Please provide a full explanation.

27. What are the industry best practices with respect to safeguarding procedures specific to residual or unclaimed funds and securities remaining in the transfer agent's possession or control post-payment but prior to the successful distribution to securityholders or escheatment to a state or territory?
28. If the Commission were to require transfer agents to disclose information pertaining to residual or unclaimed funds, what type of information and level of detail should be required, and how frequently should it be required to be reported? What would be the cost, burdens or benefits, if any, of such disclosure for issuers or transfer agents?
29. Currently, Rule 17Ad-5 only requires a transfer agent who has not handled disbursements or dividends for at least three years to respond to inquiries by simply indicating the agent is no longer the paying agent. What volume of such requests do paying agents typically receive annually? Do paying agents typically know who the current agent is? What would be the costs, burdens or benefits if paying agents were required to provide such information? Please provide a full explanation.
30. What would be the costs, benefits, and burdens, if any, of the proposals described above?

D. Restricted Securities and Compliance With Federal Securities Laws

Transfer agents play a particularly important role in the securities industry with respect to the issuance and transfer of restricted securities. Restricted securities cannot be resold legally unless there is an effective registration statement for their resale, or there is an available exemption from registration for the resale. Typically, these securities bear restrictive legends indicating that their sale or transfer may be subject to a restriction or limitation and

intermediaries will not effectuate their transfer until restrictive legends are removed. Because transfer agents are often the party responsible for affixing, tracking, and removing restrictive legends, they play an important role in helping to prevent unregistered securities distributions that violate Section 5 of the Securities Act of 1933 (“Securities Act”).<sup>393</sup> The need to prevent unregistered securities distributions is particularly acute in the microcap market, where OTC issuers may not be subject to certain of the Commission’s disclosure requirements and there is an increased potential for fraud and abuse because potential investors have few, if any, resources for obtaining meaningful disclosure or conducting independent research on microcap issuers.

The Commission’s experience in investigating abuses in the microcap market and bringing enforcement actions charging violations of the federal securities laws demonstrates how the removal of restrictive legends can often be a central element contributing to illegal, unregistered distributions of securities. While these actions typically involve misconduct by persons other than the transfer agent, the Commission has charged transfer agents as culpable participants in a variety of circumstances. Transfer agents may face potential liability for aiding and abetting or causing a violation of Section 5 of the Securities Act for an act or omission that contributes to or helps effectuate an illegal unregistered distribution.<sup>394</sup> In some cases, we have brought an action against the transfer agent for violating Section 5 on the theory that the transfer

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<sup>393</sup> See Securities Act Section 5, 15 U.S.C. 77e.

<sup>394</sup> See, e.g., National Stock Transfer, Inc., A.P. File No. 3-9949, Sec. Act Rel. No. 7924 (Dec. 4, 2000) (settled proceeding against transfer agent and an officer of the transfer agent for willfully aiding and abetting and causing Section 5 violations by issuing shares in reliance on an issuer’s representation of an S-8 transaction that had been purportedly registered with the Commission when no such registration existed); Holladay Stock Transfer, Inc., A.P. No. 3-9567, Sec. Act Rel. No. 7519 (Mar. 25, 1998) (settled cease and desist proceeding against transfer agent and president for, among other charges, willfully aiding and abetting and causing Section 5 violations by an issuer client).



agent was a “necessary participant” and “substantial factor” in the unregistered distribution or sale.<sup>395</sup> Depending on the facts and circumstances, a transfer agent also could incur liability pursuant to the anti-fraud provisions of the federal securities laws,<sup>396</sup> such as Section 10(b) of the Exchange Act,<sup>397</sup> Rule 10b-5 thereunder,<sup>398</sup> and Section 17(a) of the Securities Act.<sup>399</sup>

Some transfer agents have expressed concern, however, that they perceive a conflict in some instances between their obligation to take appropriate steps to forestall an illegal distribution, and their obligation under state law to comply with a valid request to issue a security or facilitate a transfer, which may require removal of a restrictive legend.<sup>400</sup>

Nonetheless, if a transfer would be unlawful under the federal securities laws, the transfer agent is not required by state law to comply with a request for transfer.<sup>401</sup> We note that the person or

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<sup>395</sup> See, e.g., Registrar and Transfer Company, A.P., Exchange Act Rel. No. 73189, para. 21 (Sep. 23, 2014) (settled action against transfer agent and its chief executive officer for, respectively, willfully violating Sections 5(a) and 5(c) and causing the transfer agents’ violations); SEC v. CMKM Diamonds, Inc., 2011 WL 3047476 (granting summary judgment for violations of Section 5 against transfer agent and its principal as necessary participants and substantial factors in unlawful distribution), rev’d, 729 F.3d 1248, 1259 (9th Cir. 2013) (holding that “undisputed facts do not establish that [transfer agent and its principal] were substantial participants . . . as a matter of law”); SEC v. CIBC Mellon Trust Co., Civ. Action No. 1:05-cv-0333 (PLF) (D.D.C. Feb. 16, 2005) (settled action charging a transfer agent with primary violations of Section 5 in addition to primary and aiding and abetting liability in a 10b-5 fraud to promote, distribute, and sell the stock of issuer Pay Pop, Inc. where Pay Pop officers paid a senior manager at the transfer agent bribes in the form of Pay Pop shares to obtain transfer agent services).

<sup>396</sup> See, e.g., id.

<sup>397</sup> Exchange Act Section 10, 15 U.S.C. 78j.

<sup>398</sup> Exchange Act Rule 10b-5, 17 CFR 240.10b-5.

<sup>399</sup> Securities Act Section 17(a), 15 U.S.C. 77q(a).

<sup>400</sup> See, e.g., Robert Feyder, Transfer Agents Beware: A Request to Remove a Restrictive Legend May be the Equivalent of a Request to Register Transfer, The Securities Transfer Association, Inc. Newsletter, Issue 2 (2002).

<sup>401</sup> See Campbell v. Liberty Transfer Co., 2006 U.S. Dist. LEXIS 91568 (E.D.N.Y. Dec. 19, 2006) (holding that transfer agent could not be found liable for requiring that certificate be legended and refusing to honor transfer absent attorney opinion letter; federal law precluded the transfer agent from treating the shares as if they were freely tradable; to conclude that plaintiff’s request for transfer required action by the transfer agent would be inconsistent with the Supremacy Clause); Catizone v. Memry Corp., 897 F. Supp. 732

entity requesting a transfer of restricted securities based on an exemption from the registration requirements of the Securities Act bears the burden of proving entitlement to that exemption.<sup>402</sup>

Further, it appears that issuers (and their transfer agents) may reasonably withhold consent to register a transfer until they can determine that the request “is in fact rightful” under Section 8-401(a)(7) of the UCC.<sup>403</sup> Because the relevant determinations can involve the assessment of legal issues that are fact-dependent,<sup>404</sup> transfer agents typically may seek to rely on representations or opinions provided by the issuer or securityholder and their counsels, usually in the form of an “attorney opinion letter,” to determine whether an exemption from registration under Section 5 of the Securities Act is applicable. As our enforcement experience demonstrates, however, this process is also susceptible to abuse, as many illegal distributions are facilitated by the improper issuance of such opinion letters.<sup>405</sup>

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(S.D.N.Y. 1995) (holding that since the transfer violated the Securities Act, it cannot be considered rightful under Section 8-401 of the U.C.C. and transfer agent was under no duty to register the transfer); Charter Oak Bank & Trust Co. v. Registrar & Transfer Co., 358 A.2d 505 (N.J. Sup. Ct. 1976) (holding that a transfer agent cannot be required by state law to transfer stock in violation of the Securities Act, therefore, when a transfer agent has reasonable cause to believe that a transfer will be in violation of the Securities Act, it has the right to refuse to make the transfer until it has received an explanation or showing that the proposed transfer would not violate the Securities Act).

<sup>402</sup> See, e.g., SEC v. Ralston Purina Co., 346 U.S. 119 (1953); Gilligan, Will & Co. v. SEC, 257 F.2d 461 (2d Cir. 1959); SEC v. Culpepper, 270 F.2d 241 (2d Cir. 1959); Edwards v. United States, 312 U.S. 473 (1941).

<sup>403</sup> If any of the preconditions enumerated in UCC Section 8-401 do not exist, such as where a transfer is wrongful, the issuer is under no duty to register the transfer. See U.C.C. 8-401, cmt. 1.

<sup>404</sup> These issues can include determining a securityholder’s affiliate status with the issuer or identifying the holding period during which an individual held restricted securities. See Securities Act Rule 144(b)(2), 17 CFR 230.144(b)(2) (providing for different conditions for use of the rule on affiliates than on non-affiliates); Securities Act Rule 144(d)(1), 17 CFR 230.144(d)(1) (providing for a holding period for restricted securities).

<sup>405</sup> See, e.g., SEC v. Gendarme Capital Corp., 2012 WL 346457 (E.D. Cal. Jan. 31, 2012) (denying defendant’s motion to dismiss Section 5 claims, where Commission’s complaint alleged that attorney issued more than 50 opinion letters to transfer agents containing false statements); SEC v. Czarnik, 2010 WL 4860678 (S.D.N.Y. Nov. 29, 2010) (denying defendant’s motion to dismiss Section 5 charges where

More specificity around transfer agents' responsibilities with respect to illegal distributions may help to better protect investors, facilitate the prompt and accurate clearance and settlement of securities transactions, and combat fraud and manipulation in the microcap market. We therefore intend to propose new rules or rule amendments to address transfer agents' role in facilitating transfers of securities that result in illegal distributions of securities. In particular, the Commission intends to propose a new rule prohibiting 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.

We also intend to propose 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 Exchange Act and the rules promulgated thereunder, including any new or amended rules the Commission may promulgate in the future, such as those dealing with transfer agents' safeguarding, paying agent, and other activities discussed above in Section VI.C and throughout this release. We also intend to propose 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.

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complaint alleged, among other things, that attorney drafted false opinion letters provided to transfer agents).

The Commission seeks comment on the following:

31. Is there a need for Commission rules clarifying transfer agent liability for participating in or facilitating an unlawful distribution of securities in violation of Section 5 of the Securities Act? Why or why not? If so, what rules should be considered?
32. Currently, there are no specific Commission rules regarding the placement or removal of restrictive legends by transfer agents. Is there a need for Commission rules governing the role of transfer agents in placing or removing restrictive legends? Why or why not? If so, what are the specific issues that should be addressed by Commission rulemaking?
33. Should the Commission 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)? Why or why not? Should the Commission also consider specific recordkeeping and retention requirements related to the issuance of share certificates without restrictive legends? Why or why not? How should book-entry securities be addressed? Are there other guidelines or requirements the Commission should consider with respect to the issuance of share certificates or book-entry securities without restrictive legends?
34. If the Commission were to issue any standards for restrictive legend removal, what would be an appropriate level of due diligence? Should any due diligence requirements be compatible with current state law governing the issuance and transfer of securities? Should the Commission consider specific guidelines and requirements for the review of representations that a shareholder is not an affiliate of the issuer or is not acting in coordination with other shareholders? Why or why not? If so, what guidelines or requirements should be considered? Should the Commission consider specific guidelines and requirements regarding transfer agents' obligations to review or determine the ultimate beneficial ownership of shares, identification of control persons of the shareholders, and relationship of shareholders to the issuer, officers or each other?
35. Do transfer agents currently possess detailed and accurate information regarding the ownership history of the securities they process? For example, do transfer agents know whether the securities they process were ever owned by a control person or other affiliate of the issuer, and for how long? If so, how do they know this? If transfer agents possess such information, do they provide it to other market intermediaries, such as broker-dealers and securities depositories? If not, should transfer agents be required to do so? Has the inability of broker-dealers

and other market intermediaries to obtain detailed and accurate securities ownership information facilitated the unlawful distribution of securities? Has it impaired secondary market liquidity, such as by making other market intermediaries unwilling or less willing to handle certain securities? If so, how can the Commission address these issues?

36. Should transfer agents be permitted to rely on the written legal opinion of an attorney under certain circumstances? If so, what should those circumstances be? For example, should there be requirements regarding the attorney's qualifications or the attorney's relation to the issuer or investor? Is it appropriate for transfer agents to rely on attorney opinion letters to the extent the letters are based on representations of the issuer or third parties without the attorney's review of relevant documentation or independent verification of the representations?
37. Should the Commission obligate transfer agents to: (i) confirm the existence and legitimacy of an issuer's business (for example by reviewing leases for corporate offices, etc.); (ii) obtain names and signature specimens for persons the issuer authorizes to give issuance or cancellation instructions, together with any documents establishing such authorization; (iii) conduct credit and criminal background checks for issuers' officers and directors and shareholders requesting legend removal; (iv) obtain and confirm identifying information for shareholders requesting legend removal (e.g., legal name, address, citizenship); and/or (v) obtain and review publicly-available news articles or information on issuers or principals? Why or why not?
38. Should the Commission enumerate a non-exhaustive list of "red flags" or other specific factors which would trigger a duty of inquiry by the transfer agent? Why or why not? If so, which "red flags" should be included?
39. Are there types of securities or categories of transactions commenters believe should require a heightened level of scrutiny or review by transfer agents before removing a restrictive legend or processing a transfer? If so, which ones and why? What should any such heightened scrutiny or review entail? For example, should the Commission require additional diligence requirements for securities offered by issuers that are not required to file financials with the Commission? Why or why not?
40. The Commission is aware that industry participants have suggested that the Commission provide a safe harbor for transfer agents from direct liability or secondary liability (e.g. aiding and abetting) in connection with an unregistered distribution of securities if the transfer agent follows the procedures set out in the

safe harbor concerning legend removal.<sup>406</sup> Should the Commission impose such a safe harbor? Why or why not? If so, what should be the specific conditions of the safe harbor?

41. Other than ensuring that the removal of restrictive legends is appropriate and not a means to sidestepping registration requirements, what requirements or prohibitions, if any, should the Commission consider as additional protections against the unlawful distribution of unregistered securities? For example, should transfer agents be required to deliver securities certificates directly to registered securityholders or be prohibited from delivering securities certificates to third parties that are not registered as owners of the certificates on the transfer agents' books? Why or why not?
42. In what form (e.g. certificate form or book-entry form) are restricted securities held and issued today? Please provide specific data and examples and, where available, breakdowns by asset class. To what extent, if any, do holders of restricted securities own those securities in street name today? To the extent restricted securities are held in book-entry form, what practices are used in the marketplace today with respect to sending securityholders account statements generally and, specifically, sending account statements bearing restrictive legends? Are any special issues created by intermediation, such as by broker-dealers, of any restricted securities held in street name? Should the Commission consider rules governing the display of legends on account statements of shareholders who hold restricted securities in book-entry form? Are there any technological or regulatory barriers to the application of restrictive legends to securities held in DRS form? Should the Commission regulate transfer agent processing of securities that are held in DRS form?
43. The Commission's staff understands that transfer agents may receive compensation in-kind in the form of securities of the issuer that hired the agent to remove restrictive legends. Does this create additional or different risks than if the transfer agent were paid in cash? If so, should the Commission limit transfer agents' acceptance of securities as payment for services related to penny-stock securities or small issuers, or acquiring shares of the issuers they are servicing through other means, such as gift or purchase? Why or why not?
44. What costs, benefits, and burdens, if any, would the potential requirements discussed above create for issuers or transfer agents?

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See Rhodes, *supra* note 18, at § 6:12 ("Attempts are now being made to persuade the SEC to adopt a procedure and a form which, when presented to a transfer agent, would free the transfer agent from liability in making the transfer in reliance on the form.").

45. Should the Commission require transfer agents to maintain, implement, and enforce written compliance and/or supervisory policies and procedures, similar to those required of broker-dealers? Why or why not? If so, what policies and procedures should be required? Should the Commission require transfer agents to disseminate written policies and procedures to all employees of the transfer agent on an annual or semi-annual basis? Why or why not? Please explain.
46. Should the Commission adopt rules requiring registered transfer agents to designate and identify a chief compliance officer? Why or why not? If so, should the Commission adopt rules governing the reporting lines and relationships of the chief compliance officer? Should the chief compliance officer be required to file an annual compliance report with the Commission? Why or why not? If so, what information should be included in the annual compliance report?
47. Should the Commission require transfer agents to undertake security checks or confirm regulatory and employment history for employees, certain third-party service providers, and associated persons, and to require certain employees of registered transfer agents to register with the Commission? Why or why not? What would be the costs, benefits, and burdens associated with such a requirement? What challenges does the trend toward the outsourcing and offshoring of certain aspects of transfer agents' functions pose for ensuring compliance with such a requirement? Please provide a full explanation.
48. Should the Commission require transfer agents to obtain certain information concerning their issuer clients, clients' securityholders and their accounts, and securities transactions? Why or why not? Please explain and provide supporting evidence where applicable. Should transfer agents be required to perform a form of due diligence on their clients and the transactions they are asked to facilitate, similar to the know-your-customer requirements applicable to broker-dealers? Should transfer agents be required to obtain a list of all affiliates of their issuer clients—including current and former control persons, promoters, and employees—and to take special precautionary steps whenever they are asked to process transactions for these affiliates?
49. Should the Commission require transfer agents to maintain 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? Why or why not? Please explain.

E. Cybersecurity, Information Technology, and Related Issues

Cybersecurity risk is a specific type of operational risk and includes risks related to the security of data stored on computers, networks, and similar systems, and technology-related disruptions of operational capacity. Given the increased use of and reliance on computers,

networks, and similar systems throughout society, cybersecurity threats are omnipresent today. They come from many sources and present a significant risk to a wide range of American interests, including critical governmental and commercial infrastructures, the national securities markets, and financial institutions and other entities that are involved in the National C&S System. In 2012, a single group targeted and attacked more than a dozen financial institutions with a sustained Distributed Denial of Service attack on those institutions' public websites.<sup>407</sup> That same year, 89% of global securities exchanges identified cyber-crime as a potential systemic risk and 53% reported experiencing a cyber-attack in the previous year.<sup>408</sup>

Cybersecurity risks faced by the capital markets and Commission-regulated entities are of particular concern to the Commission. Given the highly-dependent, interconnected nature of the U.S. capital markets and financial infrastructure, including the National C&S System, as well as the prevalence of electronic book-entry securities holdings in that system, the Commission has a significant interest in addressing the substantial risks of market disruptions and investor harm posed by cybersecurity issues.

Transfer agents are subject to many of the same risks of data system breach or failure that other market participants face. With advances in technology and the enormous expansion of book-entry ownership of securities, transfer agents today rely more heavily than ever on technology and automation for their core recordkeeping, processing, and transfer services,

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<sup>407</sup> FSOC Annual Report 2013, sec. 7.2, p. 136. The attacks began in September and “were targeted, persistent, and recurring.”

<sup>408</sup> See Rohini Tendulkar, Cyber-crime, securities markets and systemic risk, Joint Staff Working Paper of the IOSCO Research Department and World Federation of Exchanges (July 16, 2013), available at <http://www.iosco.org/research/pdf/swp/Cyber-Crime-Securities-Markets-and-Systemic-Risk.pdf>. Forty-six securities exchanges responded to the survey.



especially the use of computers and networks to store, access, and manipulate data, records, and other information. As a result, modern transfer agents are vulnerable to a variety of software, hardware, and information security risks which could threaten the ownership interest of securityholders or disrupt trading not only among registered securityholders but, because of transfer agents' electronic linkages to DTC, also among street name owners. For example, a software or hardware glitch, technological failure, or processing error by a transfer agent could result in the corruption or loss of securityholder information, erroneous securities transfers, or the release of confidential securityholder information to unauthorized individuals. A concerted cyber-attack or other breach could have the same consequences, or result in the theft of securities and other crimes.<sup>409</sup>

Cybersecurity issues have been analyzed and discussed in detail over the last several years in a variety of fora.<sup>410</sup> For example, the Commission has adopted a number of rules in recent years to address cybersecurity and related issues, although most of them either do not apply to registered transfer agents or do not address transfer agents' specific activities. In 2015, the Commission adopted Regulation SDR ("Reg SDR"), which addresses registration requirements, duties, and core principles for security-based swap data repositories ("SDRs") and

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<sup>409</sup> See generally, SEC Cybersecurity Roundtable transcript (Mar. 26, 2014), available at <https://www.sec.gov/spotlight/cybersecurity-roundtable/cybersecurity-roundtable-transcript.txt>.

