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March 10, 2016

Mr. Brent J. Fields, Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-9303

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

Dear Mr. Fields:

The Investment Company Institute[1] appreciates the opportunity to comment on the SEC's recent release relating to transfer agent regulations.[2] This Release, which consists of an Advanced Notice of Proposed Rulemaking ("ANPR") and a Concept Release, is intended both to assist the Commission in refining and calibrating rules it intends to propose and in evaluating the need for additional rulemaking proposals to regulate transfer agents' conduct. The Institute is pleased that the Commission is taking steps to update and modernize its regulations governing transfer agents. We support this very important initiative, and we are pleased to provide the Commission our views on it. Our comments on the ANPR and Concept Release are set forth below in Parts III and IV, respectively, of this letter. Due to the nature of the Institute's membership, our comments relate exclusively to issues and rules impacting mutual fund transfer agents.

I. BACKGROUND

A. Institute Support for Reforming the Existing Transfer Agent Rules

The Release's comprehensive history of shareholder recordkeeping, transfer agents, and their regulation in the United States is very impressive. It is obvious that in drafting the Release, the SEC

[1] The Investment Company Institute (ICI) is a leading, global association of regulated funds, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's U.S. fund members manage total assets of $17.6 trillion and serve more than 90 million U.S. shareholders.

[2] *See Transfer Agent Regulations,* SEC Release No. 34-76743 (December 22, 2015) (the "Release").

and its staff were intent on understanding how the industry's history and evolution might inform the Commission's current initiative to reform the existing regulations. We agree that the industry's evolution should be considered as the Commission continues to evaluate rulemaking in this area, and in particular, we strongly recommend that the Commission focus on updating outdated rules (*e.g.,* the rules that continue to presume, for example, that shares are maintained in certificates and not book entry), eliminating obsolete rules (*e.g.,* the Y2K rules), and adopting new rules that are necessary in the public interest either to close existing gaps in regulation or keep pace with changes in the industry that warrant additional investor protection (*e.g.,* rules requiring a written agreement between a transfer agent and an issuer). The role the Commission plays in setting robust standards for transfer agents in the interest of investor protection is crucial, and we support its work in this area.

B. Considerations To Guide the Commission's Rulemaking

We recognize that the Release is not intended to signal that the Commission will, in fact, propose rules to address the numerous and varied topics it discusses. Instead, it is intended to elicit public comment to inform the Commission's determination regarding which, if any, rules it should adopt or revise to reform, update, and enhance transfer agent regulation. As such, we presume that the Release raises issues that the Commission ultimately will determine not to pursue when it proposes rule text during the next phase of this project. We also are cognizant, however, of the fact that, according to the ANPR, the Commission is seeking comment on the issues discussed in the ANPR because it "intends to review comments and to then propose new rules, as soon as practicable, either individually or in groups or phases to expedite the rulemaking process."[3] As the Commission contemplates which transfer agent rules to adopt or revise as part of this initiative, we recommend that it proceed with caution and only propose revisions that are truly necessary in the public interest. Along these lines, we strongly recommend that the following considerations guide the Commission as it evaluates whether to propose new rules and, for the rules it determines to propose, the substance of those rules: [4]

- What evidence does the Commission have that the existing regulation is inadequate or outdated?
- How will the Commission's proposed revision address the problems/inadequacies that the Commission has documented?
- How will the proposed revision impact investors – for example, have investors been harmed or disadvantaged by the absence of a regulation and, if so, will the revision better protect them?
- Is this the most effective and efficient way to enhance investor protection or market efficiency or functionality? Is the rule precisely tailored to the transfer agent business and limited to addressing the Commission's concern?

[3] Release at p. 109.

[4] Hereafter, the letter refers to the totality of the considerations discussed in this section of the letter as our "Rulemaking Considerations."

- Recognizing that "one-size-fits-all" rules fail to accommodate the variety of transfer agents' business models and operations, does the rule incorporate a principles-based approach that provides transfer agents the flexibility to implement the rule in a way that will best serve their interests, their issuer clients' interests, and the Commission's regulatory concerns as well as in a way that will enable transfer agents to take advantage of current and future technologies?
- How might the Commission's proposal harm investors or the industry, including for example, by putting sensitive information in the public domain or in government systems that might be vulnerable to attacks?

In addition to taking into account the above listed general rulemaking considerations, as discussed below, we recommend that, in proposing any new regulatory requirements, the Commission carefully weigh the costs against expected benefits and consider whether more rigorous enforcement of existing rules would address any concerns.

Cost/Benefit Analysis. We are pleased that the Release acknowledges that the "Commission is sensitive to the effects that could result from any regulatory action"[5] and we encourage the Commission, in considering the effects of any proposed rules, to carefully weigh the costs associated with them against their benefits. Costs clearly matter and should be instrumental in guiding the Commission in both determining *whether* to act and, if so, *how* to act to address concerns with regulatory gaps in the current rules. Cost issues are particularly important for mutual fund transfer agents because transfer agent fees are a fund expense paid by shareholders of the fund and therefor they impact shareholders' bottom line and the fund's performance. Accordingly, to be justified from a cost perspective, new requirements should yield real and measureable benefits to investors and not merely hypothetical or illusory benefits.

Enforcement. As the Commission contemplates the need for new transfer agent rules, we strongly recommend that it consider whether more rigorous enforcement of the existing rules would assuage some or all of the Commission's concerns. For example, the ANPR discusses the Commission's interest in revising the existing safeguarding rule, Rule 17Ad-12, in a way that might make the rule more rigorous, inflexible, and prescriptive. And yet, it would seem that, as discussed in more detail later in this letter, the current rule's text provides the Commission ample authority to ensure that, as threats to client funds and securities evolve, transfer agents are revising their safeguarding provisions accordingly.