<sup>410</sup> See, e.g., *id.*; see also OCIE Risk Alert, "OCIE's 2015 Cybersecurity Exam Initiative," Vol IV, Issue 8 (Sept. 15, 2015); OCIE Risk Alert, "Cybersecurity Examination Sweep Summary," Vol IV, Issue 4 (Feb. 3, 2015); Luis A. Aguilar, Comm'r, SEC, Speech at "Cyber Risks and the Boardroom" Conference of the New York Stock Exchange (June 10, 2014), available at <http://www.sec.gov/News/Speech/Detail/Speech/1370542057946> (Boards of Directors, Corporate Governance and Cyber-Risks: Sharpening the Focus); Luis A. Aguilar, Comm'r, SEC, Speech at SINET Innovation Summit (June 25, 2015), available at <http://www.sec.gov/news/speech/threefold-cord-challenge-of-cyber-crime.html> (A Threefold Cord — Working Together to Meet the Pervasive Challenge of Cyber-Crime); Michael S. Piwowar, Comm'r, Interview at The World Today (Sept. 17, 2014), available at <http://www.abc.net.au/worldtoday/content/2014/s4150439.htm> (last visited Dec. 11, 2015).

includes a requirement that every SDR adopt written policies and procedures reasonably designed to ensure that its core systems provide “adequate levels of capacity, integrity, resiliency, availability, and security.”<sup>411</sup> However, unless it qualifies as an SDR, a registered transfer agent would not otherwise be subject to these requirements.

In 2014, the Commission adopted Regulation Systems, Compliance and Integrity (“Reg SCI”), which requires entities covered by the rule to test their automated systems for vulnerabilities, test their business continuity and disaster recovery plans, notify the Commission of cyber intrusions, and recover their clearing and trading operations within specified time frames.<sup>412</sup> While Reg SCI covers registered clearing agencies and other entities, it does not apply to transfer agents.<sup>413</sup>

To address cybersecurity risk issues faced by financial institutions (as defined in the Fair Credit Reporting Act) that are registered with the Commission, in 2013 the Commission adopted Regulation S-ID, which requires these entities to adopt and implement identity theft programs.<sup>414</sup>

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<sup>411</sup> Exchange Act Rule 13n-6, 17 CFR 240.13n-6. Security-Based Swap Data Repository Registration, Duties, and Core Principles, Exchange Act Release No. 74246 (Feb. 11, 2011), 80 FR 14437 (Mar. 19, 2015).

<sup>412</sup> See Regulation Systems Compliance and Integrity, Exchange Act Release No. 73639 (Nov. 19, 2014), 79 FR 72252 (Dec. 5, 2014).

<sup>413</sup> Id. at 439-40 (discussing commenters views on whether or not transfer agents and other types of entities should be subject to Reg SCI and noting “should the Commission decide to propose to apply the requirements of Regulation SCI to these entities, the Commission would issue a separate release discussing such a proposal and would take these comments into account.”). See also comment letters in response to Regulation Systems Compliance and Integrity (Proposing Release), Exchange Act Release No. 69077 (Mar. 8, 2013): The Securities Transfer Association, Inc. at 2 (Apr. 3, 2013) (commenting that transfer agents should not be subject to Reg SCI because they were not part of the Automation Review Policy (ARP Program) of the Commission existing prior to the proposal of Reg SCI and only large transfer agents have direct connectivity to entities proposed to be covered by Reg SCI); The Investment Company Institute at 3 (July 12, 2013) (transfer agents should not be subject to SCI); Fidelity Investments at 4 (July 8, 2013) (transfer agents should not be subject to SCI because they do not engage in real-time trading and they were not included in ARP Program).

<sup>414</sup> See 17 CFR 248.201.

Unless it meets the definition of a financial institution as defined in the Fair Credit Reporting Act, a registered transfer agent would not otherwise be required to comply with Regulation S-ID.<sup>415</sup>

Finally, Regulation S-P was adopted in 2000 and requires certain Commission-registered entities to adopt measures to protect sensitive consumer financial information.<sup>416</sup> Although Regulation S-P primarily covers registered brokers, dealers, investment companies, and investment advisers, it also covers transfer agents in a limited way.<sup>417</sup> In addition, Commission staff has published guidance and other documents addressing cybersecurity risks faced by specific types of Commission registrants, such as corporate issuers, broker-dealers, investment advisers, and investment companies.<sup>418</sup>

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<sup>415</sup> See 17 CFR 248.201(a)(1); 15 U.S.C. 1681 (defining “financial institution” to include certain banks, credit unions, and “any other person that, directly or indirectly, holds a transaction account (as defined in Section 19(b) of the Federal Reserve Act) belonging to a consumer.”); see also Identity Theft Red Flags Rules, Exchange Act Release No. 69359, 69 n.182 (Apr. 10, 2013), 78 FR 23637 (Apr. 19, 2013) (“SEC staff expects that other SEC-regulated entities described in the scope section of Regulation S-ID, such as...transfer agents...may be less likely to be financial institutions or creditors as defined in the rules, and therefore we do not include these entities in our [cost/benefit] estimates.”).

<sup>416</sup> See Final Rule: Privacy of Consumer Financial Information (Regulation S-P), Exchange Act Release No. 42974 (June 22, 2000), 65 FR 40334 (June 29, 2000); Disposal of Consumer Report Information, Exchange Act Release No. 50781 (Dec. 2, 2004), 69 FR 71322 (Dec. 8, 2004) (amending rule to require policies and procedures be written).

<sup>417</sup> See 17 CFR 248.30(b)(1)(v) (“Every... transfer agent registered with the Commission, that maintains or otherwise possesses consumer report information for a business purpose must properly dispose of the information by taking reasonable measures to protect against unauthorized access to or use of the information in connection with its disposal.”); see also Final Rule: Privacy of Consumer Financial Information (Regulation S-P), Exchange Act Release No. 42974 (June 22, 2000), 65 FR 40334 (June 29, 2000).

<sup>418</sup> See, e.g., Disclosure Guidance: Topic No. 2, Cybersecurity of the Division of Corporation Finance of the Commission (Oct. 13, 2011), available at <https://www.sec.gov/divisions/corpfin/guidance/cfguidance-topic2.htm>; OCIE Cybersecurity Initiative, National Exam Program Risk Alert Volume IV, Issue 2 (Apr. 15, 2014), available at <http://www.sec.gov/ocie/announcement/Cybersecurity-Risk-Alert--Appendix---4.15.14.pdf>; Cybersecurity Examination Sweep Summary, National Exam Program Risk Alert Volume IV, Issue 4 (Feb. 3, 2015), available at <https://www.sec.gov/about/offices/ocie/cybersecurity-examination->

Further, as discussed above, the Commission’s efforts to address transfer agents’ safeguarding obligations, including the adoption and application of Rule 17Ad-12,<sup>419</sup> have focused primarily on funds and securities rather than information systems or cybersecurity. Rule 17Ad-12 requires transfer agents to exercise reasonable discretion in adopting safeguards appropriate for their own operations and risks, and a transfer agent can adopt the safeguards and procedures that are most suitable and cost-effective in light of its potential exposure to risk since the reasonableness of safeguards and procedures are tested “in light of all facts and circumstances.”<sup>420</sup> The existing rule, however, prescribes no specific requirements for safeguarding additional items of potential value in a transfer agent’s possession which potentially could be used to gain access to funds or securities, such as securityholder and account information and data in either physical or electronic form. Based on its experience administering the Commission’s transfer agent examination program, the Commission staff is aware that some transfer agents have identified risks related to information and data directly or tangentially related to funds and securities used in their operations, such as securityholder and account information stored on systems and in records, and as a result, have developed policies, procedures, controls, or best practices to mitigate risk. However, the Commission is concerned that widely varying safeguarding procedures and controls among transfer agents could create uncertainty and risk in the market. The Commission is further concerned that insufficient safeguarding of information and data, such as securityholder personal and account information

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[sweep-summary.pdf](#); Cybersecurity Guidance, Division of Investment Management Guidance Update No. 2015-02 (Apr. 2015), available at <http://www.sec.gov/investment/im-guidance-2015-02.pdf>.

<sup>419</sup> Exchange Act Rule 17Ad-12, 17 CFR § 240.17Ad-12.

<sup>420</sup> See id.

stored in computer systems and in records, could lead to the loss of information, theft of securities or funds, fraudulent securities transfers, or the misappropriation or release of private securityholder information to unauthorized individuals.

In light of the foregoing, the Commission intends to propose certain amendments to the transfer agent rules to address how technology in general and cybersecurity risks in particular affect transfer agents and their activities, and how transfer agents' technology and information systems, including securityholders' data and personal information, may be related to their safeguarding activities. In particular, the Commission intends to propose new or amended rules requiring registered transfer agents to, among other things: (i) create and maintain a written business continuity plan, tailored to the size and activities of the transfer agent, identifying procedures relating to an emergency or significant business disruption, including provisions such as data back-up and recovery protocols; (ii) create and maintain basic procedures and guidelines governing the transfer agent's use of information technology, including methods of safeguarding securityholders' data and personally identifiable information; and (iii) create and maintain 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.

The Commission seeks comment on the following:

Safeguarding of Securityholder Information and Data

50. How do commentators understand transfer agents' safeguarding obligations as applied to uncertificated securities? Please be specific.
51. How have transfer agents' data gathering and retention practices evolved in recent years? Do transfer agents collect more or different types of information than in the past? What new risks, if any, have arisen as a result of these changes? Are there some types of information collected by transfer agents that are more valuable to cyber-attackers than others, or that could cause more harm to investors

or the markets if disclosed? If so, please specify. Do transfer agents currently have special protocols to protect their most sensitive information? If not, should the Commission require them to do so?

52. Have transfer agents experienced internal or external access breaches, internal or external fraud or abuse, or other issues associated with creating, accessing, controlling, altering, or securely storing issuer or investor information or data, including securityholders' private account information and other private personal information, whether electronic or otherwise? If so, please describe the nature, extent, and resolution of such problems.
53. What are the most significant risks or threats with respect to such information and data and what challenges do transfer agents face when attempting to assure that it is created, accessed, altered, controlled, and securely stored and retained in a manner reasonably free from identified risks? What policies, procedures, or controls may be employed to mitigate these risks or threats and address these challenges? What is the evidence on the beneficial impact of these practices and does it vary across transfer agents? How and why?
54. Have transfer agents identified risks related to information and data directly or tangentially related to funds and securities used in their operations, such as securityholder and account information stored on systems and in records, electronic or otherwise? Please describe the nature and scope of any such identified risks, as well as any challenges transfer agents face when attempting to mitigate them.
55. Do commenters believe that insufficient safeguarding of information and data, such as securityholder personal and account information stored in computer systems and in records, could lead to the loss of information, theft of securities or funds, fraudulent securities transfers, or the misappropriation or release of private securityholder information to unauthorized individuals? Why or why not? Are commenters aware of any such occurrences or incidents resulting from insufficient safeguarding of information? If so, please describe the nature, extent, and resolution thereof, including any steps perceived as necessary to be taken to prevent a reoccurrence.
56. What are the current industry best practices for protecting issuer or investor information or data in physical or printable records? What minimum standards, if any, should the Commission require for the safeguarding of such information or data?
57. To ensure that data, records, and other types of information stored on computers, networks, and similar systems used by various participants in the National C&S System are safeguarded in a manner that protects investors and promotes the prompt and accurate clearance and settlement of transactions in securities, should Commission requirements apply to certain types of data, records, or other

information, rather than to a particular type of entity? For example, should the Commission impose specific safeguarding, recordkeeping, or other requirements on registered transfer agents and other entities registered or required to be registered with the Commission that possess or control securityholder and account information (electronic or otherwise)? Why or why not? What would be the costs, benefits, and burdens associated with such an approach? Please provide empirical data if available.

#### Operational Risk, Cybersecurity, and Other Technology-Related Issues

58. Should the Commission impose specific cybersecurity standards for transfer agents? If so, what should they be, and what standard would be appropriate? Should these standards vary depending on the size of the transfer agent or the nature and scope of the services it provides? Do commenters believe Reg SCI or Reg SDR provide an appropriate model for potential transfer agent rules addressing cybersecurity issues? Why or why not? If so, which aspects of Reg SCI or Reg SDR might be most appropriate given the activities of transfer agents? Are there other models that might be appropriate for the Commission to consider when developing cybersecurity rules for transfer agents? Regardless of the framework utilized, should the Commission consider requiring certain minimum cybersecurity protocols, such as practicing good cyber hygiene, patching critical software vulnerabilities, and using multi-factor authentication? Should the Commission require transfer agents to implement heightened security protocols for their most sensitive data? If so, which data would merit special protection, and what form should that protection take? Please provide a full explanation.
59. Should the Commission require transfer agents to demonstrate 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? Why or why not? If so, what requirements should the Commission consider? For example, would it be appropriate to require transfer agents to adopt written procedures concerning all business services performed by, and IT and other systems used by, the transfer agent? Should the requirements be different depending on whether the transfer agent uses proprietary systems or contracts with outside parties for some or all of their services or IT and other systems? Should the requirements be different depending on the size of the transfer agent or the scope of its activities? Please provide a full explanation.
60. If the Commission proposes a rule requiring transfer agents to maintain a written business continuity or disaster recovery plan, what, if any, items should be required to be included in the plans in order to accomplish business continuity and disaster recovery objectives? Please provide a full explanation.
61. What risks do transfer agents face from internal or external cyber attacks? What costs, challenges, or issues do transfer agents face in dealing with those risks (e.g., costs and resources, government and industry cooperation, and information

sharing)? Are there different cybersecurity risks, or different best practices and procedures for addressing such risks, for transfer agents, depending on the size, activities, business lines, or technology infrastructure of the transfer agent? How often do transfer agents review operations and compliance policies and procedures related to cybersecurity?

62. What tradeoffs should the Commission consider in addressing cybersecurity issues with respect to transfer agents? What evidence should it consider in evaluating those tradeoffs, including any benefits, burdens, or costs of specific rule proposals? Please provide a full explanation.
63. Are transfer agents who have offices or do business in multiple jurisdictions subject to different standards or requirements with respect to cybersecurity, data privacy or business continuity? Do those standards or requirements conflict with one another? If so, how and to what extent do those standards conflict?
64. What are the industry best practices with respect to identifying and addressing cybersecurity risk? What are the costs associated with any such best practices? Do commenters believe these costs are reasonable in light of relevant risks?
65. What are industry best practices with respect to protecting electronic communications between and among transfer agents and other market participants using standardized communication protocols and standards? Should the Commission require standards for message encryption? Why or why not? Please provide a full explanation.
66. What consequences for shareholders and issuers could result if the privacy of transfer agent records is compromised? Are there standards to which transfer agents should be required to adhere to reduce the possibility or likelihood of such an occurrence? Similarly, what consequences for shareholders and issuers could result from actions taken by impersonators due to inadequate authentication and/or attempts to cancel or repudiate previously executed instructions? Do the current processes and requirements for signature guarantees apply adequately in an electronic environment?
67. How often do transfer agents review operations and compliance policies and procedures related to cybersecurity? Are third-party vendors utilized and, if so, to what extent? Where third-party vendors are utilized, how do transfer agents conduct oversight of such vendors?
68. Should the Commission require transfer agents to have a minimum level of cybersecurity protection, and if so, what should those levels be? Should the Commission prohibit indemnification of transfer agents by issuers for liability for losses due to the agents' cybersecurity weaknesses? Why or why not?



69. Should the Commission require transfer agents to maintain minimum insurance coverage for operational risks associated with transfer agent operations and services, including cybersecurity losses? Why or why not? Should the level and type of coverage be based on the transfer agent's particular circumstances? If so, what requirements and level of coverage would be appropriate for what circumstances?
70. A new technology, the blockchain or distributed ledger system, is being tested in a variety of settings, to determine whether it has utility in the securities industry.<sup>421</sup> What utility, if any, would a distributed public ledger system have for transfer agents, and how would it be used? What regulatory actions, if any, would facilitate that utility? How would transfer agents ensure their use of or interaction with such a system would comply and be consistent with federal securities laws and regulations, including the transfer agent rules? Please explain.
71. What costs, benefits, and burdens, if any, would the potential requirements discussed above create for issuers or transfer agents?

F. Definitions, Application, and Scope of Current Rules

The Commission intends to propose certain amendments to Rules 17Ad-1 through 17Ad-20 designed to modernize, streamline, and simplify the overall regulatory regime for transfer agents and bring greater clarity, consistency, and regulatory certainty to the area, as well as mitigate any unnecessary costs or other burdens resulting from now obsolete or outdated requirements. In particular, the Commission intends to propose to: (i) rescind Rules 17Ad-18 and 17Ad-21T; (ii) consolidate all definitions, including those in Rule 17Ad-1 and 17Ad-9, as well as specific definitions embedded in Rules 17Ad-5 (written inquiries), 17Ad-15 (signature guarantees), 17Ad-17 (lost securityholders), and 17Ad-19 (cancellation of securities certificates)

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<sup>421</sup> See generally, Nasdaq Announces Inaugural Clients for Initial Blockchain-Enabled Platform "Nasdaq Linq", Nasdaq (Oct. 27, 2015), <http://www.nasdaq.com/press-release/nasdaq-announces-inaugural-clients-for-initial-blockchainenabled-platform-nasdaq-linq-20151027-00986> (announcement regarding Nasdaq's use of blockchain technology to create a platform for trading shares of privately-held trading); Matthew Leising, Blockchain Potential for Markets Grabs Exchange CEOs' Attention, Bloomberg Business (Nov. 4, 2015), <http://www.bloomberg.com/news/articles/2015-11-04/futures-market-ceos-says-blockchain-shows-serious-potential> (discussing financial services industry's interest in blockchain technology).

into a single rule; (iii) update various definitions and references throughout the rules to correspond more accurately to the prevailing industry practices and standards, including clarifying that Rule 17Ad-2's turnaround provisions apply with equal force to book-entry securities and clarifying, where appropriate, that other references to "certificates" include book-entry securities, defining the terms "promptly," "as soon as possible," and "non-routine" in Rule 17Ad-2, and other clarifications; (iv) update the current turnaround, recordkeeping, and retention requirements to correspond more closely to the operations and capabilities of modern transfer agents; (v) amend the recordkeeping and retention requirements in Rules 17Ad-7 (record retention), 17Ad-10 (prompt posting of certificate detail, etc.), 17Ad-11 (aged record differences), and 17Ad-16 (notice of assumption and termination) and consolidate them into a single rule; (vi) update the dollar and share thresholds reflected in Rule 17Ad-11 (aged record differences); (vii) amend Rule 17Ad-13 to provide additional and more useful information regarding transfer agents' internal controls; (viii) amend Rule 17Ad-15 to require transfer agents to document in writing their procedures and requirements for accepting signature guarantees; and (ix) propose other new rules and amendments designed to address certain TA activities not currently addressed by the rules, as discussed throughout this release.

Further, the Commission's core books and records rules for transfer agents, Exchange Act Rules 17Ad-6 and 17Ad-7, prescribe minimum recordkeeping requirements with respect to the records that transfer agents must make and record retention requirements specifying how

long those records and other documents relating to a transfer agent's business must be kept.<sup>422</sup> These requirements, adopted in 1977, were intended to serve a dual purpose: (1) to assure that transfer agents are maintaining the minimum records necessary to monitor and keep adequate control over their own activities and performance; and (2) to permit the appropriate regulatory authorities to examine transfer agents for compliance with applicable rules.<sup>423</sup> The Commission is concerned that the scope of the recordkeeping and record retention rules may no longer be broad enough to serve this dual purpose relative to the expanded scope of the activities and services that transfer agents provide today as discussed throughout this release. Accordingly, the Commission intends to propose certain amendments to Rules 17Ad-6 and 17Ad-7 to ensure they adequately address: (i) any new or amended registration, reporting, and disclosure requirements adopted by the Commission; (ii) any new or amended contract rules adopted by the Commission; (iii) any new or amended safeguarding requirements adopted by the Commission, including amendments to Rule 17Ad-12; (iv) any new or amended business recovery, information security, operational, or cybersecurity requirements proposed by the Commission; and (v) any conforming or other changes or additions to the Commission's transfer agent rules. The Commission seeks comment on the following:

72. Are any of the current transfer agent rules outdated or obsolete? If so, which ones and why? Do commenters believe that any such outdated or obsolete portions of the transfer agent rules create confusion or inefficiency among transfer agents, issuers, investors, and other market participants? Why or why not? Please provide a full explanation.

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<sup>422</sup> Exchange Act Rule 17Ad-6, 17 CFR 240.17Ad-6; Exchange Act Rule 17Ad-7, 17 CFR 240.17Ad-7. For a more detailed description of the recordkeeping and record retention requirements for transfer agents, see supra Section IV.A.2.

<sup>423</sup> See Rule 17Ad-1 through 17Ad-7 Adopting Release, supra note 145.

73. Should the Commission eliminate or amend any of the definitions in the transfer agent rules? If so, which ones and why? For example, should the Commission eliminate references to “control book,” “processing,” “process” deadlines, and “outside registrar”? Are there any other definitions which should be amended? Why and how? Please provide a full explanation.
74. Should the Commission eliminate the current exemption in Rule 17Ad-4 for small transfer agents? Why or why not? Have circumstances in the industry changed such that the original rationale for this exemption should be reconsidered? Should the Commission take into account the size of a transfer agent, or any other measure, in determining whether the current exemption is appropriate? Why or why not? Please provide a full explanation.
75. Currently, Rule 17Ad-5 (written inquiries and requests) permits transfer agents to respond to certain instructions and inquiries “promptly” rather than within a specified time period unless the requestor provides specific detailed information, such as a certificate number, number of shares, and name in which the certificate was received. In commenters’ experience, is the detailed information specified in Rule 17Ad-5 an accurate description of the minimum information necessary to permit a transfer agent to identify the subject of an inquiry or instruction and respond? If not, what other information would allow a transfer agent to identify the subject of the inquiry and respond?
76. Does Rule 17Ad-5 address the full scope of inquiries received by transfer agents? If not, what additional types of inquiries and requests do transfer agents receive, and in what volume? How are those inquiries received (e.g., letter, email, phone, fax, internet)? Should the Commission include additional inquiries within the scope of Rule 17Ad-5? Why or why not? If so, what types of inquiries should be included and what types should be excluded? Please provide a full explanation.
77. Should the Commission update Rule 17Ad-6 to expand the categories and types of records required to be maintained by registered transfer agents? Why or why not? If so, what requirements should the Commission consider? Please provide a full explanation.
78. Should the Commission eliminate or amend the requirement to escrow “source code” in Rule 17Ad-7 (record retention)? Why or why not? How do transfer agents comply with this requirement, and what are the benefits, costs, burdens, and tradeoffs associated with those efforts? If the Commission amends rather than eliminate the requirement, what amendments should the Commission consider? Please provide a full explanation.
79. Rule 17Ad-7(g) requires certain records to be made available to the Commission. What records do commenters believe should be covered by the rule? Are there electronic communication standards in use by the industry to transfer such records and, if so, should the Commission require their use? Why or why not?

80. Are the different record retention requirements in Rules 17Ad-7 (record retentions), 17Ad-10 (prompt posting of certificate detail, etc.), 17Ad-11 (aged record differences), and 17Ad-16 (notice of assumption and termination) still appropriate in light of transfer agents' operational and technological capabilities? Why or why not? Particularly in light of the prevalence of electronic records, should retention periods for all documents be similar? Why or why not? For the records that transfer agents are required to maintain, should the Commission require a longer or shorter retention period? Why or why not? Please provide a full explanation.
81. Does the current definition of certificate detail in Rule 17Ad-9 (definitions) reflect current processes? Why or why not? For example, should the Commission amend the definition to include additional information relevant to identifying the specific security, such as CUSIP number or a unique product identifier if available, or additional information relevant to identifying the investor, such as investor email address and phone number? Why or why not? Do commenters believe such information would help transfer agents identify lost securityholders or improve securityholder communications? Please provide a full explanation.
82. With respect to Rule 17Ad-11 (aged record differences), which requires reports for actual overissuances, should the Commission require transfer agents to provide issuers with information about all aged differences, rather than just differences that lead to overissuance? Why or why not? Are the current dollar and share thresholds reflected in Rule 17Ad-11 appropriate indicators of current or impending problems? Should the thresholds be amended? If so, what thresholds would be more appropriate? Are commenters aware of instances where impending problems were not reported because the dollar or share threshold did not apply to the situation? Please provide a full explanation.
83. Should the Commission again consider expanding Rule 17Ad-14 (tender agents) to include reorganization events such as conversions, maturities, redemptions, and warrants, as it proposed in 1998?<sup>424</sup> Why or why not? Please provide a full explanation.
84. What are the current best practices with regard to accepting signature guarantees, if any? Should the Commission amend Rule 17Ad-15 to require transfer agents to document in writing their procedures and requirements for accepting signature guarantees? Why or why not? Should the Commission require transfer agents to establish and comply with certain minimum procedures and requirements related

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<sup>424</sup>

Processing of Reorganization Events, Tender Offers, and Exchange Offers, Exchange Act Release No. 40386 (Aug. 31, 1998), 63 FR 47209 (Sept. 4, 1998).

to accepting signature guarantees? Why or why not? If so, what procedures and requirements should be required, and why? Please provide a full explanation.

85. Should the Commission amend Rule 17Ad-16 (notice of assumption)? Why or why not? If so, what amendments should be considered, and why? Is the information required by Rule 17Ad-16 already provided to the industry, including DTC? If yes, how is that information being provided to the industry? Is there an industry standard for electronic communications of these changes? Please provide a full explanation.
86. Are there other amendments to the rules that commenters believe would be appropriate or beneficial that the Commission should consider? Please provide a full explanation.
87. What costs, benefits, and burdens, if any, would the potential requirements discussed above create for issuers or transfer agents?

G. Conforming Amendments

In connection with the potential new rules and rule amendments discussed above, the Commission also intends to propose rules for conforming and other revisions to Forms TA-1 and TA-2 and to Rules 17Ad-1 through 17Ad-20, as appropriate. For example, the Commission may propose to amend Section 8(a)(iv) of Form TA-1 to require disclosure of employees' actual percentage ownership of the transfer agent, rather than whether their percentage ownership falls within a broad range. The Commission also intends to propose defining or clarifying certain terms and definitions used in the forms, such as "independent, non-issuer" and "control," which are not currently defined in Form TA-1, and to clarify the type of disciplinary history required to be disclosed by Question 10. The Commission preliminarily believes that such clarifications would help ensure that transfer agents are interpreting, completing, and filing the requisite forms in a consistent manner. The Commission requests comment on all aspects of the conforming and other amendments described above.

## VII. CONCEPT RELEASE AND ADDITIONAL REQUEST FOR COMMENT

This section discusses additional regulatory, policy, and other issues associated with transfer agents beyond those discussed above in Section VI and seeks comment to identify, where appropriate, possible regulatory actions to address those issues. In particular, we discuss: (i) the processing of book-entry securities by transfer agents; (ii) differences between transfer agent recordkeeping for registered securityholders and broker-dealer recordkeeping for beneficial owners; (iii) characteristics of and issues associated with transfer agents to mutual funds; (iv) crowdfunding; (v) services provided by transfer agents and other entities that act as “third party administrators” for issuer-sponsored investment plans; and (vi) issues associated with outside entities engaged by transfer agents to perform certain services. Throughout, we seek comment regarding the issues raised, and conclude with a series of requests for comment on potential broad changes to the overall regulatory regime for transfer agents that may be appropriate in light of the issues discussed throughout this release.

### A. Processing of Book-Entry Securities

Most municipal and corporate bonds, U.S. government and mortgage-backed securities, commercial paper, and mutual fund securities, are offered almost exclusively in book-entry form (i.e., certificates are not available).<sup>425</sup> While equities have lagged behind this trend, they too have been moving closer to full dematerialization.<sup>426</sup> At the same time, much of the terminology and definitions found in the Commission’s transfer agent rules were written, and therefore

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<sup>425</sup> See generally, Strengthening the U.S Financial Markets, A Proposal to Fully Dematerialize Physical Securities, Eliminating the Cost and Risks They Incur, A White Paper to the Industry, DTCC 1, 3-6 (July 2012), available at [http://www.dtcc.com/~media/Files/Downloads/WhitePapers/Dematerialize\\_Securities\\_Jul\\_2012.pdf](http://www.dtcc.com/~media/Files/Downloads/WhitePapers/Dematerialize_Securities_Jul_2012.pdf).

<sup>426</sup> Id.

reflect, a time when most securities were certificated. For example, the definitions of “item” and “transfer” in Rules 17Ad-1, 17Ad-2, and 17Ad-4 primarily reference certificated securities.<sup>427</sup>

Likewise, Rule 17Ad-10, which addresses a transfer agent’s buy-in requirement in the event of physical overissuance of securities, refers only to “certificates.”<sup>428</sup>

Although many of the transfer agent rules refer only to certificated securities, it has long been the Commission’s position that, absent an explicit exemption, all of the transfer agent rules apply equally to both certificated and uncertificated securities, particularly in cases where the rules impose time limits within which a transfer agent must turn around or process a transfer. For example, when adopting Rules 17Ad-9 through 17Ad-13 in 1983, the Commission clarified in its response to public comments that the definition of certificate detail in Rule 17Ad-9 applies with equal force to both certificated and uncertificated securities and related account details.<sup>429</sup> In that same adopting release, the Commission noted that exemptions respecting uncertificated securities are inappropriate in regulations regarding registered transfer agents’ accurate creation and maintenance of issuer securityholder records and safeguarding of funds and securities in their operations.<sup>430</sup>

At the same time, the Commission is aware that differences of interpretation among transfer agents may result in widely varying compliance practices, procedures, and controls among transfer agents. For example, because Rule 17Ad-10(g) refers specifically to

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<sup>427</sup> See, e.g., Exchange Act Rules 17Ad-1(a)(1)(i), (d), 17 CFR 240.17Ad-1(a)(1)(i), (d).

<sup>428</sup> See Exchange Act Rule 17Ad-10(g)(1), 17 CFR 240.17Ad-10(g)(1).

<sup>429</sup> See 17Ad-9 through 13 Proposing Release, *supra* note 2 (noting that the reference to “certificate detail” does not necessarily require the existence of a “certificated security.” Rather, it reflects the items of information regarding the registered owner and of the security, regardless of the form of the security.).

<sup>430</sup> *Id.*



certificates,<sup>431</sup> Commission staff have received questions regarding the rule’s applicability to overissuances that did not involve certificated securities, indicating that, in applying that rule, some transfer agents may buy-in securities if an overissuance involved certificated securities, but not if it involved book-entry securities.

The Commission believes it is appropriate to consider possible amendments to address the applicability of the transfer agent rules to uncertificated or book-entry securities, including those held in DRS or issued by investment companies such as mutual funds.<sup>432</sup> Accordingly, the Commission seeks comment on the following:

88. Should the Commission amend the existing rules in light of the significant increase in book-entry securities? If so, what approach should the Commission take? For example, although a significant percentage of transfer instructions are categorized as non-routine items under the current rules (such as investor requests for certificates, to close accounts, and to act in certain types of corporate actions), there are no specific processing requirements for non-routine items. Should the same processing obligations apply to all instructions, thereby dispensing with the current routine and non-routine distinctions in Exchange Act Rule 17Ad-1? Alternatively, or in conjunction with that approach, should the existing rules be amended to explicitly apply transfer agents’ processing obligations, not only to “transfers” as defined in Rule 17Ad-1, but also to the entire range of instructions a transfer agent may receive, including those related to uncertificated securities, such as purchase and sale orders, balance certificates, establishment and movement of book-entry positions, corporate actions, and updates of securityholder book-entry account information? Why or why not? Are there other approaches that would be appropriate? If so, please describe.
89. What policies, concerns, factors, and other considerations do commenters believe should inform any approach the Commission might take to ensure the transfer

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<sup>431</sup> Exchange Act Rule 17Ad-10(g), 17 CFR 240.17Ad-10(g).

<sup>432</sup> Exchange Act Rule 17Ad-4(a) exempts from the application of Exchange Act Rule 17Ad-2, among other rules from which it provides exemption, securities held in a DRIP, redeemable securities of registered investment companies (which include open-end investment management companies (i.e., mutual funds)) and limited partnership interests. Consequently, the provisions of Rule 17Ad-2 which are a fundamental part of Commission regulation of transfer agent processing of securities do not apply to mutual fund shares or securities held in Issuer Plans that are DRIPs.

agent rules apply appropriately to book-entry securities? For example, in determining whether a specific rule or requirement is appropriate, should the focus of the Commission's consideration be on the physical nature of the security (whether certificated or uncertificated), or market-based factors, such as whether there is a potential for backlog to occur based on trading volume in the particular type of asset, or both and why? Are there other appropriate considerations? If so, please describe.

90. Given that transfer and other requests now often involve the highly automated processing of book-entry securities rather than manual processing of certificates, should the Commission modify or eliminate the turnaround and processing requirements of Rules 17Ad-1 and 17Ad-2? Why or why not? For example, is the distinction between items received before noon and items received after noon still relevant given that the vast majority of requests are now received and responded to electronically? Should the Commission shorten the timeframe for fulfilling instructions and/or increase the percentage of transfer instructions that must be fulfilled within those timeframes each month? Why or why not?
91. Should the Commission shorten Rule 17Ad-9's permitted timeframes for posting credits and debits to the master securityholder file? Should the Commission require that certificate details be dispatched daily? Why or why not?
92. Are commenters aware of instances where securityholders or broker-dealers cannot determine whether their securities have been processed by transfer agents, despite the requirements of Rule 17Ad-5? If so, please describe any such instances and indicate what requirements, if any, the Commission should consider to address such instances. For example, should the Commission expand the definition of "item" to include presentation by both individual investors and broker-dealers or other intermediaries acting on behalf of individual investors and require transfer agents to report to the presenter of an item the status of any item for transfer not processed within the required timeframes? Why or why not?
93. It is the Commission staff's understanding that investors have brought legal actions against transfer agents under state law to require the transfer agent to effect a transfer, including when the transfer agent claimed the securityholder's instructions were not in good order and therefore the relevant securities were not transferred, or were delayed for a long period of time.<sup>433</sup> Are commenters aware

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See, e.g., Kanton v. United States Plastics, Inc., 248 F. Supp. 353 (D.N.J. 1965) (involving common law claims); Bender v. Memory Metals, Inc., 514 A.2d 1109 (Del. Ch. 1986) (involving claim under UCC that transfer was rightful); Mackinder v. Schawk, Inc., No. 00 Civ. 6098 (DAB), 2005 WL 1832385, at \*16 (S.D.N.Y. Aug. 2, 2005) (involving shareholder claim under Delaware law to require the removal of restrictive legend reflecting restrictions imposed by stock purchase agreement).

of these or other problems or issues associated with transfer agents failing to effect a securityholder's transfer instructions within a reasonable period of time? If so, please describe the relevant facts and circumstances. For example, what factors might have led to such a situation and how was it resolved? What types of securityholders were directly involved? What were the adverse consequences, if any?

94. Do commenters believe there are problems associated with transfer agents failing to effect or reject transfer instructions within a reasonable time? Should the Commission amend the rules to define what information or documentation is required and from whom it must be received to constitute good order? Should the Commission amend the rules to define the terms "reject" or "rejection" in connection with transfer instructions? Why or why not? Should transfer agents be required to communicate the specific reasons why an instruction was not a good order? Should transfer agents be required to buy-in securities (or take other corrective action to satisfy transfer instructions that were received in good order but not completed after a specific period of time)? If so, should the requirement apply broadly or be limited to specific conditions? Please explain.
95. Are commenters aware of delays in processing incomplete or improper requests for DRS transactions? If so, what caused these delays, and would they be eliminated or reduced if transfer agents were to provide to securityholders the information the securityholder would need to prepare complete instructions for shares held in DRS? Please explain.
96. Given that most securityholders no longer receive paper certificates evidencing their holdings, should the Commission require transfer agents to provide securityholders with an account statement with specific details for each transaction that occurred with respect to each securityholder's account? If so, how and how often should such statements be provided and what information should be included? Please describe.

B. Bank and Broker-Dealer Recordkeeping For Beneficial Owners

Although transfer agents provide critical recordkeeping and transfer services to registered owners, they generally do not have visibility beyond the master securityholder file and therefore rarely provide recordkeeping and transfer services to beneficial owners who hold in street name. Instead, recordkeeping and transfer services usually are provided to beneficial owners by the

intermediary through whom the beneficial owner purchased the securities, usually a broker-dealer or bank.<sup>434</sup> Because many securityholders elect to hold exchange-traded securities in street name, many issuers have significantly more beneficial owners than registered owners. As a result, 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.

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. For example, banks and brokers often maintain accountholder information details, process transfers and other changes to accounts, provide securityholder services such as call center support, and provide account statements showing ownership positions for their beneficial owner customers. Yet although these services may be nearly identical to the services provided to registered owners by transfer agents, banks and brokers are typically not required to register as transfer agents under the Exchange Act solely for providing these services to beneficial owners. This is because the positions serviced are

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<sup>434</sup> Commission staff understands that some industry participants may refer to the recordkeeping and transfer services provided to beneficial owners by brokers and banks discussed herein as “sub-accounting” or “sub-transfer agent” services. We note that the term sub-transfer agent in this context is not meant to imply a contractual relationship between the registered transfer agent who provides recordkeeping and transfer services for registered owners and the broker or bank that provides the same services for their own beneficial owner customers. Although brokers and banks who act as sub-transfer agents could contract with registered transfer agents to provide recordkeeping and transfer services for their beneficial owner customers, they rarely do so, choosing instead to provide these services themselves.

“securities entitlements” under the UCC rather than “Qualifying Securities” that trigger transfer agent registration.<sup>435</sup>

As street name registration has become more prevalent and the number of registered holders has decreased, more banks and brokers are providing to more investors critical transfer, processing, and recordkeeping services, but are not required to register with the Commission or other ARA as a transfer agent.<sup>436</sup> This raises potential issues regarding the Commission’s regulation of securities processing as it pertains to the processing of equity securities by banks, brokers, and other intermediaries.<sup>437</sup> Specifically, if a bank or broker providing transfer and recordkeeping services to beneficial owners is not required to register as a transfer agent with the Commission or other ARA, it will not be 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. 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 protections as do the Commission’s transfer agent rules. For example, registered broker-dealers are subject to extensive books and records requirements pursuant to Exchange Act Rule 17a-3, but that rule does not impose the same ownership and transfer recordkeeping requirements as the transfer

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<sup>435</sup> See supra note 115 (UCC definition of “securities entitlement”), Section IV.A (discussing provisions of the Exchange Act regarding Qualifying Securities).

<sup>436</sup> Id.

<sup>437</sup> There are of course other issues raised by the increasing prevalence of bank and broker recordkeeping for beneficial owners, including complexity in the proxy distribution and voting systems and barriers to communication between securityholders and issuers. These issues are beyond the scope of this release but have been discussed in other Commission releases. See, e.g., Final Street Name Study, supra note 82; Proxy Concept Release, supra note 112. We discuss certain issues concerning bank and broker processing of investment company securities below in Section VII.C.4.

agent rules such as Exchange Act Rule 17Ad-10, which imposes detailed information requirements with respect to every securityholder account position.<sup>438</sup> Further, some third party administrators<sup>439</sup> 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. Any risks or other issues associated with these intermediaries' activities become more acute as street name ownership, and the resulting volume of processing of street name book-entry positions by brokers, banks, and other intermediaries providing transfer and recordkeeping services to beneficial owners, continues to increase.<sup>440</sup>

The Commission seeks comment on the following:

97. Are there regulatory discrepancies among transfer agents and banks and brokers who provide similar services for beneficial owners? If so, what are they and do they present risks or raise competition issues in the market for these services? If so, what are the competition issues or risks associated with any such discrepancies, and what approach, if any, should the Commission consider to address them? Please provide a full explanation.
98. Are there reasons why the Commission should regulate transfer agent processing of registered owner securities held in book-entry positions differently than bank and broker processing of street name positions held in book-entry form? If so, please describe them. Please provide a full explanation.

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<sup>438</sup> We note, however, that Rule 17a-3 does contain several requirements related to securityholder accounts, such as a "blotter" that shows "the account for which each such transaction was effected" as well as other details, and an "account record" with detailed identifying information for each customer or owner, such as their name, address, and date of birth, as well as their annual income, net worth, and the account's investment objectives.

<sup>439</sup> Third party administrators are discussed in more detail below in Section VII.E.

<sup>440</sup> For example, Professor Egon Guttman identified the lack of regulation of broker-dealer street name ownership processing as a key regulatory gap and advocated closing it as one of his key recommendations for regulatory improvement. See Egon Guttman, *Federal Regulation of Transfer Agents*, 34 Am. U. L. Rev. 281, 327-8 (1985), available at <http://www.americanuniversitylawreview.org/pdfs/34/34-2/Guttman.pdf>.