The ANPR also has a section related to cybersecurity concerns. We note that, even though currently there is no SEC rule that speaks specifically to registrants' cybersecurity responsibilities, the Commission was able to sanction an investment adviser that experienced a cybersecurity breach for violating Section 248.30 of Regulation S-P by failing to secure non-public personal information. Accordingly, prior to concluding that new rules are necessary, we recommend that the Commission

[5] Release at p. 10.

strongly consider whether rigorous enforcement of its existing rules might sufficiently address the concerns expressed in the ANPR. Also, since they were first published in 2013, the annual examination priorities of the National Examination Program of the SEC's Office of Compliance Inspection Examinations ("OCIE") have consistently included transfer agents.[6] We understand from OCIE that the inspections they have conducted of transfer agents' operations have not revealed any serious concerns with such operations. To the extent this is not the case and OCIE has, in fact, documented deficiencies that warrant additional rulemaking, we recommend that any such rulemaking be consistent with the above discussed considerations.

We believe that, keeping each of the above considerations foremost in mind throughout the rulemaking process, will assist the Commission in focusing its efforts on designing rule proposals that update, as necessary, the existing rules so they keep pace with changes in the industry, address those regulatory gaps of concern to the Commission, and enhance investor protection.

II. TRANSFER AGENTS TO MUTUAL FUNDS

Section VII.C. in the Concept Release portion of the Release focuses on issues relating to mutual fund transfer agents and, in particular, those transfer agents that exclusively service mutual funds. As correctly noted in the Release, since the Commission last revised its transfer agent rules significantly, which was decades ago, "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."[7]

Part IV of this letter contains our comments on the Concept Release, including whether the Commission should address specific issues relating to mutual fund transfer agents. In light of both the unique nature of their business and their responsibilities under the Investment Company Act of 1940 (the "ICA"), we strongly recommend that the Commission establish a set of rules that are exclusive to mutual fund transfer agents. We believe this approach, for the reasons we discuss in Part IV, will better serve mutual fund transfer agents, their clients, and their clients' clients and increase the effectiveness and efficiency of the Commission's regulation. Because our comments on the Concept Release and on this issue follow our comments on the ANPR, as the Commission considers our comments on the ANPR, we recommend that it keep in mind the unique business of mutual fund transfer agents and, where appropriate, consider limiting the application of any new rules or rule amendments to those transfer agents for which they would be relevant. Indeed, as discussed in Part III of this letter, some of the issues the Commission seeks to address in rulemaking following the ANPR (*e.g.,* requiring vaults to protect securities) may not be relevant to mutual fund transfer agents due to the nature of their business. We also recommend that, to the extent the Commission contemplates tailoring a rule set to mutual fund transfer agents, it do so in connection with any rulemaking under the ANPR.

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[6] *See National Examination Priorities,* OCIE (2013), (2014), (2015), and (2016).

[7] Release at p. 165.

III. THE ANPR

As noted above, our comments on the ANPR (and the Release) are solely from the perspective of how the issues discussed might impact mutual fund transfer agents. We do not express any views on the extent to which the rules or types of rules contemplated by the ANPR might be appropriate for other transfer agents. And, as also noted above, we recommend that the Commission consider limiting the scope of any proposed rules to those transfer agents for which they are appropriate based on the nature of the transfer agent's activities and how those activities are currently regulated.

A. Forms TA-1 and TA-2

1. Proposal

The ANPR seeks comment on proposed revisions to the contents of, and filing requirements associated with, the Form TA-1, which is the registration form transfer agents use to register with the Commission, and Form TA-2, which is the form transfer agents use to fulfill their obligation to report to the Commission annually. According to the Release, "the Commission believes the usefulness and utility of both forms in serving [the] important goals [of the Commission] 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."[8] According to the Release, the Commission's "important goals" for using these forms are to:

1. 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;
2. Help regulators, issuers, investors, and other interested parties determine the nature of the business conducted by a particular transfer agent;
3. Permit the Commission to effectively target its transfer agent inspection program, including assisting examiners in preparing for and conducting transfer agent examinations;
4. Monitor transfer agent activity generally;
5. Enable the Commission staff to evaluate particular burdens and benefits that would be placed on the industry in potential rulemaking endeavors; and
6. Assist the Commission and Commission staff in assuring that rules are properly focused and refined. [9]

To fulfill these important goals, the Commission "intends to propose amendments to the forms to include disclosure requirements with respect to certain financial information, such as financial statements . . . (*e.g.,* statement 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

[8] Release at p. 111.

[9] Release at p. 111.

security, regardless of the nature of those services."[10] According to the ANPR, "these anticipated amendments are intended to facilitate disclosure that is more closely targeted at risks associated with contemporary transfer agent activities."[11]

The Commission also is contemplating requiring transfer agents to disclose any relationship it or its officers or directors has with an issuer serviced by the transfer agent or a broker-dealer affiliated with the transfer agent because "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."[12]

In support of rules in this area, Section VI.C. of the ANPR states that the Commission "preliminarily believes it would be appropriate to . . . [require] 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" that are similar to those required annually of broker-dealers.[13] The ANPR seeks comment on whether: (1) the financial statements the Commission requires to be filed "should be required to be audited" (Question 7); (2) these statements should be submitted using a data-tagged format such as XML or XBRL (Question 8); (3) the Commission should require transfer agents "to disclose information regarding the fees imposed or charged by the transfer agent for various services or activities" (Question 10); and (4) "to increase the ability of the Commission to monitor trends, gather data and address emerging regulatory issues," whether "the Commission should require registered transfer agents to file material contracts with the Commission as exhibits to Form TA-2" (Question 11). The Commission also seeks comment on its proposal to revise Form TA-2 to require "transfer agents to disclose the number and/or dollar value of residual and unclaimed funds."[14]

2. Discussion

The Institute fully supports the Commission updating the existing content of Forms TA-1 and TA-2 to ensure that the information disclosed continues to be relevant and meaningful from a regulatory perspective. Towards this end, attached as Appendix I to this letter is a list of the items in Forms TA-1 and TA-2 that we believe are either no longer relevant, that need to be clarified, or that should be revised to accommodate changes in the industry since these forms were last amended. In addition, while the ANPR's discussion of the forms does not include a discussion of Form TA-W,[15] we

[10] Release at pp. 111-112.

[11] Release at p. 112.

[12] Release at p. 112.

[13] Release at p. 124.