99. In light of increased obligations under federal law for certain issuers to ascertain their securityholders' identities and the barriers to doing so created by the street name system, as discussed above in Section III.B, should the Commission require entities that are regulated by the Commission, including brokers, banks, or others who provide transfer and recordkeeping services to beneficial owners, to provide or "pass through" securityholder information to transfer agents? If so, what type of information should be provided and how should it be transmitted? What would be the effect on the actions and choices of affected parties, including transfer agents, banks and brokers, issuers, registered owners, and beneficial owners? Please provide a full explanation.
100. If the Commission were to require certain registrants to pass through securityholder information regarding beneficial owners to transfer agents, should the Commission prohibit transfer agents from using such information for other than certain prescribed purposes? If so, for what purposes should such information be allowed to be used, and why? For example, should the information be used solely for the transfer agent's legal/compliance purposes, or should it be permitted to be used for other purposes, such as securityholder communications? Should transfer agents' ability to share information be limited, particularly where information is shared in return for compensation or where information sharing is not fully disclosed to parties such as the issuer or the securityholder? Why or why not? Should such information be permitted to be shared only with the securityholder's consent? Please provide a full explanation.

C. Transfer Agents to Mutual Funds

U.S. registered investment companies managed \$18.7 trillion in assets at year-end 2014.<sup>441</sup> This figure is primarily comprised of mutual funds (i.e., open-end management investment companies or "open-end funds"), but also includes closed-end management investment companies ("closed-end funds") of \$289 billion, unit investment trusts ("UITs")<sup>442</sup> of

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<sup>441</sup> See Testimony of David W. Grim, Director, Division of Investment Management, before the House subcommittee on Capital Markets and Government Sponsored Enterprises (Oct. 23, 2015) ("Grim Testimony").

<sup>442</sup> UITs are funds that offer a fixed, unmanaged portfolio, generally of stocks and bonds, as redeemable "units" to investors for a specific period of time, each of which represents an undivided interest in a unit of specified securities. See Investment Company Act Section 4(2), 15 U.S.C. 80a-4(2).

\$101 billion, and exchange-traded funds (“ETFs”)<sup>443</sup> of approximately \$2 trillion, which have seen considerable growth in recent years.<sup>444</sup> While the discussion on transfer agents to mutual funds is focused on open-end funds, the Commission also seeks comment on transfer agents to other registered investment companies as discussed in Section 5 below.

Open-end funds<sup>445</sup> have become one of the main investment vehicles for retail investors<sup>446</sup> in the United States and play a major role in the U.S. economy and financial markets. When the first transfer agent rules were adopted in 1977, there were approximately 477 mutual funds with \$48 billion in assets for shareholders in just under 8.7 million accounts.<sup>447</sup> By the end of 2014, there were approximately 7,900 mutual funds with approximately \$16 trillion in assets<sup>448</sup> held on behalf of hundreds of millions of investors.<sup>449</sup>

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<sup>443</sup> ETFs may be formed as either open-end funds or UITs.

<sup>444</sup> See Grim Testimony, *supra* note 441.

<sup>445</sup> Open-end management investment companies are a type of registered investment company under Section 8 of the Investment Company Act that issue redeemable securities. Other types of investment companies include, but are not limited to, closed-end funds and UITs. See Investment Company Act Sections 4(2), 15 U.S.C. 80a-4(2) (definition of unit investment trust) and 5(a) (definition of open and closed-end 1940 Act companies). ETFs are typically organized as open-end funds or UITs.

<sup>446</sup> See Grim Testimony, *supra* note 441; see also Investment Company Institute, 2015 Investment Company Fact Book, 29 (2015), available at [http://www.ici.org/pdf/2015\\_factbook.pdf](http://www.ici.org/pdf/2015_factbook.pdf) (“2015 ICI Factbook”). At year-end 2014, retail investors (i.e., households) held the vast majority (89 percent) of the nearly \$16 trillion in mutual fund assets, whereas institutions held about 11 percent.

<sup>447</sup> 2015 ICI Factbook, *supra* note 446, at 173 (Data sec. 1, tbl. 1).

<sup>448</sup> *Id.*

<sup>449</sup> The number of shareholder accounts last reported by the Investment Company Institute (“ICI”) was approximately 265 million in 2013 and includes a mix of individual and omnibus accounts (excluding certain underlying beneficial owner accounts), thus understating the total number of shareholder accounts for funds. See ICI, 2014 Investment Company Fact Book, 168 (2014), available at [http://www.ici.org/pdf/2014\\_factbook.pdf](http://www.ici.org/pdf/2014_factbook.pdf).



By mid-2014, 53.2 million households, approximately 43 percent of all U.S. households, owned mutual funds.<sup>450</sup> Today, the typical investor has \$103,000 invested in mutual funds, which, for approximately 68 percent of investors, represents more than half of their household financial assets.<sup>451</sup> For many of these investors, mutual funds are their primary source of investing for retirement, higher education, and other financial goals.<sup>452</sup> Historically, many mutual fund investors purchased their shares “direct” from the fund or through the fund’s transfer agent.<sup>453</sup> However, today many investors engage an investment professional (also referred to as an “intermediary” for beneficial owners of fund shares), such as a broker-dealer or investment adviser<sup>454</sup> who provides many services, such as helping them identify their financial goals, analyzing an existing financial portfolio, determining an appropriate asset allocation, and (depending on the type of investment professional) providing investment advice or recommendations.<sup>455</sup> In addition, many intermediaries have arrangements with the mutual fund or the mutual fund’s transfer agent to perform the underlying shareholder recordkeeping and servicing for their customers’ mutual fund positions.<sup>456</sup> Under such arrangements, the

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<sup>450</sup> 2015 ICI Factbook, supra note 446, at 114 (fig. 6.2).

<sup>451</sup> Id.

<sup>452</sup> Id.

<sup>453</sup> In this section, when discussing transfer agents providing services to mutual funds, we refer to “Mutual Fund Transfer Agents,” and when discussing transfer agents to operating company issuers, or issuers whose business is not primarily investing in securities, we refer to “Operating Company Transfer Agents.”

<sup>454</sup> Also, the 2015 ICI Factbook notes that among households owning mutual fund shares outside employer-sponsored retirement plans, 80 percent own fund shares through investment professionals. Id. at 104.

<sup>455</sup> Id. at 104 (“The investment professional also may provide ongoing services, such as responding to investors’ inquiries or periodically reviewing and rebalancing their portfolios.”).

<sup>456</sup> Examples of these services include communicating with their customers about their fund holdings; maintaining their financial records; processing changes in customer accounts and trade orders; recordkeeping for customers; answering customer inquiries regarding account status and the procedures for

intermediary performs recordkeeping on their own books and other services with respect to the beneficial owner, and in many cases aggregates their customer records into a single or a few “omnibus”<sup>457</sup> accounts registered in the intermediary’s name on the Mutual Fund Transfer Agent’s recordkeeping system.<sup>458</sup>

We understand that the shift to omnibus account arrangements for mutual fund shareholders<sup>459</sup> has altered the landscape of recordkeeping and other services provided to fund investors. This fundamental shift in the roles and responsibilities of traditional shareholder servicing and recordkeeping, however, has resulted in a lack of transparency of beneficial owners, their trading activities and related records.<sup>460</sup>

The complexity of recordkeeping for mutual fund shares also has increased significantly over the last several decades. The total number of mutual fund share classes offered increased

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the purchase and redemption of fund shares; providing account balances and providing account statements, tax documents, and confirmations of transactions in a customer’s account; transmitting proxy statements, annual reports and other communications from a fund; and receiving, tabulating and transmitting proxies executed by customers.

<sup>457</sup> Omnibus accounts are held by and registered in the name of a single intermediary, such as a broker, and the holdings in the account represent the aggregated positions of multiple beneficial owner customers of the intermediary. Typically, the issuer will not have information regarding the intermediary’s underlying beneficial owners. See ICI, Navigating Intermediary Relationships, 3, 6-7 (2009), available at [https://www.ici.org/pdf/ppr\\_09\\_nav\\_relationships.pdf](https://www.ici.org/pdf/ppr_09_nav_relationships.pdf). Regarding omnibus relationships generally, see also The Stock Market, *supra* note 8, at 542.

<sup>458</sup> The growth in retirement plan assets also has resulted in a significant increase in the number of third party administrators that perform retirement plan recordkeeping on behalf of mutual fund investors that are plan participants, whose mutual fund positions are held in omnibus accounts on the fund’s transfer agent recordkeeping system. Third Party Administrators are discussed further in Section VII.E.

<sup>459</sup> See generally, Deloitte, Mutual Fund Directors Digest, The Omnibus Revolution: Managing risk across an increasingly complex service model (2012), available at <http://www2.deloitte.com/content/dam/Deloitte/us/Documents/financial-services/us-fsi-fund-director-digest-1-090412.pdf> (“Deloitte Digest on Omnibus Revolution”).

<sup>460</sup> See generally, PricewaterhouseCoopers LLP, Evolution of the Mutual fund Transfer Agent: Embracing the Challenges and Opportunities, 9 (July 2015), available at <https://www.pwc.com/us/en/asset-management/investment-management/publications/assets/pwc-mutual-fund-transfer-agent-evolution.pdf> (“PWC Evolution of the Mutual Fund Transfer Agent”).

from 1,243 share classes in 1984 to over 24,000 share classes in 2014.<sup>461</sup> Historically, as products and share classes evolved, shareholders and their investment professionals looked for diversification by focusing on a mutual fund complex with a broad lineup of funds taking advantage of breakpoint discounts offered on their suite of mutual fund products.<sup>462</sup> In recent years, however, many intermediaries are managing clients' mutual fund investments using advisory type models, where typically a wide range of mutual fund investments from many different fund companies are utilized.<sup>463</sup>

The Commission understands that the growth in both mutual fund products and share classes offered has added complexity and requires Mutual Fund Transfer Agents to maintain, in addition to the master securityholder file, extensive CUSIP databases 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.<sup>464</sup> As a result, Mutual Fund Transfer Agents have made significant investments in technology advancements to manage

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<sup>461</sup> 2015 ICI Factbook, *supra* note 446, at 173 (Data sec. 1, tbl. 1).

<sup>462</sup> See generally, ICI Research Perspective, Vol. 20, No.2, Mutual Fund Load Fees (May 2014), available at <https://www.ici.org/pdf/per20-02.pdf> (“Thirty years ago, fund shareholders usually compensated financial professionals through a front-end load – a one-time, up-front payment for current and future services. That distribution structure has changed significantly.”). The report notes that there has been a marked reduction in load fees paid by mutual fund investors, from nearly 4 percent in 1990 to roughly 1 percent in 2013. It also notes that funds often waive load fees on purchases made through retirement plans, as well as waive or reduce load fees for large initial or cumulative purchases.

<sup>463</sup> Id. In these advisory arrangements, the investment professional who sells mutual funds is assessing an asset based-fee (a percentage of the net assets managed for an investor), rather than a percentage of the dollars initially invested (a front-end load), utilizing newer free or low-fee share classes designed for advisory type programs. The report also notes that because of the recent trend toward asset-based fees the market share of traditional front-end and back-end load shares has fallen, while the market share of newer share classes that are no-load has increased substantially.

<sup>464</sup> We note that, generally, many of the recordkeeping and processing tasks discussed in this section may be performed by either the Mutual Fund Transfer Agent or the intermediary, depending on whether the investor holds his or her mutual fund shares directly with the mutual fund or through an intermediary. We focus herein primarily on transfer agents.

more frequent and diverse transaction processing and shareholder communications through different channels. The industry also has relied heavily on the automation developed through NSCC for processing and settling mutual fund transactions<sup>465</sup> and exchanging and reconciling customer account information, whether held in direct or omnibus accounts.<sup>466</sup>

The growth of the mutual fund industry since 1977, the attendant growth of the portion of the transfer agent community specifically focused on servicing that industry, the proliferation of fund share classes, the growth in intermediary omnibus account arrangements and the Mutual Fund Transfer Agent community, and the complexity of fund processing and reliance on NSCC's systems (discussed below), are among the factors informing the Commission's examination of its transfer agent rules.

*1. Key Characteristics of Mutual Fund Transfer Agents*

If any person performs for a mutual fund any services listed in Exchange Act Section 3(a)(25), such as registering transfers and transferring registered investment company securities, the person must register with the Commission as a transfer agent pursuant to Exchange Act Section 17A(c)(1).<sup>467</sup> When mutual funds were first introduced, many transfer agents provided these services because the traditional services they offered to operating company issuers (i.e., issuers whose business is not primarily investing in securities), such as maintaining records of stock ownership, paying dividends, sending securityholder communications, and transferring

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<sup>465</sup> See DTCC, 2014 Annual Report (2014), available at <http://dtcc.com/annuals/2014/wealth-management-services/index.php>. The value of mutual fund (Fund/SERV) transactions reported was \$4.9 trillion.

<sup>466</sup> See PWC Evolution of the Mutual fund Transfer Agent, *supra* note 460.

<sup>467</sup> Exchange Act Section 17A(c)(1), 15 U.S.C. 78q-1(c)(1).

stock ownership, were easily adapted to the particularities of mutual funds.<sup>468</sup> But as mutual fund processing and operations came to involve greater numbers of investors and intermediaries, greater numbers of products, and a broader array of services, some transfer agents evolved with the 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.<sup>469</sup>

Today, these specialized Mutual Fund Transfer Agents provide many of the same transfer and account maintenance services that other transfer agents perform for operating companies, including the recordkeeping, transfer, and related activities discussed above in Section V.<sup>470</sup> They also commonly provide recordkeeping and other services related to the mutual funds’

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<sup>468</sup> Lee Gremillion, Mutual Fund Industry Handbook: A Comprehensive Guide for Investment Professionals (Sept. 2005) (“Mutual Fund Industry Handbook”).

<sup>469</sup> Id. Today, there is no overlap among the Mutual Fund Transfer Agents with the largest market share and the Operating Company Transfer Agents with the largest market share. Compare SourceMedia, Mutual Fund Service Guide, 41 (2015), available at <http://www.mmexecutive.com/mutual-fund-guide/ranking-stats/?service=transfer-agent> (providing tables listing the ten largest Mutual Fund Transfer Agents by number of accounts and the eleven largest Mutual Fund Transfer Agents by number of clients) with Jessica Fritz, Audit Analytics, 2013 Transfer Agent Market Share: AST Still On the Rise (Oct. 14, 2013), available at <http://www.auditanalytics.com/blog/2013-transfer-agent-market-share-ast-still-on-the-rise/> (providing charts showing the five largest Operating Company Transfer Agents by market share and the six largest Operating Company Transfer Agents by market share of initial public offerings).

<sup>470</sup> For example, Mutual Fund Transfer Agents effect transfers in ownership of fund securities, which usually involves making changes to the master securityholder file but not cancelling or issuing certificates because almost all mutual fund securities are issued and held in book-entry form. They also facilitate communications between issuers and securityholders, including by sending to securityholders mutual fund prospectuses, confirmations, periodic account statements, semi-annual and annual reports, and proxy statements. See, e.g., Robert Pozen & Theresa Hamacher, The Fund Industry: How Your Money is Managed, 348 (2<sup>nd</sup> ed. 2015) (“Pozen & Hamacher”) (discussing transfer agent distribution of such materials). Mutual Fund Transfer Agents also distribute to securityholders tax information, such as estimates of fund distributions, Form 1099-DIV and Form 1099B. Id. at 349. They also process cash distributions by the fund, ensuring that cash from distributions is properly credited to securityholder accounts. Id. at 348. In addition, where securityholders elect to reinvest cash distributions by the fund by purchasing additional shares of the fund, Mutual Fund Transfer Agents help facilitate execution of the purchase and calculate and record the number of additional shares purchased. Id.

recordkeeping obligations under the Investment Company Act.<sup>471</sup> However, instead of processing exchange or OTC-traded equity or debt securities, like other transfer agents, Mutual Fund Transfer Agents process redeemable securities of investment companies registered under Section 8 of the Investment Company Act,<sup>472</sup> which under Rule 17Ad-4, are exempt from: (i) the turnaround and processing requirements of Rule 17Ad-2; (ii) the limitations on expansion under Rule 17Ad-3; and (iii) key recordkeeping requirements related to the transfer agent's processing and performance obligations under Rules 17Ad-6(a)(1)-(7) and (11).<sup>473</sup> Thus, although they provide many services identical to those provided by Operating Company Transfer Agents, Mutual Fund Transfer Agents are exempt from the key turnaround, processing, performance, and recordkeeping requirements.

Although many of the core services Mutual Fund Transfer Agents provide are similar to the core services provided by Operating Company Transfer Agents, there are differences. One is the degree to which the securities typically serviced by Mutual Fund Transfer Agents are dematerialized.<sup>474</sup> The mutual fund industry was an early adopter of the practice of issuing shares in book-entry form. By the time the first Commission transfer agent rules were adopted in 1977, registered ownership of mutual fund shares already had been predominantly dematerialized.<sup>475</sup> In contrast, the trend towards dematerialization of registered ownership

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<sup>471</sup> See Investment Company Act Rule 31a-1(b)(1), 17 CFR 270.31a-1(b)(1) (requiring current journals detailing sales and redemptions of the investment company's own securities and the trade date).

<sup>472</sup> See supra note 183.

<sup>473</sup> Exchange Act Rule 17Ad-4(a), 17 CFR 240.17Ad-4(a).

<sup>474</sup> For discussion of dematerialization, see supra note 69 and accompanying text.

<sup>475</sup> See 1971 Study of the Securities Industry Hearings, supra note 299 (statements of David Hughey, Senior Vice President-Operations, Putnam Management Co., Inc. that the percentage of Mutual Fund holders

positions of operating companies evolved over a much longer period of time through some of the incremental developments discussed in this release, such as DRS and issuer plans (e.g., DRIPs). And, for beneficial owners, equity securities issued by operating companies have largely been immobilized in central securities depositories, as discussed above in Sections II and III. Thus, while both Mutual Fund Transfer Agents and Operating Company Transfer Agents today process large numbers of dematerialized securities, Mutual Fund Transfer Agents process them in larger numbers and have been doing so for a longer period of time.

There are also important differences in how Mutual Fund Transfer Agents are organized and compensated compared to Operating Company Transfer Agents generally. For example, there are, in general, three types of Mutual Fund Transfer Agent arrangements: (i) internal (which may also be referred to as “captive,” “affiliated” or “full internalization”),<sup>476</sup> (ii) external (which may also be referred to as “third party” or “full service”), and (iii) hybrid (which may also be referred to as “remote vendor”).<sup>477</sup> Mutual funds generally tend not to have employees; therefore, internal transfer agent services are not actually provided by the fund. “Internal”

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owning in certificated form dropped from 72 percent in 1956 to 27.5 percent by 1969). It was estimated in 1978 that less than 10% of registered owners of Mutual Fund shares requested certificates. See, e.g., Martin J. Aronstein, The Decline and Fall of the Stock Certificate in America, 1. J. Int’l L. 273, 278 (1978), available at <http://scholarship.law.upenn.edu/jil/vol1/iss3/4>.

<sup>476</sup> Mutual funds generally do not have employees. As a result, the Commission understands that transfer agent services that are characterized as being provided “internally” are not actually provided by the fund but are provided by personnel from the investment adviser to the mutual fund or by an affiliate of such investment adviser.

<sup>477</sup> See generally, ICI, The Role and Responsibilities of a Mutual Fund Transfer Agent: Workbook, 4 (2001) (“Mutual Fund Transfer Agent Workbook”); PWC Evolution of the Mutual fund Transfer Agent, supra note 460. For a discussion of one mutual fund complex’s evaluation of using the internal (“full internalization”), hybrid (“remote vendor”), or external (“full service”) Mutual Fund Transfer Agent models, see In the Matter of Smith Barney Fund Management LLC and Citigroup Global Markets, Inc., Exchange Act Release No. 51761 at 4-15 (May 31, 2005).

transfer agents are typically affiliated with the mutual fund complex, or the fund’s investment adviser.<sup>478</sup> The main advantage of an internal transfer agent arrangement is that it allows a mutual fund or fund complex to closely monitor the delivery and quality of services provided to securityholders, which may be important to attracting and retaining investors who value service quality.<sup>479</sup> Larger mutual funds or mutual fund complexes may be more inclined to use internal transfer agents than their smaller counterparts because these funds’ sponsors may be better able to undertake the costs required to develop and maintain the extensive technology systems and internal workforce needed to provide service to a large number of accounts.<sup>480</sup> External (or third-party) transfer agents are independent from (as opposed to being affiliated with) the mutual fund and its fund complex or investment adviser. While there may be variation from firm to firm, the external model may not require the same capital expenditures by fund sponsors as for internal transfer agent services, and therefore may be viewed as a cost effective alternative to the internal model.<sup>481</sup>

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<sup>478</sup> “Independent” and “affiliated” are used generally in connection with this discussion and are not intended to refer to any particular definition of those terms in any of the provisions of the federal securities laws or other authorities.