[14] Release at p. 125.

[15] In its discussion of the rules applicable to transfer agents, page 53 of the Release mentions Rule 17Ac3-1 and the duty of a transfer agent to file Form TA-W when it voluntarily withdraws its registration. In our view, many of the concerns the Commission expresses with a transfer agent passing records to a successor transfer agent could be addressed by requiring the

would support the Commission revising Form TA-W to address the Commission's concern with transfer agents whose registration with an issuer has been terminated failing "to pass through certain records to newly appointed or successor transfer agents in a prompt, complete, and uniform manner."[16]

As the Commission contemplates imposing additional filing requirements on transfer agents, it bears remembering the Commission's previous rulemaking relating to requiring information of transfer agents. In particular, in 1982, the Commission proposed Rules 17Ad-9 through 17Ad-13. Two of these rules, Rule 17Ad-11 and 17Ad-13, required transfer agents to provide information to issuers and the Commission respectively. With respect to issuers, Rule 17Ad-11, among other things, this rule requires every transfer agent to provide to each issuer within ten business days following each month end a report containing specified information. Rule 17Ad-13 requires every transfer agent to annually file with the Commission an accountant's report that contained the information set forth in the rule. According to the release adopting these rules, they were adopted "as a result of [the Commission's] experience since 1975 in operating the transfer agent regulatory program under Section 17A of the Exchange Act.[17] As noted in the proposing release, this rulemaking was intended to both (1) provide *issuers* (not the Commission) with "the information necessary to make informed decisions" about their transfer agent and the agent's operations that might impact shareholders and (2) provide the SEC and "regulatory authorities with timely information concerning the source and extent of aged record differences and the identity of transfer agents who are experiencing difficulties in posting their records." With respect to (2), the proposing release notes that, while the information required by the rules "will provide regulatory authorities with information regarding those transfer agents that are not performing their functions promptly or accurately," importantly, "the regulatory authorities *will only be informed under certain circumstances.* Armed with such reports, regulatory authorities will then be able *to focus their attention on those transfer agents whose performance may represent potential harm to investors or a threat to the smooth operation of the national system for clearance and settlement of securities transactions.*"[18] By contrast, in the ANPR, the Commission seems to be contemplating significantly

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transfer agent to file a Form TA-W when it ceases acting as a transfer agent for a particular issuer and including in the form items relating to the date the relationship ceased, the date the records were provided to a successor transfer agent, the name and contact information for the new transfer agent, and contact information for a person at the terminated transfer agent who can provide the Commission any additional detail regarding these issues.

[16] Release at p.117. While the Release discusses this issue in connection with its discussion of requiring transfer agents to have a written agreement with the issuers they service, as the Commission considers revisions to the forms that transfer agents file with it, it also may want to consider whether amendments to Form TA-W may help address this concern.

[17] *See* 1983 Adopting Release at p. 28232. This is the rulemaking in which the Commission also adopted Rule 17Ad-12, relating to safeguarding of funds and securities, which is discussed in more detail below in this letter. With respect to Rule 17AD-12, the release notes that the "External Evaluation provides an important objective review and should promote uniform high-quality transfer agent performance . . . [and] increase public confidence in the national clearance and settlement system." 1983 Adopting Release at p. 28243.

[18] *See Maintenance of Accurate Securityholder Files and Safeguarding of Funds and Securities by Registered Transfer Agents,* SEC Release No. 34-19142 (October 15, 1982) ("1982 Proposing Release") [Emphasis added.]

increasing the information that transfer agents must file with the Commission without documenting – or even discussing – the regulatory relevance or value of such information to the Commission.

a. Disclosure of the Transfer Agent's Clients

We support the Commission updating Forms TA-1 and TA-2 to make sure they keep pace with changes in the industry and continue to capture information that would be of regulatory value to the Commission. We strongly oppose, however, while the Commission updating these forms in a way that would impose significant new disclosure requirements that would appear to be of questionable regulatory value or that would not appear to enhance investor protection. For example, while we support the Commission requiring a transfer agent to disclose the *nature* of the services it provides to customer and the *types* of those customers, we oppose transfer agents having to disclose to the Commission annually the identities of its customers. We note that this information is readily available to the Commission under Rule 17Ad-6, the recordkeeping requirement. For mutual fund transfer agents, it is available also to the Commission through Item 19(h)(2) of the Form N-1A, the registration statement filed by mutual funds under the ICA. We therefore fail to see why the Commission would require mutual fund transfer agents to disclose on the Form TA-2 the mutual funds it services or how such disclosure will further any of the Commission's enunciated goals.

Disclosure regarding the *types* of clients the transfer agent services could be similar to the disclosure required of broker-dealers pursuant to Item 12 of Form BD. We support disclosure of this information because it would appear to be meaningful to the Commission in understanding the transfer agent community, the *nature* of the services they provide, and the *nature* of their issuer clients (*e.g.,* operating company or mutual fund). In addition to opposing the Commission requiring transfer agents to disclose the identities of their clients to the Commission because the Commission already has access to this information, we note that broker-dealers are not required to disclose the identities of their clients. Indeed, when FINRA, through its Comprehensive Automated Data System ("CARDS") proposal[19] attempted to require similar disclosure regarding broker-dealer customers, it was met with so much resistance from the public, the broker-dealer community, and Congress that FINRA abandoned the proposal.[20] We believe FINRA's experience should inform the Commission's consideration of imposing a similar disclosure requirement.

b. Disclosure of the Transfer Agent's Direct and Indirect Conflicts of Interest

We also oppose the Commission requiring transfer agents to disclose on Forms TA-1 or TA-2 all of their direct and indirect conflicts of interest. We fail to see how this information will enable the Commission to target "risks associated with contemporary transfer agent activities." Indeed we do not understand the regulatory nexus between this disclosure and a transfer agent's "risks." We are not

[19] *See* FINRA Notice 14-37 (September 2014), which sought comment on the proposal.