<sup>479</sup> See, e.g., Mutual Fund Industry Handbook, supra note 468, at 277 (“In many cases, fund groups that outsource their transfer agent back-office functions perform investor service from their own, internal contact centers. This reflects the widespread belief that the quality of this visible service has competitive implications. The back-office functions, by contrast, must be performed correctly, but they offer little opportunity for the fund to differentiate itself from the competition.”).

<sup>480</sup> See generally, Mutual Fund Transfer Agent Workbook, supra note 477. We note, however, even among larger mutual funds, it is possible for decisions to vary from firm to firm and for similar size firms to come to different conclusions concerning expected costs and the degree to which the mutual fund should internalize transfer agent services when faced with similar factors.

<sup>481</sup> It is the understanding of the Commission that these capital expenditures to build and maintain transfer agent technology and infrastructure systems may be absent or reduced in the case of an external transfer agent because an external transfer agent may have already made these investments in the past and, to the extent some or all of the cost of those investments may be passed on to transfer agent issuer clients, the full



External transfer agents have their own business model, processing and procedural routines, computer systems, and service providers.<sup>482</sup> Because of this independence, the mutual fund or mutual fund complex may have less input or control over how a fund's securityholders are ultimately serviced. For this reason, some mutual funds use a hybrid transfer agent arrangement, whereby an internal transfer agent performs certain services in an effort to maintain control over the quality of the securityholder servicing relationship, and other services are sub-contracted to an external transfer agent.<sup>483</sup> For example, many mutual funds using a hybrid arrangement will use an external transfer agent for core record-keeping functions and an internal transfer agent for securityholder servicing, especially when such servicing involves direct interaction with mutual fund securityholders.<sup>484</sup> As a result, there may be significant variation in services provided, technology resources and capability, and corporate structure and organization among Mutual Fund Transfer Agents.

Mutual Fund Transfer Agents may also have different compensation arrangements than typical Operating Company Transfer Agents, which generally will be compensated on a per securityholder account basis. While Mutual Fund Transfer Agents may also be compensated on

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extent of the redistributed cost is unlikely to be borne by a single issuer and is more likely to be diffused across multiple issuers.

<sup>482</sup> In contrast to mutual funds, operating companies with a large number of shareholders rarely use the internal or hybrid models and nearly always use an external transfer agent, although there are exceptions where a public company serves as its own transfer agent, particularly among local utility companies and local banks where the administration to service stockholders as a transfer agent is already in place and where the stockholders are often customers of the company.

<sup>483</sup> See, e.g., supra note 479 (discussing internal servicing and quality of service).

<sup>484</sup> See, e.g., Mutual Fund Industry Handbook, supra note 468, at 277 (citing ICI, Mutual Funds and Transfer Agent Billing Practices 1997 (1998) (finding that 87 percent of 483 funds surveyed performed such securityholder servicing "internally" (i.e., using personnel from the management company or an affiliate of the management company))).

a per securityholder account basis, many of them instead receive compensation based on a percentage of a fund's net assets.<sup>485</sup> Mutual Fund Transfer Agent fees are typically the second largest expense borne by mutual funds, exceeded only by the investment management fee.<sup>486</sup>

## 2. *Increased Complexity*

As a result of the collective effect of the five factors discussed below, transaction processing for Mutual Fund Transfer Agents may be more complex or involve additional responsibilities as compared to Operating Company Transfer Agents. First, Mutual Fund Transfer Agents receive cash and perform calculations as a 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 Operating Company Transfer Agents. As a general matter, unlike publicly traded equity securities, mutual fund securities are redeemable, meaning that investors in mutual fund securities (or their intermediaries) purchase or redeem mutual fund shares directly with the mutual fund itself rather than on the secondary market.<sup>487</sup> Mutual fund securities must be purchased and redeemed at their current net asset value ("NAV") per share next computed after receipt.<sup>488</sup> Investor orders to purchase mutual fund shares are ultimately received by a Mutual

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<sup>485</sup> Fee arrangements may vary from Mutual Fund Transfer Agent agreement to agreement and other fee permutations are possible, for example as an at-cost arrangement between an internal Mutual Fund Transfer Agent and the fund.

<sup>486</sup> See, e.g., Mutual Fund Industry Handbook, supra note 468, at 231 ("Transfer agent service is typically the largest component of a fund's expense after investment management."); H. Kent Baker, Greg Filbeck & Halil Kiyamaz, Mutual Funds and Exchange-Traded Funds: Building Blocks to Wealth, 406 (2015) (analyzing 2014 data of one Mutual Fund and finding \$21 million in transfer agent fees to have been the fund's second largest expense after \$65 million in investment management fees).

<sup>487</sup> See Investment Company Act Sections 5(a), 2(a)(32), 15 U.S.C. 80a-5(a), 80a-2(a)(32) (defining open-end companies and redeemable securities, respectively).

<sup>488</sup> See Investment Company Act Rule 22c-1 17 CFR 270.22c-1. Under Rule 22c-1, commonly called the "forward pricing" rule, an investor who submits an order before the next computed NAV, generally

Fund Transfer Agent, regardless of whether the investor's order is submitted directly by the investor or is submitted by an intermediary such as a broker (including where a broker may submit the order via NSCC's Fund/SERV system).<sup>489</sup> After receiving a purchase order, Mutual Fund Transfer Agents calculate the number of shares purchased in some cases (such as where the investor indicates the dollar amount the investor seeks to purchase rather than the number of shares). With respect to purchase orders from investors, Mutual Fund Transfer agents collect the payment for those shares, deposit the payment into the account of the custodian of the mutual fund, issue on behalf of the mutual fund the shares to be purchased, and record the transaction on the master securityholder file of the mutual fund.<sup>490</sup> Mutual Fund Transfer Agents engage in a comparable process when an investor decides to redeem shares in a mutual fund.

Second, Mutual Fund Transfer Agents also play a role that serves to assist in the determination of the appropriate price for an investor's purchase or redemption order (which is based on the NAV per share and any applicable commissions or fees). They do so by coordinating with mutual fund administrators, who commonly perform the main calculations that

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calculated by most funds as of the time when the major U.S. stock exchanges close at 4:00 pm Eastern Time, receives that day's price, and an investor who submits an order after the pricing time receives the next day's price. See generally, Amendments to Rules Governing Pricing of Mutual Fund Shares, Investment Company Act Release No. 26288 (Dec. 17, 2003), 68 FR 70388 (Dec. 17, 2003) (proposing release).

<sup>489</sup> For additional details regarding Fund/SERV, see Exchange Act Release No. 22928 (Feb. 20, 1986), 51 FR 6954 (Feb. 27, 1986) (File No. SR-NSCC-85-09); Exchange Act Release No. 25146 (Nov. 20, 1987), 52 FR 45418 (Nov. 27, 1987) (File No. SR-NSCC-87-08); Exchange Act Release No. 26376 (Dec. 20, 1988), 53 FR 52544 (Dec. 28, 1988) (File No. SR-NSCC-88-08); Exchange Act Release No. 31487 (Nov. 27, 1992), 57 FR 56611 (Nov. 30, 1992) (File No. SR-DTC-92-02).

<sup>490</sup> See, e.g., Exchange Act Release No. 12440 (May 12, 1976), 41 FR 22595 (June 4, 1976) (ICI comment letter (July 19, 1976)) ("The mutual fund transfer agent receives cash for investment in mutual fund shares and pays cash to shareholders for the redemption of outstanding shares."); Pozen & Hamacher, supra note 470 ("The transfer agent is responsible for collecting payment for share purchases and arranging for its deposit into the fund's bank account.").

assist a mutual fund in determining its NAV.<sup>491</sup> The coordination with the mutual fund’s administrator is necessary, not only because Mutual Fund Transfer Agents must process purchases and redemptions at current NAV as described above, but because current NAV as calculated by the administrator on behalf of the mutual fund must reflect changes in the number of shares of the mutual fund outstanding pursuant to Investment Company Act Rule 2a-4(a)(3).<sup>492</sup> Because the Mutual Fund Transfer Agent is the entity primarily responsible for keeping track of this information on behalf of the mutual fund, the administrator typically receives this record of changes in the capital stock of the mutual fund from the Mutual Fund Transfer Agent. Because Mutual Fund Transfer Agent transaction processing is price-dependent as described above, if an error is made and later discovered in connection with some aspect of this process, the Mutual Fund Transfer Agent may need to reprocess all of the purchases and redemptions that were affected by the error (“as of” transaction processing). Both the daily NAV and any corrections are communicated by Mutual Fund Transfer Agents to intermediaries for transaction processing conducted on behalf of beneficial owners of mutual funds.

Third, some mutual funds may provide their investors with options which may add additional complexity to the Mutual Fund Transfer Agent’s or intermediary’s processing tasks. For example, many mutual funds allow investors to exchange a mutual fund within the same

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<sup>491</sup> The Commission understands that most mutual funds and other investment companies that are required to register with the Commission contract with one service provider for transfer agent services and a different provider for fund “administration,” which generally involves services such as calculation of NAV and management fee accruals. In contrast, it is the understanding of the Commission that many private funds (i.e., investment funds not registered with the Commission) use a single service provider for both transfer agent and administration functions.

<sup>492</sup> See Investment Company Act Rule 2a-4(a)(3), 17 CFR 270.2a-4(a)(3) (“Changes in the number of outstanding shares of the registered company resulting from distributions, redemptions, and repurchases shall be reflected no later than in the first calculation on the first business day following such change.”).

fund complex without having to pay a sales load or other fee for purchasing shares of the new mutual fund. This arrangement may require Mutual Fund Transfer Agents (or intermediaries) to determine if the exchange qualifies for a waiver of the sales charge and to track the total time the investor has been invested in the mutual fund complex. In addition, some mutual funds may offer other services and options, such as systematic withdrawal plans, that may require Mutual Fund Transfer Agents and their intermediaries to keep track of a potentially wide range of securityholder elections, transaction types, and prospectus and business processing rules in CUSIP databases that are utilized for transaction processing.

Fourth, the use of different sales load structures and distribution methods, particularly with respect to redemption of mutual fund securities, as well as other fee payments to intermediaries, also adds complexity in the mutual fund context. For example, for load funds, or funds that charge a sales load to the investor, Mutual Fund Transfer Agents commonly process and distribute related commission payments to intermediaries in connection with sales of mutual fund shares.<sup>493</sup> As part of a distribution strategy, some mutual funds compensate distributors such as broker-dealers with trail commissions that are processed and distributed by the Mutual Fund Transfer Agent, even after completion of a sale.<sup>494</sup> A Mutual Fund Transfer Agent may process redemption fee charges or track relevant information and give effect to sales load discounts (often referred to as breakpoints) for direct investors, often based on the amount

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<sup>493</sup> In addition, if the mutual fund has a contingent deferred sales load (often referred to as a “back-end load”), transfer agents commonly process and distribute these commissions to distributors in connection with a redemption.

<sup>494</sup> See Investment Company Act Rule 12b-1, 17 CFR 270.12b-1.

invested or intended to be invested. Mutual Fund Transfer Agents also may process and distribute ongoing sub-transfer agency fees to intermediaries.<sup>495</sup>

Fifth, Mutual Fund Transfer Agents traditionally have functioned in a more central role in connection with clearing and settlement of securities transactions than have Operating Company Transfer Agents. With a mutual fund purchase or redemption, there is no clearing corporation involved that serves to novate trades as a central counterparty as in the case of a broker-facilitated trade in an equity security on a national securities exchange (as shown in Figure 1 in Section III.B above) because mutual funds generally are not exchange-traded.<sup>496</sup> As a result of this clearance and settlement environment, Mutual Fund Transfer Agents interact with sub-transfer agents such as broker-dealers, who hold shares on behalf of their beneficial owner customer, similar to the way in which DTC interacts with Operating Company Transfer Agents.<sup>497</sup> Mutual Fund Transfer Agents also maintain on the master securityholder file omnibus positions for intermediaries (on behalf of the intermediaries' beneficial owner-customers), which is similar to the way in which DTC maintains securities accounts of participants, but there is no jumbo Cede & Co. position at DTC in the case of a mutual fund.

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<sup>495</sup> See supra Section VII.B for a discussion of sub-transfer agents.

<sup>496</sup> While as discussed above, there is no clearing corporation that serves as central counterparty in mutual fund transactions, there are services provided by NSCC, such as Fund/SERV and Networking. This centralized clearance and settlement platform employs standardized data fields and protocols for mutual fund transaction processing and daily net settlements, through which intermediaries such as brokers may transmit and settle orders with Mutual Fund Transfer Agents. For additional details regarding Fund/SERV, see supra note 489.

<sup>497</sup> See supra note 113 for definition of sub-transfer agent.

### 3. *Compliance and Other Services*

Many Mutual Fund Transfer Agents may assist mutual funds with their compliance obligations, not only with respect to general recordkeeping obligations, but also to enable mutual funds to comply with regulations to which operating companies may not be subject in the same way or at all.<sup>498</sup> One such obligation is that mutual funds have various “client on-boarding” requirements under federal law<sup>499</sup> and commonly rely upon their Mutual Fund Transfer Agent to do the work that will enable the mutual fund to meet such obligations. For example, mutual funds are required to implement anti-money laundering (AML) programs pursuant to an interim final rule of the Treasury.<sup>500</sup> In addition, mutual funds are required to establish customer identification programs pursuant to a joint rule of the Commission and Treasury.<sup>501</sup> That rule requires, at a minimum, that the mutual fund verify an investor’s identity to the extent reasonable and practicable, maintain records of the information used to verify identity, and determine whether the investor appears “on any list of known or suspected terrorists or terrorist organizations issued by any federal government agency and designated as such by Treasury in

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<sup>498</sup> Regarding general recordkeeping obligations, see Investment Company Act Rule 31a-1(b)(1), 17 CFR 270.31a-1(b)(1) (requiring current journals detailing sales and redemptions of the investment company’s own securities and the trade date).

<sup>499</sup> See, e.g., Bank Secrecy Act Section 5312(a)(2) (including “investment compan[ies]” within the definition of “financial institution”). Transfer agents may also be subject directly to related federal requirements that do not apply solely to “financial institutions.” See, e.g., Section 6050I of the Internal Revenue Code, 26 U.S.C. 6050I (requirement to report to Internal Revenue Service receipt of cash in excess of \$10,000 in a single or related transaction).

<sup>500</sup> See Financial Crimes Enforcement Network, Anti-Money Laundering Programs for Mutual Funds, 67 FR 21117 (Apr. 29, 2002).

<sup>501</sup> 31 CFR 103.131; see Customer Identification Programs for Mutual Funds, Investment Company Act Release No. 26031 (Apr. 29, 2003), 68 FR 25131 (May 9, 2003).

consultation with the federal functional regulators.”<sup>502</sup> While mutual funds bear ultimate responsibility for compliance, as a practical matter, the customer identification processes commonly are carried out by Mutual Fund Transfer Agents for direct investors.<sup>503</sup> In addition, mutual funds are required to report suspicious transactions (“Suspicious Activity Reports”) to the Treasury’s Financial Crimes Enforcement Network.<sup>504</sup> Mutual Fund Transfer Agents may assist the mutual fund in filing the Suspicious Activity Reports.

Mutual Fund Transfer Agents may also assist mutual funds in complying with requirements related to the price-dependent nature of mutual fund transaction processing. First, Mutual Fund Transfer Agents may be responsible for monitoring, on behalf of the mutual fund, that intermediaries such as dealers are properly separating orders received from customers before NAV is next computed from those received afterwards and are sending them in separate batches to the Mutual Fund Transfer Agent.<sup>505</sup> As another example, mutual funds are entitled to receive

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Id.

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See, e.g., Pozen & Hamacher, supra note 470 (discussing transfer agent verification of investor identity information as part of the mutual fund share purchase process); Id. at 352 (“Funds must take steps to avoid providing a laundry service for criminals with dirty money. As mentioned earlier, transfer agents verify a customer’s identity when they open an account, under what are referred to as the *know your customer*, or KYC rules.”) (emphasis in the original); Practising Law Institute, Mutual Funds and Exchange Traded Funds Regulation § 1A:3.1 Money Laundering (Clifford A. Kirsch ed., 3rd ed. 2014) (“Most funds accomplish AML compliance through their transfer agents and distributors.”)

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31 CFR 103.15(a)(1); see Financial Crimes Enforcement Network; Amendment to the Bank Secrecy Act Regulations--Requirement That Mutual Funds Report Suspicious Transactions, 68 FR 2716 (Jan. 21, 2003); see also Guidance, Frequently Asked Questions, Suspicious Activity Reporting Requirements for Mutual Funds, FIN-2006-G013 (Oct. 4, 2006) (authorizing mutual fund to use an agent to file reports but stating the “mutual fund remains responsible for assuring compliance with the regulation and must monitor performance by the service provider.”).

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See Compliance Programs of Investment Companies and Investment Advisers, Investment Company Act Release No. 26299 (Dec. 17, 2003) (reliance solely on “contractual provisions with transfer agents and other intermediaries that obligate those parties to segregate orders received by time of receipt in order to prevent “late trading” based on a previously determined price” would be “insufficient to meet the



taxpayer identification numbers of beneficial owner customers upon request under shareholder information agreements that mutual funds (other than money market mutual funds and mutual funds that expressly authorize short-term trading) must enter into pursuant to Investment Company Act Rule 22c-2(a)(2) with financial intermediaries who submit orders on behalf of beneficial owner customers.<sup>506</sup> Mutual Fund Transfer Agents commonly assist the mutual fund's review of this taxpayer identification number and related transaction information in order to monitor against trading practices that may dilute the value of the outstanding securities issued by the mutual fund.<sup>507</sup>

#### 4. *Broker-Dealer Recordkeeping for Beneficial Owners Who Invest In Mutual Funds*

As happens in the operating company space, many securities intermediaries such as broker-dealers and banks perform recordkeeping and processing services for their customers who are beneficial owner investors in mutual funds.<sup>508</sup> A key difference is that frequently a mutual fund will compensate the intermediary pursuant to an agreement with the intermediary for the provision of those 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. However, most operating companies do not compensate intermediaries for servicing their beneficial owner

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requirements of the new rule. Funds should . . . also take affirmative steps to . . . obtain[] assurances that those policies and procedures are effectively administered.”).

<sup>506</sup> Investment Company Act Rule 22c-2(a)(2), 17 CFR 270.22c-2(a)(2).

<sup>507</sup> See id. (authorizing a Mutual Fund Transfer Agent to enter into the shareholder information agreement on behalf of the mutual fund with the financial intermediary).

<sup>508</sup> See Section VII.B for a discussion of the transfer and account maintenance-related services performed by broker-dealers and banks for their beneficial owner customers and related issues. We note that the relationship between fees received by intermediaries for these types of “sub-transfer agent” services and the 12b-1 fee plan of a mutual fund is beyond the scope of this release.

customers. The oversight and invoicing for these payments is often delegated to the Mutual Fund Transfer Agent,<sup>509</sup> who will commonly process and distribute ongoing sub-transfer agency fees to intermediaries.

Because intermediaries are compensated for providing recordkeeping and processing services for their customers who are beneficial owner investors in mutual funds, many of the issues discussed above in Section V.D.3 are relevant to Mutual Fund Transfer Agents.

“Networking” of a single investor’s account or position potentially gives Mutual Fund Transfer Agents more transparency through to beneficial owners than is available to Operating Company Transfer Agents, because the recordkeeping for such accounts is primarily kept on the Mutual Fund Transfer Agent’s system. “Networking” is a service provided by NSSC by which Mutual Fund Transfer Agents can also exchange general shareholder account data with intermediaries such as brokers that provide sub-transfer agency services.<sup>510</sup> This service provides for different levels of securityholder account networking between mutual funds and securities

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<sup>509</sup> See generally, ICI, Financial Intermediary Controls and Compliance Assessment Engagements (2015), available at [https://www.ici.org/pdf/ppr\\_15\\_ficca.pdf](https://www.ici.org/pdf/ppr_15_ficca.pdf). The mutual fund industry has developed a standardized framework, the Financial Intermediary Controls and Compliance Assessment Engagement (FICCA), for intermediary oversight, where fund sponsors are seeking assurances on the effectiveness of the intermediary’s control environment. The framework calls for the omnibus account recordkeeper to engage an independent accounting firm to assess its internal controls related to specified activities the intermediary performs for fund shareholder accounts. FICCA is performed under attestation standards issued by the AICPA and the auditor report expresses an opinion on its evaluation of an intermediary’s assertion that controls were suitably designed and operating effectively. The framework includes 17 areas of focus, including document retention and recordkeeping, transaction processing, shareholder communications, privacy protection and anti-money laundering. It is the understanding of the Commission that FICCA engagements are voluntary and some intermediary reports may not provide an assessment on all 17 areas of focus.

<sup>510</sup> Data communicated via NSSC Networking may include: (i) shareholder elections regarding the settlement of cash dividends and capital gains distributions (such as by check or direct deposit), (ii) reinvestment elections, (iii) address changes, (iv) the financial adviser associated with the account, and (v) tax reporting information. See Mutual Fund Transfer Agent Workbook, supra note 477, at 84.

intermediaries.<sup>511</sup> Networked accounts are in the name of the intermediary on the master securityholder file but can represent both individual customers and omnibus accounts. Nevertheless, Networking's advantages are less utilized today as many beneficial owner accounts are now held in omnibus accounts that may also be networked. Thus, due in part to the increasing prominence of the omnibus account, Mutual Fund Transfer Agents' ability to look-through to beneficial owners has decreased.

The use of breakpoints historically highlights some of the issues faced by Mutual Fund Transfer Agents that are associated with recordkeeping and processing services provided by intermediaries.<sup>512</sup> A 2003 joint report of the staffs of the Commission, NASD and NYSE, found that "[t]he dramatic growth in the number of [mutual fund] families, share classes, and, to a lesser extent, customer account types, has increased the complexity of applying breakpoints appropriately."<sup>513</sup> The Staff Report also noted that whereas "in the past, broker-dealers dealt directly with mutual fund transfer agents and disclosed the customer's identity to them, the increasing prominence of omnibus account arrangements and sub-transfer agency services

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<sup>511</sup> Intermediary accounts can be networked at three levels (0, 3 and 4), providing different information concerning underlying beneficial owners. In Level 3, the intermediary handles all aspects of the customer relationship and the customer does not interact with the Mutual Fund Transfer Agent. In Level 4, the Mutual Fund Transfer Agent handles all client communications, and customers as well as their intermediary may interact with the Mutual Fund Transfer Agent. Level 0 refers to a bank trust networked account that functions similar to a Level 3 account, and the term also is used when referencing non-networked accounts.

<sup>512</sup> Some mutual funds that charge front-end sales loads will charge lower sales loads for larger investments (i.e., "breakpoints). For additional information on breakpoints, see Final Rule: Disclosure of Breakpoint Discounts by Mutual Fund, Exchange Act Release No. 49817 (June 7, 2004), 69 FR 33262 (June 14, 2004).

<sup>513</sup> Staff Report: Joint SEC/NASD/NYSE Report of Examinations of Broker-Dealers Regarding Discounts on Front-End Sales Charges on Mutual Funds (Mar. 2003), available at <https://www.sec.gov/news/studies/breakpointrep.htm>.

provided to these accounts by intermediaries such as brokers had made the tasks related to the application of breakpoints more challenging.”<sup>514</sup>

Finally, the Commission understands that there has been a movement to omnibus sub-accounting arrangements over the years for mutual fund shareholders<sup>515</sup> and that this movement has resulted in a fundamental shift in the roles and responsibilities of traditional shareholder servicing and recordkeeping.<sup>516</sup> 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.

#### 5. *Discussion and Request for Comment*

Given these developments, as well as the proliferation and growth of registered investment companies, including open-end funds, closed-end funds, UITs<sup>517</sup> and ETFs,<sup>518</sup> the

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<sup>514</sup> Id.; see also infra Section C.4 for additional discussion of Mutual Fund sub-transfer agent issues.

<sup>515</sup> See generally, Deloitte Digest on Omnibus Revolution, supra note 459; Deloitte, The Omnibus Revolution; managing risk across an increasingly complex service model (2012), available at [http://www.deloitte.com/view/en\\_US/us/Industries/Private-Equity-Hedge-Funds-Mutual-Funds-Financial-Services/e89659d4db516310VgnVCM3000001c56f00aRCRD.htm](http://www.deloitte.com/view/en_US/us/Industries/Private-Equity-Hedge-Funds-Mutual-Funds-Financial-Services/e89659d4db516310VgnVCM3000001c56f00aRCRD.htm).

<sup>516</sup> See generally, PWC Evolution of the Mutual fund Transfer Agent, supra note 461; PricewaterhouseCoopers, LLP, Evolution of the mutual fund transfer agent: Embracing the challenges and opportunities (July 2015), available at <http://www.pwc.com/us/en/asset-management/investment-management/publications/mutual-fund-transfer-agent-evolution.html>.

<sup>517</sup> See supra note 442.

<sup>518</sup> The first Commission transfer agent rules were adopted in 1977. See generally, supra Section IV.A. The advent of ETFs occurred more than a decade later. For examples of some of the earliest ETFs authorized under Commission exemptive orders, see, e.g., SPDR Trust, Series 1, Investment Company Act Release No. 18959 (Sept. 17, 1992) (notice), 19055 (Oct. 26, 1992) (order); Diamonds Trust, Investment Company Act Release No. 22927 (Dec. 5, 1997) (notice), 22979 (Dec. 30, 1997) (order). For a discussion of key characteristics of ETFs, see Request for Comment on Exchange-Traded Products, Exchange Act Release

Commission believes it is appropriate to examine the regulation of transfer agents who provide services to registered investment companies.

In particular, 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 they service. Some of the issues posed by these unique characteristics of these registered investment companies are illustrated by the potentially different treatment of UITs and closed-end funds with respect to the Rule 17Ad-4(a) exemptions, despite the many similarities that have existed historically among the secondary market trading characteristics of UITs and closed-end funds. Closed-end funds typically trade in a secondary market and often list on a national securities exchange for trading. By definition under Section 5 of the Investment Company Act, the securities of closed-end funds are not redeemable (i.e., the investor does not have a right to require the fund to redeem the investor's shares in exchange for a proportionate share of the fund's underlying asset or cash equivalent thereof).<sup>519</sup> As a result, transfer agents servicing closed-end funds do not qualify for the Rule 17Ad-4(a) exemption, with respect to closed-end funds.<sup>520</sup> In contrast, transfer agents servicing UITs qualify for the exemption because UIT units are redeemable.<sup>521</sup> Yet, although UIT units

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No. 75165 (June 12, 2015), 80 FR 34729 (June 17, 2015); Exchange-Traded Funds, Investment Company Act Release No. 28193 (March 11, 2008), 73 FR 14618 (March 18, 2008).

<sup>519</sup> While a closed-end fund investor may not have the right to require the fund to redeem the investor's shares, in some cases, a closed-end fund may elect to purchase shares from its investors if they wish to sell their shares. See also Investment Company Act Rules 23c-1 through 23c-3, 17 CFR 270.23c-1 through 23c-3.

<sup>520</sup> See 17Ad-1-7 Proposing Release, supra note 165, at n.14 ("The turnaround rules do apply to registered transfer agents performing transfer agent functions for securities issued by closed-end investment companies.")

<sup>521</sup> Id.

are redeemable, because UITs are static trusts, redemptions of the UIT would require the UIT to dilute the corpus of the trust in order to meet redemption requests (whether paid out by the UIT in cash or met by distributions by the UIT of in-kind assets of the UIT). Therefore, just like closed-end funds, in order to provide liquidity to selling shareholders, historically UITs commonly have been traded in a secondary market, typically made up of broker-dealers, but UITs typically do not list their shares on a national securities exchange for trading as closed-end funds often do.<sup>522</sup> Thus, UITs and closed-end funds are treated differently for purposes of Rule 17Ad-4, despite historically having similar trading characteristics.<sup>523</sup>

The Commission also seeks comment with respect to the Rule 17Ad-4(a) exemptions. As discussed above, although Mutual Fund Transfer Agents provide many of the same recordkeeping, transfer, account maintenance, and related services that Operating Company Transfer Agents provide, under Rule 17Ad-4(a) they are exempt from some of the turnaround, processing, performance, and recordkeeping requirements that make up the foundation of the

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<sup>522</sup> See Thomas Harman, Emerging Alternatives to Mutual Funds: Unit Investment Trusts and Other Fixed Portfolio Investment Vehicles, 1987 Duke L.J. 1045, 1046 (1987), [available at http://scholarship.law.duke.edu/dlj/vol36/iss6/4/](http://scholarship.law.duke.edu/dlj/vol36/iss6/4/); Gould and Lins, Unit Investment Trusts: Structure and Regulation under the Federal Securities Laws, 43 Bus. Law. 1177, 1185 (Aug. 1988); Form N-7 for Registration of Unit Investment Trusts under the Securities Act of 1933 and the Investment Company Act of 1940, Investment Company Act Release No. 15612 at text following n.1 (Mar. 9, 1987), 52 FR 8268 (Mar. 17, 1987); and SEC, Office of Investor Education and Advocacy, Unit Investment Trusts (UITs), [available at http://www.sec.gov/answers/uit.htm](http://www.sec.gov/answers/uit.htm).

<sup>523</sup> With respect to UITs that are not ETFs and that do not serve as separate account vehicles that are used to fund variable annuity and variable life insurance products, broker-dealers have historically maintained a secondary market in UIT units. At present, based on Commission staff analysis of data as of December 2014, the Commission understands that approximately 75% of the assets held in UITs serve as separate account vehicles that are used to fund variable annuity and variable life insurance products, and the sponsors of these UITs do not typically maintain a secondary market in UIT units. See Open-End Fund Liquidity Risk Management Programs; Swing Pricing; Re-Opening of Comment Period for Investment Company Reporting Modernization Release, Investment Company Act Release No. 31835, 51-52 (Sept. 22, 2015), 80 FR 62273, 62289 (Oct. 15, 2015).

transfer agent rules.<sup>524</sup> One of the primary justifications for the Rule 17Ad-4(a) exemption was that at the time of adoption most equity securities at that time were issued in certificated form, while most mutual fund shares were uncertificated.<sup>525</sup> Thus, the Commission viewed the “redemption of fund shares” as being “significantly different from the transfer of ownership of stocks and bonds on the issuer’s records.”<sup>526</sup> However, today most equity securities are either immobilized at DTC or completely dematerialized and issued in book-entry form, potentially making the processing of securities issued by mutual funds and equity securities issued by operating companies more alike than different and raising the question of whether the Commission should consider amending or eliminating the Rule 17Ad-4 exemption.

Based on these and the other issues and developments discussed in this section and throughout this release, the Commission believes it is appropriate to consider whether new or amended rules governing transfer agents’ services and activities with respect to mutual funds and other registered investment companies could be appropriate. Accordingly, the Commission seeks comment on the following:

101. What are the similarities and differences among transfer agents that service equity securities, debt securities, and registered investment company securities? Please explain.

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<sup>524</sup> As noted above, Rule 17Ad-4(a) creates an exemption from Rules 17Ad-2, 17Ad-3, and 17Ad-6(a)(1)-(7) and (11) for interests in limited partnerships, DRIPs, and redeemable securities issued by investment companies registered under Section 8 of the Investment Company Act. See supra Section IV.A.2 for additional information regarding Rule 17Ad-4.

<sup>525</sup> See supra Section IV.A.2.

<sup>526</sup> Rule 17Ad-1 through 17Ad-7 Adopting Release, supra note 145, at 32408; see also id. at n.13 (“[t]he amount of certificated fund shares is relatively small, and the amount of transfer agent activity in connection with transferring ownership of certificated shares represents a very small part of a transfer agent’s activity with regard to an open-end investment company.”).

102. Do transfer agents face different risks and challenges depending on the industry segment or asset class they service? Does the level of complexity associated with transaction processing by Mutual Fund Transfer Agents create risks or challenges the Commission should consider addressing? Why or why not? Please explain.
103. Should the Commission address specific issues related to Mutual Fund Transfer Agents and transfer agents that service other registered investment companies? Should the Commission, in regulating transfer agents to registered investment companies, take into account the trading, market, asset class, or other characteristics of the securities or issuers being serviced? What other factors, if any, should be considered and why? Alternatively, should the Commission regulate all transfer agents uniformly, regardless of the industry segment or asset class they service? Why or why not? What data should the Commission consider in making that determination? Please explain.
104. Should the Commission impose additional recordkeeping and disaster recovery requirements for Mutual Fund Transfer Agents? Why or why not?
105. Should the Commission require that transfer agents provide more detailed information on Form TA-2 about the type of issuers they are servicing and the types of work they are performing for those issuers? Why or why not? For example, should Form TA-2 include information regarding whether a transfer agent is servicing investment companies or pension plans? Why or why not? Would this information be helpful to issuers who seek specific skills or experience from their transfer agent? Should Form TA-2 require the disclosure of the name of each issuer serviced during the reporting period? Why or why not? What would be the benefits, costs, or burdens associated with any such requirements? Are there already freely available sources for this information? Please provide empirical data, if any.
106. As noted, transfer agent services for interests in limited partnerships, DRIPS, and redeemable securities of registered investment companies are exempt from certain turnaround rules under Rule 17Ad-4(a). In light of the expanded role of transfer agents in these areas, should the Commission eliminate these exemptions? If so, what costs, burdens, or benefits would accrue to investors, issuers, or the transfer agent industry? If these exemptions are not eliminated, should the Commission add other book-entry forms of ownership to the list of exemptions, including direct registration system positions, direct purchase plan positions, and employee purchase plans? Why or why not?
107. Are limited partnerships traded today in greater volumes than they were in 1977? Please provide empirical data. If so, do commenters believe the Commission should consider this as a potential basis for eliminating the exemption for transfer agents to limited partnerships in Rule 17Ad-4(a)? Why or why not?



108. In light of increased dematerialization, do commenters believe transfer agent processing of DRIP transactions today is largely similar to the processing of equity and debt securities? Why or why not? If so, do commenters believe the Commission should consider this as a potential basis for eliminating the exemption for transfer agents to DRIPs in Rule 17Ad-4(a)? Why or why not?
109. Transfer agents that service UITs are currently exempt under Rule 17Ad-4(a), but transfer agents that service closed-end funds are not. Should the Commission continue this distinction? Should the Commission apply transfer agent rules to transfer agents that service UITs in the same manner as the rules apply to transfer agents that service closed-end funds on the basis of historical similarities in the secondary market trading of both types of funds? Why or why not? Please explain.
110. Should the Commission amend the current transfer agent rules to explicitly address transfer agents for ETFs? Why or why not? How do transfer agent functions in connection with ETFs differ, if at all, from services transfer agents provide to other types of investment companies? Are there any particular issues unique to transfer agent service of ETFs that raise risks not present with respect to other types of investment companies? Please explain. If Rule 17Ad-4(a) is retained by the Commission in some form and is not proposed to be eliminated, should the Commission amend Rule 17Ad-4(a) to specify explicitly the applicability of its exemption to transfer agents to ETFs? If so, should transfer agents to ETFs be able to avail themselves of the exemption or should the exemption not apply to transfer agents to ETFs similar to the way in which the exemption today does not apply to transfer agents to closed-end funds, which in some cases are traded on national securities exchanges as are ETFs? Why or why not?
111. How are Mutual Fund Transfer Agents compensated today? Do any aspects of the structure or terms of their compensation raise regulatory concerns? Do Mutual Fund Transfer Agent fees based upon the fund's net assets create any conflicts of interest? Why or why not? If so, are there alternative fee structures that would not create conflicts of interest? Do Mutual Fund Transfer Agents provide fee rebates to issuers and, if so, do these raise any issues of regulatory concern? Do the internal and hybrid transfer agent models discussed above raise any special regulatory concerns? Why or why not? Please explain.
112. Should the Commission adjust its regulatory oversight of Mutual Fund Transfer Agents and, if so, how? Should any aspects of the Commission's regulatory regime for registered clearing agencies, including those that act as central securities depositories, apply to Mutual Fund Transfer Agents? Why or why not?
113. Given the increasing volume of transactions and activities facilitated through NSCC as the central clearance and settlement utility for mutual funds and intermediaries, what issues or concerns, if any, should the Commission consider

with respect to the various activities conducted through NSCC for mutual fund investors? Please describe.

114. How often do Mutual Fund Transfer Agents serve as fund administrators for the same mutual fund? Does this dual role create conflicts of interest for either the mutual fund or the Mutual Fund Transfer Agent? Does this dual role raise other concerns? If so, please describe.
115. What ancillary information or systems do Mutual Fund Transfer Agents or intermediaries rely on to ensure accurate processing and recordkeeping of mutual fund shares (e.g., master security/CUSIP databases, systems for tracking the age of fund shares for fee processing, cost basis systems for tax reporting)? Should the recordkeeping rules be modified or expanded to address such records? Please explain.
116. Transfer agents currently engage in the processing of “as of” transactions, or transactions which correct errors in the purchase or sale of mutual fund shares. What, if anything, differentiates the “as of” transactions from an initial purchase or sale? Should the Commission specifically address “as of” transactions in transfer agent rules? Why or why not? Should the Commission adopt rules that govern which party, the mutual fund issuer or the Mutual Fund Transfer Agent, loses or retains profits resulting from processing errors when these errors are corrected by later “as of” transactions?
117. Mutual fund transfer agents facilitate the delivery of critical information (e.g., daily fund NAVs, dividend accrual information) to intermediaries for overnight batch processing of beneficial owner transactions. What issues or concerns, if any, should the Commission consider with respect to the timely delivery of such information, and the impacts of potential processing delays and downstream effects, including to investors? Please describe.
118. Should the Commission require that the number of “as of” transactions be reported by Mutual Fund Transfer Agents on Form TA-2? Why or why not? Are greater numbers of “as of” transactions indicative of potential processing problems at a Mutual Fund Transfer Agent, such as a turnaround backlog or problems with accuracy? Why or why not? Do greater numbers of “as of” transactions indicate potentially risky mutual fund trading practices that may dilute the interests of long-term investors in the mutual fund? Why or why not?
119. Does mutual funds’ use of intermediaries who act as sub-transfer agents introduce new or additional risks to the prompt and accurate settlement of securities transactions? If so, what are those risks, should the Commission consider addressing those risks, and if so, how? Please explain.
120. Should the Commission propose rules governing how Mutual Fund Transfer Agents oversee sub-transfer agents to mutual funds? Why or why not? If so,

what rules should the Commission consider? Why, and what would be the benefits, costs, or other consequences of such rules? Please explain.

121. What oversight functions, if any, do Mutual Fund Transfer Agents typically perform for intermediaries performing sub-transfer agent or sub-accounting services to beneficial owners of mutual fund shares? What are the types of initial versus ongoing due diligence performed? What types of obstacles do Mutual Fund Transfer Agents face in performing the oversight function?
122. What problems, if any, are created by transfer agents' lack of visibility into the identity of beneficial owners and products serviced by intermediaries acting as sub-transfer agents? Please describe. If appropriate, could these issues be addressed solely by the Commission through revisions to the rules governing transfer agents? Would other regulatory changes be necessary, such as changes to the rules under the Investment Company Act or rules for broker-dealers under the 1934 Act (and 1933 Act)? Would other regulators also need to enact rule changes (for example, banking regulators and the Department of Labor for retirement plan recordkeepers) to assist with transparency?