[20] *See "Finra CEO Rick Ketchum Backs Off Data Collection Plan,"* Investment News (April 30, 2015), which is available at: http://www.investmentnews.com/article/20150430/FREE/150439991/finra-ceo-rick-ketchum-backs-off-data-collection-plan.

aware of any other Commission registrant that is required to catalog and disclose to the Commission *all* of its direct and indirect conflicts of interest or their clients.[21] Even in the absence of a regulatory requirement, we note that conflicts of interests of mutual fund transfer agents are already amply addressed as mutual funds and their advisers have a fiduciary and legal duty to understand their conflicts of interest, manage them, and disclose them to shareholders. In addition, mutual fund boards of directors generally oversee potential conflicts of interest between a fund's transfer agent and the fund. Aside from the fact that, in our view, regulation is not needed on this issue, if the Commission were to impose such a requirement, we question how it would be able to define with specificity its parameters.

c. Financial Statement Filing Requirements

With respect to the Commission's interest in requiring the filing of financial statements – such as statements of financial condition, income statements, and cash flows – we question the regulatory value of these statements. Financial statements are required of broker-dealers to ensure their compliance with net capital requirements imposed on them under the Exchange Act. Such financial statements are not filed as part of their Form BD or Form BD updates. Consequently, while the contents of a Form BD are publicly available, a broker-dealer's financial statements are not. Transfer agents have no such net capital requirements so the regulatory value of requiring them to file financial statements with the Commission is questionable.

In addition, however, any concerns of the Commission regarding a transfer agent's financial stability would appear to be addressed by Rule 17Ad-13, which requires transfer agents to "file annually with the Commission . . . a report . . . prepared by an independent accountant concerning the transfer agent's system of internal accounting controls and related procedures . . .." The rule further specifies the issues the report must cover, how the review must be conducted, and steps the transfer agent must take if the report identifies any "material inadequacy."[22] As noted in the Commission's Release adopting this rule in1983, the rule "provides an important objective review and should promote uniform high-quality transfer agent performance."[23]

If the Commission has determined – after consideration of relevant information – that this rule does not, in fact, promote uniform high-quality transfer agent performance or is otherwise inadequate to address a specific problem the Commission has identified, we recommend that the

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

[22] Noticeably missing from the Release is any discussion of how often the Commission is informed of a "material inadequacy" or, when informed of such inadequacy, the sufficiency of the Commission's regulation to respond to or address such inadequacy. As discussed above, we recommend that the focus of the Commission's rulemaking be on supplementing and revising those rules that the Commission can document have proven to be inadequate to fulfill the Commission's regulatory obligations to investors, issuers, and the national clearing and settlement system.

[23] *See Maintenance of Accurate Securityholder Files and Safeguarding of Funds and Securities by Registered Transfer Agents,* SEC Release No. 34-19860 (June 10, 1983), 48 Fed. Reg. 28232 (June 21, 1983) (the "1983 Adopting Release") at p. 28243.

Commission revise Rule 17Ad-13 to address those concerns. The Commission could do so in a number of ways. For example, it could supplement the scope or coverage of these annual audits. Such a targeted solution would be far preferable to imposing on all transfer agents a duty to file annually a variety of financial statements. To the extent that the Commission believes that the report Rule 17Ad-13 requires needs to be supplemented by financial statements, we recommend that it instead consider revising the recordkeeping rule, Rule 17Ad-6, to require transfer agents to *create and maintain* financial statements, rather than require the annual filing of such statements. This approach would ensure that these statements are readily available to the Commission during an inspection.

d. Disclosure of a Transfer Agent's Relationships

The Commission also is planning to require disclosure of the relationship between a transfer agent's officers and directors and any issuer serviced by the transfer agent or a broker-dealer affiliated with the transfer agent in order to highlight "possible" conflicts of interest that could incentivize inappropriate conduct. We fail to understand how, through this disclosure on a Form TA-1 or TA-2, the Commission would be able either to highlight possible conflicts of interest or determine that such conflicts are likely to result in inappropriate conduct that could result in Commission sanctions. Also, as discussed above, as part of its fiduciary duties to the fund, the fund's board oversees potential conflicts of interest between the fund's transfer agent and the fund and may inquire whether the fund's contract with the transfer agent raises any potential conflicts of interest. For these reasons, we oppose the Commission requiring this disclosure.[24]

e. Disclosure of a Transfer Agent's Fees

We strongly oppose the Commission revising Form TA-2 to require disclosure of the fees a transfer agent charges. Such disclosure would put into the public domain confidential and proprietary information that is competitively sensitive. This could be harmful to a fund and its transfer agent, as well as to the industry at large. We see such a requirement resulting in far more harm than benefit because disclosure of this information would not appear to serve any public or regulatory purpose. Indeed, we note that the registration forms required of broker-dealers (Form BD) and investment advisers (Form ADV) do not require disclosure of the fees they charge. We therefore question why mutual fund transfer agents, alone among SEC registrants, would be required to disclose this information and what the regulatory value of such information would be to the Commission. Indeed, because the services a mutual fund transfer agent provides to mutual funds and their shareholders will differ in scope and quality from fund-to-fund, this information would not appear to be valuable to the Commission because it would be the proverbial comparing of "apples to oranges" based solely on the fees.

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[24] In contrast, where the Commission has required funds to disclose information about a fund director's relationship with various entities, it has done so in a manner tailored to address a specific potential or actual conflict of interest. *See, e.g.,* Schedule 14A, Information Required in Proxy Statement, of Regulation 14A under the Exchange Act, at Item 22, 17 C.F.R. §240.14a-101.

Regarding our concerns with non-public proprietary fee information winding up in the public domain, the Release itself notes that information disclosed on the Form TA-2 is "publicly available once filed."[25] We believe, therefore, that the Commission should proceed with extreme caution when it contemplates adding to the Form TA-1 or TA-2 any information that is currently confidential, privileged, and/or proprietary. While the Commission may agree to maintain the confidentiality of such information to assuage transfer agents' concerns, this fails to address our concern relating to the Commission not needing this information to regulate transfer agents or protect investors. We recommend that the Commission be cognizant of the fact that, the more information it collects from registrants, the greater the security risk associated with that information. As a panelist noted at the Commission's Cybersecurity Roundtable in March 2014:

> . . . by centralizing data, are we creating more risks out there? So, I think something to always consider, always to a part of, you know, any consideration as [the Commission is] putting regulations together is what are the security implications? Are you putting the [financial services] sector at greater risk by putting that regulation into place, or . . . how do we mitigate that?[26]

In strongly opposing fee disclosure, we also note that the information the Commission seeks access to through such a requirement is largely already available to it through the existing recordkeeping rule, Rule 17Ad-6.[27] While we do not oppose the Commission having access to this information through a transfer agent's non-public records – we oppose the Commission requiring the filing of this information. To the extent the Commission believes that Rule 17Ad-6 does not sufficiently capture the contractual or fee information of interest to the Commission, we would not oppose the Commission revising the rule to address this deficiency.[28] Consistent with our Rulemaking Considerations, we believe this approach – amending the recordkeeping requirements to ensure that transfer agents maintain information of regulatory value or interest to the Commission – is a more reasoned and cost-effective way to satisfy the Commission's interest in this information and address our concerns.

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[25] Release at no. 380. We note that that the SEC requires fees paid to the fund's transfer agent to be disclosed "in the line item 'other expenses' in the fee table near the front of every fund prospectus." *See* Pozen, Robert C., *The Mutual Fund Business* (2nd ed.). Houghton (2002) at p. 392.

[26] *See Transcript, Cybersecurity Roundtable* (March 26, 2014) at p. 94.

[27] Rules 17Ad-6(a)(8), in part, requires a registered transfer agent to maintain a copy of "any document, resolution, contract, appointment, or other writing, and any supporting document, concerning the appointment and the termination of such appointment of such registered transfer agent to act in any capacity for any issue on behalf of the issuer . . .."

[28] As discussed elsewhere in this letter, the Institute support the Commission requiring transfer agents to create and maintain all written agreements with their issuer clients and we support these agreements being required to include the fees to be paid under them.

f. Requirement to File Material Contracts

The ANPR seeks comment on whether the Commission should require transfer agents "to file material contracts with the Commission as an exhibit to Form TA-2" in order to "increase the ability of the Commission to monitor trends, gather data, and address emerging regulatory issues." We oppose the Commission requiring the filing of material contracts with the Commission and we do not understand how such a requirement would enable the Commission to monitor "trends."

It would appear that the statistical information and data the Commission requires of transfer agents annually on the Form TA-2 would serve as a better barometer of industry trends than the filing of all material contracts. To the extent the Commission believes that Form TA-2 does not require the reporting of statistical information or data that the Commission needs to monitor industry trends, consistent with our Rulemaking Considerations, we recommend that the Commission revise the content of the form to capture such information. We are not aware of any other registrant under the Federal securities laws that must provide the Commission copies of each of its material contracts. As also noted above, SEC Rule 17Ad-6(a)(8) already requires transfer agents to maintain copies of all contracts, not just material contracts, so the Commission would have access to these documents during an inspection.

g. Disclosure of Information Relating to Residual and Unclaimed Funds

Finally, in connection with revisions to Form TA-2, the Commission seeks comment on whether it should revise Form TA-2 to require "transfer agents to disclose the number and/or dollar value of residual and unclaimed funds." According to the ANPR, "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."[29] This is not the case for mutual fund transfer agents. Unclaimed funds held by a mutual fund securityholder remain invested in the fund the securityholder purchased – not in an account of the mutual fund's transfer agent – until such time as the account is turned over to a state pursuant to state law.[30] Accordingly, with respect to mutual fund transfer agents, we interpret the Commission's request for comment to be a request for comment on whether or how the Commission should revise Form TA-2 to capture information relating to a transfer agent's "lost securityholders" as such term is defined in Rule 17Ad-17. We recommend that the Commission not revise Form TA-2 to collect information on the value of residual and unclaimed funds and we recommend that the Commission delete Item 11(a) from the Form.

With respect to the searches required by Rule 17Ad-17, Item 11(a) of Form TA-2 currently requires disclosure of the (1) the date of searches conducted by the transfer agent, (2) the number of lost securityholders account searched; and (3) the number of addresses obtained by these searches. We question the continued regulatory value to the Commission of these three pieces of information.

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[29] Release at p. 118.

[30] Prior to escheatment, these shares continue to be held by the mutual fund's transfer agent in the shareholder's name.

When the Form was adopted, state laws required escheatment of property in according with a standard similar to the Commission's lost securityholder standard so the searches required by Rule 17Ad-17 might have provided the Commission information regarding how many securityholders could not be found after conducting the required searches and how many securityholders' property might be subject to escheatment. However, today it is wholly possible for a shareholder's property to escheat to a state even though such shareholder *never becomes a lost securityholder* under Rule 17Ad-17 and even though the transfer agent never has a duty to conduct the searches required by the rule. This is because, while the Commission deems a shareholder to be a "lost securityholder" based solely on returned mail, the states increasingly are deeming accounts to be abandoned and subject to escheatment if the account owner fails to have "contact" with the mutual fund – even though the shareholder is receiving all mail sent by the transfer agent and may not have a reason to contact the transfer agent due to the long-term nature of mutual funds. As a result of these changes to state law, and as a result of the fact that escheatment of property is exclusively a state function, we recommend that the Commission delete Item 11(a) from Form TA-2. For the same reasons, we also recommend that the Commission delete Item 11(b), which requires a transfer agent to report the number of lost securityholder accounts that have been remitted to states during the reporting period.

3. Recommendations

To summarize the above discussion, the Institute:

- Supports the Commission revising Forms TA-1 and TA-2 to update their contents to ensure these forms both remain relevant in light of the evolution of the transfer agent industry and require disclosure of: the *nature* of the transfer agent's business; the *types* of clients the transfer agent services; and statistical information and data that would be meaningful to the Commission. Appendix I contains a list of the items on these forms that we recommend be updated or clarified.[31]
- Recommends that the Commission delete Item 11, relating to lost securityholders, from Form TA-2.
- Supports the Commission revising Form TA-W to capture information to address the Commission's concerns regarding transfer agents failing to transfer shareholder records to a successor transfer agent in a timely and complete fashion.
- Supports the Commission revising Rule 17Ad-6, relating to recordkeeping, to supplement its existing requirements relating to contractual, fee, or financial information provided that the Commission first performs the appropriate analysis.