D. Crowdfunding

Pursuant to the Jumpstart Our Business Startups (JOBS) Act (“JOBS Act”), the Commission adopted Regulation Crowdfunding on October 30, 2015.<sup>527</sup> These rules permit an issuer to raise up to \$1,000,000 in a crowdfunding offering that is not registered under the Securities Act, subject to, among other things, certain caps on amounts individual investors may invest.<sup>528</sup> Crowdfunding offerings are offerings that are conducted primarily over the internet

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<sup>527</sup> See Crowdfunding, Securities Act Release No. 9974 (Oct. 30, 2015), 80 FR 71388 (Nov. 16, 2015) (“Crowdfunding Adopting Release”). In addition, pursuant to Section 401 of the JOBS Act, the Commission adopted amendments to Regulation A in March 2015. These amendments included a conditional exemption for securities issued in a Tier 2 offering under Regulation A from the mandatory registration requirements of Section 12(g) of the Exchange Act. One of the conditions of the exemption is that the issuer “[h]as engaged a transfer agent registered pursuant to Section 17A(c) of the Act to perform the function of a transfer agent with respect to...securities” issued in a Tier 2 offering pursuant to Regulation A. Amendments for Small and Additional Issues Exemptions under the Securities Act (Regulation A), Exchange Act Release No. 74578 14, 249, 285 n. 972 (Mar. 25, 2015), 80 FR 21805, 21809, 21820, 21867, 21879 n. 972 (Apr. 20, 2015), available at <http://www.sec.gov/rules/final/2015/33-9741.pdf>; Exchange Act Rule 12g5-1(a)(7)(iii), 17 CFR 240.12g5-1(a)(7)(iii).

<sup>528</sup> See Regulation Crowdfunding Rule 100(a); Crowdfunding Adopting Release, *supra* note 527, at 71389.

through registered brokers or a new class of intermediaries, called “funding portals.” The JOBS Act and Regulation Crowdfunding contain provisions that relate directly to transfer agents.

First, Regulation Crowdfunding created an exemption from the record holder count under Section 12(g) of the Exchange Act provided that certain conditions are met. One of these conditions is that “the issuer... has engaged the services of a transfer agent registered with the Commission pursuant to Section 17A of the Exchange Act.”<sup>529</sup>

Second, under the JOBS Act and new Rule 501 of Regulation Crowdfunding, securities issued in crowdfunding offerings are subject to restrictions on resale for a period of one year, with the exception that they may be resold to other investors under specific conditions prior to the expiration of the holding period.<sup>530</sup> Regulation Crowdfunding does not mandate the use of a restrictive legend on crowdfunding securities certificates or book-entry security positions, but it does require the placement of a legend in the offering statement used in the offering.<sup>531</sup> Because of their experience in handling restricted securities, transfer agents retained by issuers in connection with crowdfunding offerings may be asked to track securities that were issued in

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<sup>529</sup> The other conditions are that the issuer is current in its ongoing annual reports required pursuant to Rule 202 of Regulation Crowdfunding and has total assets as of the end of its last fiscal year not in excess of \$25 million. See Crowdfunding Adopting Release, supra note 527, at 330, 662.

<sup>530</sup> Securities Act Section 4A(e) provides that “Securities issued pursuant to a transaction described in section 4(6) may not be transferred by the purchaser of such securities during the 1-year period beginning on the date of purchase, unless such securities are transferred” under certain specified conditions. Rule 501(a) of Regulation Crowdfunding provides “Securities issued in a transaction exempt from registration pursuant to section 4(a)(6) of the Securities Act . . . and in accordance with section 4A of the Securities Act . . . and this part may not be transferred by any purchaser of such securities during the one-year period beginning when the securities were issued in a transaction exempt from registration pursuant to section 4(a)(6) of the Securities Act . . . unless such securities are transferred” under certain specified conditions, including that the transfer is to the original issuer, to an accredited investor, is part of a registered offering, or to a family member.

<sup>531</sup> See Regulation Crowdfunding, Form C, Item 2, General Instruction III; see also Crowdfunding Adopting Release, supra note 527, at 68-69.

crowdfunding offerings and handle issues related to the restrictions on transfer and exemptions thereto.

Third, Rule 301(b) of Regulation Crowdfunding requires intermediaries to have a “reasonable basis” for believing that an issuer has established means to keep accurate records of the holders of the securities it would offer and sell through the intermediary’s platform.<sup>532</sup>

Intermediaries may rely on the representations of the issuer concerning its means of recordkeeping unless the intermediary has reason to question the reliability of those representations.<sup>533</sup> Rule 301(b), however, also provides a safe harbor for compliance for those issuers that use a registered transfer agent.<sup>534</sup>

As a result of these new provisions, transfer agents are likely to be involved in at least some crowdfunding offerings. Accordingly, the Commission seeks comment on the following:

123. What services, if any, do commenters anticipate transfer agents providing for crowdfunding issuers? How do commenters anticipate transfer agents will comply with their recordkeeping, safeguarding, and other requirements in the context of crowdfunding securities? Does the entry of transfer agents into the crowdfunding space pose new or additional risks for the prompt and accurate settlement of securities transactions? What are these risks, should the Commission address them, and, if so, how?
124. Transfer agents have traditionally assessed fees on a per shareholder basis. Do commenters believe transfer agents are likely to impose a per shareholder fee in connection with crowdfunding issuances? If so, is a per-shareholder fee appropriate? If not, what other kinds of fees are likely to be charged, and would they be appropriate?

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<sup>532</sup> Regulation Crowdfunding Rule 301(b).

<sup>533</sup> Id.

<sup>534</sup> Id. (“An intermediary will be deemed to have satisfied this requirement if the issuer has engaged the services of a transfer agent that is registered under Section 17A of the Exchange Act . . .”)

## E. Administration of Issuer Plans

Many transfer agents provide transfer, recordkeeping, administrative, and other services related to certain types of issuer-sponsored plans that provide incentives to the issuer or securityholders in the form of reduced fees and commissions, as well as other benefits. These plans include DRIPs, DSPPs,<sup>535</sup> employee stock purchase plans (“ESPPs”),<sup>536</sup> equity-based incentive compensation plans,<sup>537</sup> odd lot programs,<sup>538</sup> and subscription rights programs (collectively, “Issuer Plans”).<sup>539</sup> Many transfer agents also help administer employer-sponsored retirement plans (“Retirement Plans.” The specific services provided will vary depending on the nature of the plan or mutual fund and the agreement between the issuer and agent, but many are similar and can be thought of broadly as “Plan Administration”<sup>540</sup> services. Depending on the transfer agent and the specific services provided, some of these activities may raise broker-dealer registration issues. This section discusses these and other issues associated with transfer

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<sup>535</sup> DSPPs allow individuals to purchase stock directly from the issuer or its transfer agent, again without going through a broker. Unlike DRIPs, investors do not need to be existing securityholders to participate in DSPPs.

<sup>536</sup> ESPPs allow employees to invest in their employer’s securities by purchasing shares directly from the employer (issuer) or its transfer agent, frequently at a discount to the market price.

<sup>537</sup> Equity-based incentive compensation plans for example include plans regarding stock options, restricted stock units, and stock appreciation rights.

<sup>538</sup> Odd-lot program are used by issuers to purchase shares of their own stock back from owners of less than 100 shares (a 100 share block is considered to be a “round lot”), which may reduce the issuer’s transfer agent and other fees by reducing the number of registered stockholders and/or allow small investors to sell their stock without a broker. The Commission staff has provided no-action relief to a transfer agent in connection with its participation in an odd-lot program and charging of fees to investors (that were estimated to be lower than standard broker commissions) without requiring registration of the transfer agent as a broker-dealer. See American Transtech Inc., SEC Staff No-Action Letter (Sept. 22, 1985).

<sup>539</sup> Subscription rights programs allow existing stockholders to avoid dilution of their percentage ownership by purchasing enough shares in the issuance to retain at least the same level of percentage ownership.

<sup>540</sup> “Plan Administration” and “Administration,” as used in this release are not terms of art with a fixed definition. We use them broadly as simplified shorthand to refer to some of the services discussed herein.

agents' Plan Administration activities and seeks comment regarding possible regulatory actions regarding those issues.

*1. Third Party Administrators*

The majority of Plan Administrators that provide services for Retirement Plans (and some Issuer Plans and mutual funds) do not perform statutory transfer agent functions,<sup>541</sup> and therefore may not be required to register as a transfer agent with the Commission or other ARA. Because they are generally hired by the Retirement Plan or other plans rather than the issuer, in this context, Plan Administrators may be referred to as Third-Party Administrators ("TPAs").<sup>542</sup> It is the Commission staff's understanding that the majority of TPAs are not registered as transfer agents, although some do so voluntarily.

One of the TPA's main responsibilities is acting as an intermediary between benefit plan participants and the plan. For example, TPAs provide various services when enrolling new employees in a company's benefit plan, including recording and processing their enrollment and collecting information about their funding and investing preferences (e.g., fund allocations). TPAs use this information to generate payroll deduction instructions and transmit these instructions to the participant's payroll or human resources department for processing.

TPAs continue to act as intermediaries between the benefit plan participants and plans after participants enroll in the plan. For example, if participants wish to transfer or reallocate mutual funds within their plan, they submit their request to the TPA, which will process and

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<sup>541</sup> See supra note 139 and Section IV.A for a description of the specific activities which require registration as a transfer agent under the Exchange Act.

<sup>542</sup> The term "TPA" is used here to refer generally to a broad category of "administrators" who provide the types of services described herein.

record these requests and provide the transactional details to the plan trustee or investment manager. Similarly, when participants request a payment, the TPA may send the transaction details to the NSCC, plan trustee, and investment manager, and provide payment instructions to the mutual fund and Mutual Fund Transfer Agent. In addition to processing transactions, TPAs may provide participants with customer service support, activity statements, and other communications.

TPAs may also provide sub-transfer agent services for plans that offer, as investment options of the plan, investment in the shares of mutual funds.<sup>543</sup> In this arrangement, TPAs take orders from investors and perform record consolidation services as sub-transfer agents to the plan. Instead of submitting to mutual funds (and their Mutual Fund Transfer Agents) hundreds or thousands of individual purchase and redemption orders each day in the shares of those mutual funds that have been submitted to the plan (and its TPA) by individual plan participants, TPAs may aggregate and, in some instances, net orders on behalf of the plan to be submitted to a mutual fund.<sup>544</sup> Orders are aggregated by adding all of the purchase and redemption orders for a particular mutual fund and submitting the total purchase order and the total redemption order to the mutual fund.

Once aggregated, TPAs may go a step further and create a single net order by offsetting the purchase and redemption orders against each other. These services allow TPAs to complement the administrative and recordkeeping services they already provide to plans and

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<sup>543</sup> For additional discussion of sub-transfer agent services, see supra Section VII.B

<sup>544</sup> See, e.g., comment letters to Investment Company Act Release No. 26288 (Dec. 11, 2003), 68 FR 70388, 70388-89 (Dec. 17, 2003), available at <http://www.sec.gov/rules/proposed/s72703.shtml>.



possibly earn additional fees from mutual fund complexes. They also reduce the amount of transactions that mutual fund complexes (and their Mutual Fund Transfer Agents) need to process. Under this arrangement, the mutual fund often does not know the identity of the plan participants since TPAs, not the mutual funds, are taking the orders directly from the plan participants and submitting orders to the mutual funds on behalf of and generally in the name of the plan.<sup>545</sup> In these situations, the Mutual Fund Transfer Agent would know only the plan, which is the legal owner of the shares of the mutual fund held by the plan for the benefit of its participants.

## 2. *Issuer Plans*

Issuers commonly appoint Plan Administrators to administer their Issuer Plans. Depending on the type of security being serviced and the scope of the activities performed, Plan Administrators may be required to register with the Commission or other ARA as a transfer agent.<sup>546</sup> For simplicity and because of the pre-existing relationship, issuers may simply hire their existing transfer agent.

Plan Administrators perform primarily four tasks for these plans. First, they handle communications with investors, including their initial plan registration,<sup>547</sup> often by operating a website that allows investors to sign up for and manage their account.

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<sup>545</sup> See supra note 506 and accompanying text for a discussion of Investment Company Act Rule 22c-2, the provision of taxpayer identification numbers to assist mutual funds in complying with rules related to “forward pricing,” and transfer agent services that assist mutual funds in complying with Rule 22c-2.

<sup>546</sup> For additional discussion of transfer agent registration requirements, see supra Section IV.A.

<sup>547</sup> Many DRIPs require investors to own at least one share registered in their name (as opposed to being held in street name) before they will be allowed to participate in the DRIP.

Second, they purchase company shares for the plan,<sup>548</sup> typically on the secondary market, although purchases can also be made through negotiated transactions or from the company itself, for example by using authorized but unissued shares of common stock or shares held in the company's treasury.<sup>549</sup> Some issuers offer investors who participate in their plans discounts on the share price, but there is wide variation in how this is offered.

Third, Plan Administrators maintain custody of purchased shares on the participants' behalf,<sup>550</sup> with the purchased shares typically being registered in the name of the transfer agent's nominee. This could lead to plan participants holding the issuer's shares in two places: their bank or brokerage firm for the original registered shares, and the Plan Administrator for shares purchased through a plan. To address this, many Plan Administrators allow Plan participants to deposit their original registered shares into the participant's DRIP account for safekeeping at no charge or for a modest fee. Once deposited with the transfer agent, the shares are treated the same way as the other shares in the participant's account.

Finally, Plan Administrators maintain Plan records and send regular account statements and other communications to plan participants. These typically include quarterly account statements and transactional statements after each cash investment, transfer, deposit, withdrawal,

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<sup>548</sup> When investors join a plan, they are typically required to sign a document authorizing the agent to make purchases on their behalf.

<sup>549</sup> Plan Administrators typically purchase shares on or around the dividend payment date, but they may spread out large purchases made on the secondary market over a longer period of time to avoid affecting the share price. When purchasing shares on the secondary markets, the share price is generally determined by averaging the price of all shares purchased for that investment period; when purchased directly from the company, it is based on an average of the high and low or the closing price for the stock as reported by a specified source.

<sup>550</sup> Paper certificates for shares of the company's common stock purchased under the plans will generally not be issued unless requested by the participant. Paper certificates are also issued when a participant no longer wants to participate in the plan.

or sale. These statements generally show cash dividends and optional cash payments received, the number of shares purchased, the purchase price for the shares, the total number of shares held for the participant, and an accumulation of the transactions for the calendar year to date. In addition, Plan Administrators send plan participants the same communications that are sent to every other securityholder of the company's common stock, including the company's annual report, annual meeting notices, proxy statements, and income tax information for reporting dividends paid by the company.

### 3. *Potential Broker-Dealer Registration Issues*

As described above, Plan Administrators, TPAs, and Mutual Fund Transfer Agents all provide some level of transaction execution and order routing services. The specific services may vary depending on the plan or firm, but in general, administrators that provide transaction execution services will handle customer funds and securities and may provide some level of netting, which is the process of offsetting expected deliveries and payments against expected receipts in order to reduce the amount of cash and securities to be moved. For example, some administrators for employer-sponsored retirement plans offset purchase and sale transactions in the same target mutual fund by different participants in the plan and submit a net order to the transfer agent of the mutual fund. Netting is a function commonly performed by clearing agencies and may also be performed by broker-dealers for customers holding in street name, but is not among the core functions enumerated in Exchange Act Section 3(a)(25) performed by registered transfer agents. Hence, netting and other execution services may not themselves implicate transfer agent requirements, but nonetheless may trigger broker-dealer regulatory requirements.

The Exchange Act defines a “broker” as “any person engaged in the business of effecting transactions in securities for the account of others”<sup>551</sup> and requires non-exempt brokers to register with the Commission.<sup>552</sup> “Effecting securities transactions” includes, among other things, identifying potential purchasers of securities, soliciting securities transactions, routing or matching orders, handling customer funds or securities, and preparing and sending transaction confirmations (other than on behalf of a broker-dealer that executes the trades).<sup>553</sup> Receiving transaction-based compensation may also indicate that a person is effecting securities transactions for the account of other.<sup>554</sup>

The Commission has brought enforcement actions against transfer agents operating as broker-dealers without registering as such with the Commission. For example, the Commission found that a transfer agent was acting as an unregistered broker-dealer in violation of Exchange Act Section 15(a) when it, among other things: opened accounts for individual retirement account (“IRA”) customers; established an interest bearing depository account to receive IRA customer monies; had a power of attorney to withdraw, deposit and transfer IRA customer funds held by custodial banks, and to purchase assets in the name of the custodian; charged IRA customers a transaction fee when IRA customers made a purchase or sale of securities through a

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<sup>551</sup> Exchange Act Section 3(a)(4)(A), 15 U.S.C. 78c(a)(4)(A).

<sup>552</sup> Exchange Act Section 15(a)(1), 15 U.S.C. 78o(a)(1). Exchange Act Section 3(a)(4)(B), 15 U.S.C. 78c(a)(4)(B), provides an exception to the definition of “broker” for certain bank activities.

<sup>553</sup> Definition of Terms in and Specific Exemptions for Banks, Savings Associations, and Savings Banks Under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934, Exchange Act Release No. 44921, 66 FR 27760, 2772-3 (May 18, 2001).

<sup>554</sup> See, e.g., SEC v. Margolin, 1992 WL 279735, at \*5 (S.D.N.Y. Sept. 30, 1992) (ruling that Commission had demonstrated a substantial likelihood of success on the merits of its claim that a person was acting as an unregistered broker where the defendant “provided clearing services” for many transactions, “receiv[ed] transaction-based compensation, advertis[ed] for clients, and possess[ed] client funds and securities.”)

broker-dealer or issuer; prepared periodic account statements for IRA customers; and physically held certain IRA customers' securities in its office vault.<sup>555</sup> Furthermore, a transfer agent that effects securities transactions for investors in connection with administering certain types of Issuer Plans may be engaging in broker activity.<sup>556</sup>

The Commission staff has stated its view that it will not recommend enforcement action where a TPA performs some "clerical and ministerial" activities without registering as a broker, subject to the conditions that, among things, the TPA refrain from netting or matching orders.<sup>557</sup> This guidance is consistent with long-standing views on what constitutes broker activity.<sup>558</sup> The Commission also notes that its staff has taken the position in connection with no-action relief that, depending on the facts and circumstances, the performance of some or all of the administrative activities discussed in this section are also performed by entities that have registered with the Commission as brokers for such purposes.<sup>559</sup> Transfer agents that solicit

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<sup>555</sup> In the Matter of Bankers Pension Services, Inc., Exchange Act Release No. 37567 (Aug. 14, 1996) (settled action). See also In the Matter of Transcorp Pension Services, Inc., Exchange Act Release No. 37278 (Jun. 4, 1996) (finding a transfer agent acted an unregistered broker-dealer for engaging in similar conduct).

<sup>556</sup> In the Matter of CIBC Mellon Trust Company, Exchange Act Release No. 51291 (Mar. 2, 2005); In the Matter of Computershare Trust Company of Canada, Exchange Act Release No. 53668 (Apr. 18, 2006).

<sup>557</sup> See Universal Pensions, Inc., SEC Staff No-Action Letter 25 (Jan. 30, 1998) (applicant letter noting that "the SEC staff has previously agreed that broker registration is not required for persons who perform 'clerical and ministerial' services similar to services provided by the TPA."); see also Urratia, Carlos M., SEC Staff No-Action Letter (Aug. 27, 1980); Investment Company Institute, SEC Staff No-Action Letter (June 13, 1973); Applied Financial Systems, SEC Staff No-Action Letter (Sept. 25, 1971); Dreyfus Group Equity Fund, SEC Staff No-Action Letter (June 26, 1971) ("No Action Letters").

<sup>558</sup> See generally, Louis Loss, Joel Seligman, and Troy Paredes, Securities Regulation, § 8(A)(3) (2007); David A. Lipton, Broker-Dealer Regulation, Vol. 15, § 1:6 (2006).

<sup>559</sup> See, e.g., No-Action Letters, supra note 557 (regarding condition that the recipients of the letters refrain from executing orders).

purchase and sale orders, accept orders directly from investors, advertise services directly to investors, and make investment recommendations, also raise broker-dealer registration issues.<sup>560</sup>

#### 4. *Discussion and Request for Comment*

The Commission is generally requesting comment on whether new rules may be appropriate to 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.<sup>561</sup> Specifically, the Commission requests comment on the following:

125. Exchange Act Rule 17Ad-9(m) describes various transfer agent functions that are broader than the five statutory functions defined in Exchange Act Section 3(a)(25). Likewise, as discussed in this and other sections, modern transfer agents perform a wide array of services and functions that do not fall within the confines of Section 3(a)(25) and are not otherwise identified or contemplated in the existing transfer agent rules. Should the Commission update the transfer agent rules to address additional transfer agent services and functions that do not fall within the confines of Section 3(a)(25)? Why or why not?
126. Should the Commission impose supervisory obligations on entities engaged in transfer agent activities, such as transfer agents and plan administrators, such as requiring that employees be properly trained, comply with continuing education requirements, and adhere to regulations and company policies? Why or why not?
127. Definitions in Rules 17Ad-1 and 17Ad-9 do not explicitly apply to all types of transactions and functions related to Issuer Plans, investment company securities,

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<sup>560</sup> See, e.g., SEC v. Deyon, 977 F. Supp. 510 (D. Me. Aug. 27, 1997) (two unregistered defendants violated Section 15(a) of the Exchange Act by, among other things, soliciting investors by phone and in person); SEC v. Century Inv. Transfer Corp., Fed. Sec. L. Rep. (CCH) 93,232 (S.D.N.Y. Oct. 5, 1971) (defendant was engaged in the broker-dealer business by, among other things, advertising in the Wall Street Journal to solicit customers); SEC v. Corporate Relations Group, Inc., 2003 WL 25570113 (M.D. Fla. Mar. 28, 2003) (defendant acted as an unregistered broker when it actively sought investors, recommended securities to investors through registered representatives, and provided its broker relations executives with transaction-based compensation for stock sales).