[31] Consistent with our recommendation that the Commission develop a regulatory regime for mutual fund transfer agents, we would also support the Commission revising the Form TA-1 and the Form TA-2 to add questions regarding the nature of the transfer agents clients (*e.g.,* mutual fund or operating company) and tailor the remaining items, where appropriate, to elicit relevant information from the transfer agent based on the nature of its business.

- Opposes the Commission requiring transfer agents to file with the Commission financial statements, materials contracts, and information on their clients, conflicts of interests, relationships, and fees.

B. Written Agreements Between Transfer Agents and Issuers

1. Proposal

According to the ANPR, the Commission "intends to propose amendments to the transfer agent rules to require that any arrangement for transfer agent services between a registered transfer agent and issuer be set forth in a written agreement that covers certain basic topics."[32] These basic topics include, among others, the services to be provided, the terms of payments and fees, and arrangements regarding the timely transitioning of shareholder records to a successor transfer agent in the event the relationship between the transfer agent and an issuer is terminated. In support of this requirement, the ANPR notes that: (1) not all arrangements between an issuer and a transfer agent are set forth in written agreements; and (2) "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 . . .." These 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."[33]

2. Discussion

The ANPR's discusses how the Commission has determined, through its experience, inspections and observations that the failure of some transfer agents to have written agreements with their issuer clients has resulted in harm to investors and the operations of the markets. We appreciate the Commission documenting concerns it has observed relating to written agreements and we support it addressing these concerns by requiring all transfer agents to have a written agreement with their issuer clients. We note that these concerns likely do not arise in connection with mutual fund transfer agents due to the fact that funds have a written agreement with the fund's transfer agent.

We also support the Commission specifying the "basic terms" that might be required to be in a written agreement to include defining the relationship, including the services to be provided, the terms and conditions of the relationship, and the fees to be paid under the agreement, as well as provisions governing successor transfer agents.[34] We strongly recommend, however, that the Commission limit the "basic terms" it requires to those that are necessary to document the terms and conditions of the transfer agent/issuer relationship or that are required by law and that it not impose additional

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[32] Release at p. 117.

[33] Release at p. 115.

[34] As noted above, we also support the Commission revising Form TA-W to address the Commission's concerns with successor transfer agents.

responsibilities on the parties to the agreement. So, for example, while "many transfer agents enter into written contracts with an issuer that cover," in part, "business continuity requirements," we would oppose the Commission requiring these written agreements to include provisions governing "business continuity requirements."[35] Because service providers to transfer agents may or may not have a legal obligation to have a business continuity plan, it seems inappropriate for the Commission to indirectly impose such an obligation through transfer agent agreements. It should be up to the parties to the agreement whether they elect to include such subjects in their written agreement.

3. Recommendations

To summarize the above discussion, the Institute:

- Supports the Commission requiring all transfer agents to have written agreements with each issuer serviced by the transfer agent and requiring these agreements to include specified "basic terms."

- Opposes the Commission defining the "basic terms" of the written agreement to include provisions beyond those necessary to document the terms and conditions of the relationship between the issuer and the transfer agent.

C. Safeguarding Funds and Securities

1. Proposal

The ANPR notes how "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 [Clearance and Settlement] System."[36] It also notes that given "the risk of loss from fraud, theft, or other misappropriation, the funds 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."[37] It then goes on to discuss the complexity of "routine paying agent activity;[38] distributions and payouts requiring "special attention," such as those "arising from lawsuits and settlements;"[39] and the current lack of specific and "robust" standards governing the activities of "paying agents."[40]

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[35] We do not oppose these agreements being required to address "the use and protection of data, such as privacy," because Regulation S-P imposes legal obligations on the privacy and security of shareholder data.

[36] Release at p. 120.

[37] Release at pp. 120-121.

[38] Release at p. 121.

[39] Release at p. 122.

[40] Release at p. 123.

Against this backdrop, the ANPR announces the Commission's intent to: (1) propose new rules or amend Rule 17Ad-12 (the Commission's current safeguarding rule) "to require transfer agents to comply with specific minimum best practices requirements relating 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."[41] The Commission also plans to propose rules to: require transfer agents to segregate client funds to ensure that bank accounts are appropriately designated to protect clients' funds from being counted as transfer agent funds in the event of insolvency; obtain written notification from banks holding the funds that the funds are for the exclusive benefit of the customers and not the transfer agent; amend annual reporting, independent audit, and notification requirement to better align the Commission's rules with rules "recently adopted for broker-dealers;" require transfer agents to file annual financial reports; 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;" revise Form TA-2 to require disclosure of "the number and/or dollar value of residual and unclaimed funds;" and revise 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."[42]

2. Discussion

The Institute supports the safeguarding rules applicable to transfer agents keeping pace with changes in the threat landscape that might put customer funds or securities or the transfer agent's operations in jeopardy. We note that the Commission's concern with adopting rules to provide for the safeguarding of customer funds and securities in the transfer agent's possession is long-standing, dating back to 1982-1983 when Rule 17Ad-12 was proposed and adopted. In that rulemaking, the Commission did not mandate *how* a transfer agent was to safeguard customer funds and securities – it deliberately left this determination up to each transfer agent. As stated in the 1983 Adopting Release, Rule 17Ad-12:

> . . . would provide registered transfer agents with considerable flexibility in adopting measures to safeguard and securities, because the appropriate steps would be tested '*in light of all the facts and circumstances.'* Although the Commission listed [in the proposing release] several safeguarding measures[43] that could be implemented, the

[41] Release at p. 124.

[42] Release at pp. 124-125.

[43] According to the proposing release, and as reaffirmed in the adopting release,

> Adequate 'safekeeping' measures might include: a dual control vault for safekeeping of unissued blank certificates and unissued dividend checks; sign-in procedures for vault entry; closed circuit TV cameras; security guards; locked doors to departments or officers where transfer agent activities are performed; identification badges worn by persons entering those areas; magnetized identification other cards or electronically control locked doors for

> Commission noted *that each transfer agent should exercise responsible discretion in adopting safeguards appropriate for its own operations.*[44]

Accordingly, since 1983 the Commission has required any transfer agent with custody or possession of any funds or securities related to its transfer agent activities to assure: (1) all securities held in safekeeping "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." [Emphasis added.] Because a transfer agent's compliance with the rule is assessed "in light of all facts and circumstances" and because the rule requires that funds and securities be free from the risk of theft, loss, or destruction, *regardless of how such loss, theft, or destruction occurs,* we believe the current rule provides sufficient protection to clients and sufficient flexibility to the Commission to redress a particular transfer agent's inadequate safeguards.

By contrast, in considering rule amendments today relating to safeguarding, the Commission seemingly intends to mandate specifically how a transfer agent must safeguard customer funds and securities in its possession (*e.g.,* by requiring "secure vaults"). We note that the ANPR does not indicate if or how the current safeguarding rule is inadequate or why the Commission believes it is appropriate to replace the existing flexible rule with rigid safeguarding requirements that fail to take into account the unique facts and circumstances of each transfer agent. We believe the Commission's previous approach to this issue is far preferable to its current approach for the reasons discussed below.

As with some of the other significant issues addressed in the ANPR, noticeably absent from its discussion of safeguarding is *any* issue or problem the Commission has documented that warrants additional regulation. Instead, the ANPR summarizes those issues that transfer agents have long been dealing with (*e.g.,* holding residual funds prior to their distribution;[45] recordkeeping errors; attachment) and the increasing scope and complexity of the industry[46] without explaining how these

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> entry to the transfer agent's EDP department; user code, password procedures or other terminal access codes to ensure security over EDP system terminals in connection with operation identification and the initiation and processing of transaction; and dual control values or other secure locations for the original books and records regarding securities transfers (*e.g.,* transfer journals).

See Maintenance of Accurate Securityholder Files and Safeguarding of Funds and Securities by Registered Transfer Agents, SEC Release No. 34-19142 (October 15, 1982) at p. 35. *See, also,* 1983 Adopting Release at p. 28241 and n. 47.

[44] *See* the 1983 Adopting Release at p. 28241. [Emphasis added.] With respect to Rule 17Ad-12, the release notes the adoption of the rule "is desirable because it would establish a clear and straightforward legal standard regarding transfer agents' responsibilities to safeguard funds and securities." 1983 Adopting Release at p. 28241.

[45] As noted above, mutual funds do not hold "residual funds" prior to their distribution. All customer funds are held in the securityholders' account until they are disbursed at the request of the owner or escheated to a state.

[46] For example, the ANPR states "even routine paying agent activity such as dividend distribution processing may be complex" and the "other distributions, like those arising from lawsuits or settlements, may require special attention." Release at pp. 121-122. We agree but note that, but for the Commission now referring to distribution processing as a "paying agent activity," dividend paying agents (who may or may not be the same entity as the issuer's transfer agent) have

issues have resulted in gaps in the current rule that need to be addressed. [47] Unless and until the Commission can document a problem that warrants a solution, we recommend that it refrain from significant additional rulemaking in this area. We also recommend that, if the Commission engages in rulemaking in this area, it do so judiciously and precisely and refrain from adopting sweeping, prescriptive, and intrusive rules. Additionally, we recommend that the Commission refrain from drafting rules that might, in whole or in part, usurp a transfer agent's business judgment about how to run and operate its business in its best interest and in the best interests of its clients.[48]

As discussed in more detail below, we also strongly encourage the Commission to avoid overly prescriptive rules that take a "one-size-fits-all" approach to regulation – particularly any regulation relating to security and safeguarding – and instead ensure the safeguarding of funds and securities through a principles-based, flexible approach. We believe this approach would better serve the interests of transfer agents and the issuers that engage them because it provides transfer agents flexibility to determine the most effective means of safeguarding funds and securities based on their particular facts and circumstances. In contrast, a prescriptive safeguarding rule will inevitably become outdated and result in a "check-the-box" approach as registrants ensure they have checked each box necessary to ensure they withstand regulatory scrutiny.[49] A principles-based approach would appear also to be in the Commission's best interest because whenever an inspection of a transfer agent reveals inadequate safeguards, the Commission would be able to sanction the transfer agent for violating Rule 17Ad-12. By contrast, so long as a transfer agent can "check-the-box" associated with a prescriptive rule's requirements, the transfer agent could be deemed to have provided sufficient safeguards regardless of how effective those safeguards truly are and regardless of whether the safeguards implemented have any relevance to the transfer agent's business. Accordingly, while we concur with the Commission that safeguarding client funds and securities is vital to the integrity and smooth functioning of the national clearance and settlement system, we strongly encourage the Commission to tread lightly with its rulemaking in this area and avoid mandating prescriptive safeguarding requirements.

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been dealing with dividend distribution processing for the entirety of their business life and with distributions requiring "special attention" since these issues first arose decades ago.

[47] Instead of discussing the problem the Commission seeks to solve through additional rulemaking relating to safeguarding, the ANPR merely notes the "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 evolving roles transfer agents occupy in this space." Release at p. 123. While more specificity and standards may be necessary for other transfer agents, we disagree that they are necessary for mutual fund transfer agents.

[48] Examples of the Commission usurping the transfer agent's business judgment might include, for example, rules requiring all transfer agents to have "secure vaults" or theft or fire alarms without regard to the appropriateness of these requirements for particular transfer agents.

[49] For example, as discussed under a., below, the Commission, in part, is contemplating requiring transfer agents to install fire or theft alarms without regard to whether such alarms are appropriate for the transfer agent. Accordingly, a transfer agent would be required to satisfy this requirement (check the box) even though it may be wholly irrelevant to the transfer agent's operations.