<sup>561</sup> As noted, depending on the type of securities being administered and the scope of administration services being performed, an entity may or may not be required to register with the Commission in the capacity of a transfer agent and/or a broker-dealer.

restricted securities, and corporate actions, or to all transactions relating to book-entry activity and DRS transactions. For example, the rule does not specify that “credit” and “debit” include Issuer Plan transactions and book-entry accounts as well as investment company securities transactions. Does the lack of specificity cause difficulties in providing services relating to those areas not specifically enumerated? Why or why not?

128. Does Rule 17Ad-2 create uncertainty concerning the applicability of the rule to activities related to Issuer Plans, investment company securities, restricted securities, and corporate actions? If there is such uncertainty, how does it impact transfer agents’ functionality? Are issuers concerned about impacts on service levels? If so, please describe.
129. The recordkeeping requirements in Rule 17Ad-6 do not specifically include activities associated with investment company securities, Issuer Plans, DRS transactions, paying agent activities, or corporate actions. Are transfer agents applying the rule’s recordkeeping requirements to these activities? If not, what would be the additional cost, benefits and/or burdens, if any, in doing so? Please describe.
130. Rule 17Ad-10 does not specifically address activities performed by many transfer agents, such as Plan Administration, paying agent activities, or corporate action recordkeeping. Does this create any obstacles to complying with the rule, such as by creating confusion or uncertainty? Why or why not? Please explain.
131. There are no Commission regulations addressing plan enrollment practices, such as negative consents or automatic enrollments. What risks, if any, arise from these enrollment methods? Should the Commission address any such risks? Why or why not? If, so how?
132. To ensure that transfer agents make and keep comprehensive records relating to all of their activities, should the Commission address records related to Issuer Plan and mutual fund activities? Why or why not? For example, should transfer agents be required to make and maintain records of orders for the purchase or sale of Plan or mutual fund securities in a manner similar to that required of broker-dealers? Why or why not? Should they be required to create and maintain records relating to reconciliations with custodial accounts and order-submitting entities? Should they be required to make and maintain specific records relating to plan participants? Why or why not? Please explain and provide supporting evidence regarding any potential effects. To the extent that any data, records, and/or other information that such rules might require to be made and preserved are prepared and maintained by an outside party on the transfer agent’s behalf, should the Commission require that the outside entity file a signed, written undertaking with the Commission to the effect that such records are the property of the transfer agent and will be surrendered promptly on request of the transfer agent and subject to examination by the Commission or other ARA? Why or why

not? Please explain and provide supporting evidence regarding any potential effects.

133. Should the Commission amend the rules so that transfer agents performing specific activities are exempt from broker-dealer registration only if they are (i) registered with the Commission as a transfer agent, (ii) limit their activities to those specified in the general rule, and/or (iii) agree to abide by certain other conditions designed to protect investors and limit the risks associated with those activities? Why or why not? Should the Commission require broker-dealer registration for any activities beyond what is permitted or conducted by an entity that is not registered with the Commission as a transfer agent under such an exemption? Why or why not? Please explain and provide supporting evidence regarding any potential effects.
134. Do commenters have any concerns about TPAs who voluntarily register with the Commission as transfer agents, but do not provide statutory transfer agent services as defined by Exchange Act Section 3(a)(25)? Why or why not? Should the Commission prohibit TPAs who do not perform statutory transfer agent functions as defined by Exchange Act Section 3(a)(25) from voluntarily registering with the Commission as transfer agents? Alternatively, should the Commission deny transfer agent registration applications or revoke registrations of TPAs that do not provide statutory transfer agent services as defined by Exchange Act Section 3(a)(25)? Why or why not? Please explain and provide supporting evidence regarding any potential effects.
135. Do commenters have any concerns regarding the activities or business practices of TPAs that are not registered with any federal financial regulator? If so, what actions, if any, should the Commission consider taking to address these concerns? Please explain and provide supporting evidence regarding any potential effects.
136. What risks, if any, do commenters believe are posed by the enrollment and purchase and sale activities of transfer agents with respect to Issuer Plans and registered investment companies? What, if anything, should the Commission do to address such risks and why? For example, would rules focusing on risk management address any risks associated with transfer agents' current role in the purchase and sale of securities? Please explain and provide supporting evidence regarding any potential effects. Are there additional Issuer Plan activities or services provided by transfer agents, Plan Administrators, or other entities that are not described in the release? If so, what are they?
137. Should the Commission conditionally exempt from broker-dealer registration transfer agents that effect orders to purchase or sell securities in connection with their servicing of Issuer Plans? If so, what conditions, if any, should apply to that exemption? Should they be subject to net capital or customer protection requirements to guard against the risks of mishandling investors' funds or securities? What regulations, if any, should the Commission propose to safeguard



investor privacy? Does the Issuer Plan business necessitate different books and recordkeeping requirements? If so, how should the Commission amend its books and recordkeeping requirements? Should the Commission's rules require the personnel of Issuer Plan transfer agents who interact with Issuer Plan investors, such as call center representatives, to be subject to registration, licensing, training, or continuing education requirements? Should transfer agents for Issuer Plans be permitted to net customer buy and sell orders? Why or why not, and if so, under what conditions? Should transfer agents be required to hold the funds of Issuer Plan securities in a bank account for the exclusive benefit of investors? Why or why not? Under what circumstances should a transfer agent or its personnel be disqualified from effecting transactions on behalf of Issuer Plans? Should transfer agents be permitted to receive payment for order flow in connection with Issuer Plan transactions? Why or why not? What rules might help to ensure the integrity of the master securityholder file in cases where a transfer agent servicing the Issuer Plan is not the recordkeeping transfer agent?

138. What fees are being charged today by transfer agents directly to investors or indirectly to investors (such as through transaction fees in connection with Plan Administration activities that are comparable to broker commissions or dealer markups)? Should the Commission require transfer agents to clearly and concisely disclose fees charged to the investor? Do fees charged to investors by transfer agents or by sub-transfer agents encourage or deter investor decisions regarding their form of ownership (e.g. the investor decision to hold in DRS, the investor decision to request a certificate, or the investor decision to hold in registered versus street name)? If these fees influence investor decision-making, is the aggregate effect on this influence good or bad for: (i) the protection of investors and (ii) continued improvement in the promptness and efficiency of the National C&S System? What is the available evidence?
139. Investors who transact with or through a broker-dealer receive confirmations pursuant to Rule 10b-10. However, investors holding securities positions directly with a transfer agent in DRS, in an Issuer Plan or other program administered by a transfer agent, or in a mutual fund that attracts self-directed investors, do not always receive comparable information from the transfer agent. Should the Commission require transfer agents to provide written communication to a securityholder with details about a transaction within a set time period? Why or why not? Are there other approaches the Commission could consider to ensure that investors are informed about their transactions on a timely basis? If so, please describe.
140. While transfer agents may be authorized by an issuer to assist with the enrollment process for plan participants, it may not be clear whether investors have initiated the enrollment or whether the transfer agent solicited the transaction. Similarly, while transfer agents may assist with securityholder inquiries, it may not be clear whether agents in so doing may, inadvertently or not, solicit securityholders for purchase or sale activities. What controls, if any, do transfer agents put in place

to prevent solicitation? Do commenters believe those controls are effective? Why or why not? Should the Commission impose additional or different controls? Why or why not? Please explain.

F. Outsourcing Activities and Non-Qualifying Securities Serviced by a Registered Transfer Agent

As noted, the transfer agent rules established by the Commission are designed not only to ensure that transfer agents meet prescribed performance standards for their core recordkeeping and transfer activities, but to ensure they are regulated appropriately in the context of the National C&S System<sup>562</sup> and that any problems meeting these performance standards do not negatively impact individual investors or the National C&S System as a whole.<sup>563</sup> Today, some transfer agents maintain offices and provide services outside the United States, and almost all transfer agents provide an array of services, including for non-Qualifying Securities. Other transfer agents may outsource some of their activities or operations to outside entities. For example, some registered transfer agents rely on outside entities to provide data hosting or specific IT services, perform data entry, or provide call center services. While the Commission believes the consistent application of the transfer agent rules to all activities of registered transfer agents is critical to protect investors and promote the safe and efficient functioning of the National C&S System, we also are mindful that applying the transfer agent rules uniformly to all

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<sup>562</sup> See Rule 17Ad-1 through 17Ad-7 Adopting Release, supra note 145 (noting the importance of avoiding impediments to “the Commission’s efforts to provide necessary or appropriate regulations for transfer agents in the broader context of the establishment of a national system for the prompt and accurate clearance and settlement of securities transactions.”).

<sup>563</sup> Id. (Exchange Act Rule 17Ad-3 prohibits transfer agents from taking on new or additional business in certain circumstances where they fail to meet their performance standards over certain time periods, in part, because “it is not in the public interest or consistent with the protection of investors for a transfer agent which is unable to perform its current obligations in a timely manner to take on additional responsibilities.”)

securities serviced by those transfer agents could: (i) increase costs above those that would be incurred if the transfer agent rules applied only to Qualifying Securities; (ii) create conflicts with the laws of the other jurisdictions in which a transfer agent operates;<sup>564</sup> or (iii) impact transfer agents in other ways.

Accordingly, the Commission seeks comment on the following:

141. What activities do transfer agents outsource, domestically or foreign, and why? Does the outsourcing of these activities present risks or raise other issues? What is the empirical evidence? What regulations, if any, should the Commission impose to address these risks? For example, should the Commission require outsourcing arrangements to be memorialized in a written agreement detailing the allocation of responsibilities? Why or why not? If such a written agreement were required, should the Commission require some or all records associated with the performance of the agreement to be considered records of the registered transfer agent and therefore subject to inspection by the Commission? Why or why not? Should outsourcing arrangements be disclosed in Form TA-2? Why or why not? Should the Commission apply different standards or different rules to transfer agents who use or engage in outsourcing activities? If so, what standards should apply, and why? Please identify any tradeoffs, including any costs and benefits that the Commission should consider. Please also provide supporting empirical evidence, if available.
142. Are there non-U.S. regulations governing transfer agents operating outside the United States that commenters believe the Commission could use as a model for similar regulations in the United States? If so, why, and how do these regulations serve the public interest in the jurisdictions in which they apply? If the Commission were to consider similar regulations, in what ways should such regulations be tailored to operations in the U.S. securities markets? What tradeoffs should the Commission consider in evaluating the alternatives?
143. Should the Commission's transfer agent rules apply with equal force to U.S. and non-U.S. transfer agents (or non-U.S. subsidiaries of U.S.-based transfer agents) that provide transfer-related services for Qualifying Securities? Why or why not?
144. Should the Commission codify existing staff interpretations stating that registered transfer agents that service at least one Qualifying Security must apply all of the

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<sup>564</sup> For example, the privacy laws of some foreign jurisdictions may not permit the fingerprinting required under Rule 17f-1.

transfer agent rules to all securities serviced by that transfer agent, including non-Qualifying Securities? Alternatively, should the Commission provide exemptions regarding non-Qualifying Securities from one or more or from all of the Commission's transfer agent rules? Why or why not? If so, what exemptions would be appropriate, and why? How would any such exemptions protect investor funds and securities, ensure the safe and efficient functioning of the National C&S System, and ensure appropriate oversight by regulators of transfer agents and the entities that perform services on their behalf?

145. Are there technological, legal, policy, or other reasons why a registered transfer agent would not be able to apply the transfer agent rules to all securities serviced by the transfer agent? Why or why not? If so, should the Commission provide exemptions to address such issues, and what should such exemptions provide?
146. Do transfer agents typically have access to or control over records created or held by sub-contractors?<sup>565</sup> If so, are those records part of the records that transfer agents provide to the Commission in response to requests? Why or why not?
147. Do other transfer agent activities, such as operating call centers, present investor protection or other concerns? How are call center employees supervised? How are call center employees trained on applicable federal securities law and legal documents that may govern or affect the issuer, for example policies and procedures of the issuer and, for certain types of issuers, prospectus limitations? Are risks greater if these securityholder services are conducted by offshore call centers?
148. Should the Commission impose additional recordkeeping, processing, and transfer rules on outside entities retained by transfer agents to address concerns that third-party firms may pose a risk to investors and the National C&S System? If so, should those rules apply to foreign firms that are engaged in services for U.S. issuers? Why or why not?
149. As noted, both Reg SDR and Reg SBSR may permit, in certain circumstances, substituted compliance for foreign participants and registrants. Should the Commission take a similar approach to regulating non-U.S. transfer agents? Why or why not?

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Regarding sub-contractor relationships, see generally, Section VII.C.1.

G. Additional Request for Comment

We are also interested in more generalized concerns related to transfer agents and any other issues that commenters may wish to address relating to transfer agents. For example, we seek comment on how the role of transfer agents may continue to evolve, and what regulatory challenges these changes may pose. Please be as specific as possible in your discussion and analysis of any additional issues. In connection with comments, we also welcome comments that respond to requests for comment or of their own accord, and/or suggest specific amendments or new additions to the transfer agent rules including draft rule text. We also request commenters to provide any specific, detailed data and information related to potential or actual costs and benefits associated with any of the suggested reforms, changes, or amendments discussed throughout this release. Accordingly, the Commission seeks comment on the following:

150. Do the transfer agent rules accomplish the Commission's regulatory objectives of protecting investors, promoting the prompt and accurate clearance and settlement of securities transactions, and evaluating transfer agents' ability to perform their functions properly? Why or why not? Please provide a full explanation.
151. Do the current transfer agent rules adequately address the interests of issuers? If not, in what ways do they not address issuers' interests and should they? Why and in what way?
152. Do the current transfer agent rules adequately address the interests of other market participants? If not, in what ways do they not address those interests and should they? Why and in what way?
153. Some of the original transfer agent rules established metrics-based performance standards designed to measure the transfer and processing of paper certificates. Given the prevalence of electronic transactions, do those metrics-based performance standards adequately address transfer agents' operational capabilities, which now largely depend on systems and technology that did not exist when the original rules were adopted in 1977? Should the Commission rely on a different or additional approach to regulating transfer agents, such as a risk-based approach focused on the risks associated with specific activities or conduct? Please provide a full explanation.

154. In what ways do the activities performed and services provided by transfer agents differ depending on the type of issuer, asset class, product category, market segment, or other factors the transfer agent is servicing? For example, are there differences in activities, services, or other areas between issuers that act as their own transfer agent and independent transfer agents? If so, what are those differences? Do a transfer agent's processes differ if the transfer agent is servicing debt securities instead of equity securities? If a transfer agent primarily services debt securities, do the transfer agent's processes differ depending on the specific type of debt security being serviced (e.g., corporate, asset-backed, etc.)? Are there differences in services provided, compensation arrangements, or other areas between or among different types of transfer agents? If so, what factors influence or affect those differences? Do transfer agents tend to service one type of issuer, asset class, or market segment to the exclusion of others? If so, what factors influence that focus and why? Please explain.
155. Do commenters believe that transfer agent servicing of debt securities raises different issues or concerns than those raised by servicing of equity securities? Do commenters believe there are specific risks or issues related to transfer agents' servicing of debt issues that are not addressed by existing Commission transfer agent rules? Are there differences in agreements that equity transfer agents enter into with issuers as compared to transfer agency agreements between debt transfer agents and issuers, including differences in services to be provided, methods of compensation, or any other topics?
156. Should the Commission propose different rules for different types of transfer agents depending on the particular issuer type, asset class, or market segment serviced by the transfer agent? Why or why not?
157. What fees do transfer agents assess with respect to processing DRS instructions? How and to whom are such fees assessed? Do commenters believe the Commission should consider regulating such fees in some manner? If so, why and how? Please explain.
158. Do transfer agent fees vary, depending upon the asset class of the security serviced by the transfer agent? If so, how do they vary? To what extent does competition among transfer agents constrain such fees, and what is the evidence? Should the Commission require that any such fees be fair and reasonable? Why or why not? Please provide a full explanation.
159. To what extent are co-transfer agents used in securities processing today? Should the Commission amend its rules with respect to co-transfer agents?
160. What, if any, are the problems in the marketplace today with respect to the role of transfer agents and corporate actions? Should the Commission propose rules governing transfer agent services provided in connection with corporate actions? Why or why not? If so, which types of services provided in connection with

corporate actions should the Commission consider regulating?

161. Should the Commission propose rules requiring standardized corporate actions processing as a method to facilitate communications among market participants? Why or why not? If so, what are the primary market issues that such a standardization program is likely to address? Would there be any market issues that such a standardized program would not be able to address? Please explain.
162. What, if any, are the risks posed by transfer agents' role when they serve as: (i) tender agent; (ii) subscription agent; (iii) conversion agent; or (iv) escrow agent? Do commenters believe rules governing transfer agent services provided in connection with these services would be appropriate? Why or why not? If so, what regulatory action should the Commission consider to address those concerns and why?
163. Do commenters believe there are any concerns that might arise from regulation of the proxy tabulation process generally and the transfer agents' role in the proxy process in particular? If so, what regulatory action, if any, should the Commission consider to address those concerns and why?
164. Is the role that transfer agents play in the proxy process useful for efficient, accurate, and timely communications between issuers and their securityholders? In light of comments previously received by the Commission in connection with its concept release concerning the proxy process, are there additional concerns regarding consolidation in the market? If so, please describe any such concerns.
165. In connection with considerations of transfer agents' role within the National C&S System, do commenters believe the creation of an SRO for transfer agents would be useful or appropriate? Why or why not? If so, what should the scope of the purview of such an SRO be, and what should the SRO be tasked with? Please explain.
166. Do commenters believe the introduction of certain alternatives to the current central securities depository model, such as a modified transfer agent depository, could be beneficial to issuers, securityholders, and/or the National C&S System? Why or why not? Could it co-exist with the current central depository system? Why or why not? What would such a modified depository entail or look like?
167. Some observers have commented that current DTC requirements, such as those related to DRS and FAST, operate as so-called *de facto* regulation of transfer

agents by DTC.<sup>566</sup> Is this accurate? If so, do such DTC requirements create inconsistencies and/or conflicts for transfer agents to comply with all rules and requirements? Why or why not? If yes, please describe the inconsistencies and/or conflicts. Should the Commission adopt any of DTC's current requirements or standards that apply to transfer agents who conduct business with DTC as rules? Why or why not? If so, what requirements or standards should be considered, and why?

168. Should the Commission propose any other amendments to the transfer agent rules that are not discussed above? If so, please describe what amendments should be considered and why, including any information on the benefits, risks, and/or burdens of any suggested approach.
169. How might the transfer agent industry continue to evolve in the future, and what challenges might that evolution pose for the regulatory structure? What regulatory issues and other challenges are posed by the industry's increasing concentration and specialization? What does the decline in the number of registered securityholders mean for the industry, and for the regulatory regime? Do commenters believe that, as dematerialization progresses, the role of transfer agents to operating companies will change? If so, will it converge with that of Mutual Fund Transfer Agents? If so, what are the possible implications of this?
170. Are there any other issues that commenters may wish to address relating to transfer agents? Please provide a full explanation.

By the Commission.

Brent Fields

Secretary

December 22, 2015

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<sup>566</sup> See Securities Exchange Act Release No. 60196 (June 30, 2009), 74 FR 33496 (File No. SR-DTC-2006-16) (specifically, comment letter from Martin (Jay) J. McHale, President, U.S. Equity Services, Computershare, Mar. 20, 2008; comment letter from Charles V. Rossi, President, Securities Transfer Association, June 22, 2007; comment letter from Gary N. Nazare, Managing Director, Transfer Agency Services, The Bank of New York, June 29, 2007).