We also encourage the Commission, as it contemplates additional rulemaking in this area, to distinguish the safeguarding requirements applicable to mutual fund transfer agents from those applicable to other transfer agents.[50] This recommendation is appropriate in light of the regulatory requirements of the ICA that impact the functions that transfer agents perform on behalf of mutual funds. Indeed, while safeguarding is vital to the business of all transfer agents, it is particularly vital to a mutual fund transfer agent due to the interconnected relationship between the mutual fund and its transfer agent and the significant role a mutual fund transfer agent plays within a mutual fund complex. This role differs significantly from the relationship other transfer agents have with the operating companies and the shareholders they service. For example, unlike other transfer agents, the manner in which fund shares are priced pursuant to Section 22 of the ICA and the manner in which the fund's assets are invested in accordance with the fund's prospectus requires a mutual fund's transfer agent daily to reconcile and report on shareholder transactions. This daily reconciliation function is vital to the effective management of funds.[51]

With respect to the Commission's concerns with ensuring that funds and securities are safeguarded through adequate segregation at a bank, the ICA, too, should assuage the Commission's concerns with respect to funds held by a mutual fund transfer agent. This is because overlaying a mutual fund transfer agent's responsibilities for the funds and securities in its possession and custody are the ICA requirement that fund assets be held by a qualified custodian in a segregated account. The contract under which the custodian provides services to the fund limits the purposes for which the custodian may disburse money. For example, the contract typically will provide for payment of fund assets against receipt of portfolio securities purchased, payment of fund expenses for services received, and payment of redemption proceeds for shares redeemed. Payment of fund assets for these purposes must be approved by officers or employees of the adviser specifically named in the custodian contract to approve disbursement of money. In addition, registered funds typically on a daily or weekly basis, reconcile fund assets as recorded on the fund's accounting system with the custodian bank's records of assets it maintains on behalf of the fund. This reconciliation with the bank's custodian's records is an important control mechanism that ensures that the fund's accounting records are accurate, that fund assets as reported on the accounting systems exist and are maintained at the custodian, and that they are not subject to unauthorized use or misappropriation. Similarly, mutual fund transfer agents maintain

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[50] As noted earlier in this letter and as discussed in more detail in the Concept Release portion of this letter, we recommend the Commission establish a separate rule set for mutual fund transfer agents.

[51] *See* Pozen, supra at note 36, at p. 402, where that function is described as follows:

> Each morning that a fund is open for business, the transfer agent must forward information about how much cash is available from shareholder transactions to the fund's pricing and bookkeeping agent, who combines this information with other data to determine the total amount of cash available to the fund. This amount is reported to the fund's portfolio manager, who must decide whether the fund has sufficient cash to purchase additional securities or whether the fund must sell securities to handle shareholder redemptions. The timeliness of this report on cash availability is critical for the effective management of the funds.

separate bank demand deposit accounts ("DDAs") to segregate fund assets (by subscriptions and redemptions) from other assets. Mutual fund transfer agents typically, on a daily or weekly basis, reconcile assets within their DDAs to the transfer agent's recordkeeping system and the assets are than recorded on the fund's accounting system. Accordingly, we recommend that the Commission's transfer agent rules not impose segregation or custodial requirements on mutual transfer agents to avoid such requirements being redundant of or inconsistent with existing requirements imposed under the ICA.

Our comments on the specific components the Commission is considering in connection with adopting more rigorous safeguarding rules are next discussed.

a. Mandating Compliance with Specific Minimum Best Practice Requirements

As noted above, the Commission is considering proposing to amend Rule 17Ad-12 to require transfer agents to comply with minimum best practices, including "secure vaults," "theft and fire alarms," and procedures governing access and control over securityholder accounts. For the reasons discussed above, we strongly recommend that the Commission avoid replacing its existing flexible safeguarding rule with an inflexible prescriptive rule that likely will not stand the test of time and that unduly elevates uniformity of regulation over the effectiveness of such regulation.[52] As regards "secure vaults," we note that, with respect to mutual funds, which are held in book entry, this is an outdated concept. With respect to "theft and fire alarms," we believe these are best left to the discretion of a transfer agent, its insurance carrier, its building management, its own security advisors, and government building and fire codes. With respect to procedures governing access and control over securityholder accounts, while we would support the Commission requiring mutual fund transfer agents to include policies and procedures relating to access and control over securityholder accounts in their compliance policies and procedures, we note that mutual fund transfer agents already are subject to such a requirement under Rule 38a-1 under the ICA.[53]

b. Protecting Client Funds Held in Bank Accounts

To the extent the Commission determines to regulate how transfer agents hold funds in bank accounts, we recommend that it not impose such new requirements on mutual fund transfer agents. This is because the regulatory requirements the Commission is contemplating imposing would not appear to be relevant to or necessary for mutual funds transfer agents due to rules under the ICA. These rules include Rule 17f-1, which governs mutual fund custody arrangements, and Rule 38a-1, which requires mutual fund transfer agents to have policies and procedures that are approved by a fund's board that are reasonably designed to ensure compliance with the Federal Securities Laws. These requirements, coupled with other regulatory requirements under the ICA, which are discussed

[52] To the extent the Commission believes the "safekeeping measures" discussed in the Commission's 1983 Adopting Release should be supplemented, we would encourage the Commission to do so through the publication statements in a release rather than through a rule mandating particular safekeeping measures.

[53] Our support for the Commission requiring transfer agents to have written compliance policies and procedures is discussed below in Part III.D.2.b.

elsewhere in this letter, obviate the need for the Commission to regulate the banking arrangements of mutual fund transfer agents.

c. Imposing Broker-Dealer Regulation on Transfer Agents

According to the ANPR, 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."[54] The SEC approved the broker-dealer rules referred to in this excerpt in July 2013.[55] Importantly, while these rules were adopted by the SEC in 2013, they resulted from a review the Commission began in 2009. As noted in the SEC's Broker-Dealer Release, "the Commission began reviewing rules regarding the safekeeping of investor assets *in connection with several cases the Commission brought alleging fraudulent conduct* by investment advisers and broker-dealers, including, among other things, misappropriation or other misuse of customer securities and funds."[56] In other words, in revising and supplementing the reports broker-dealers and investment advisers must file, the Commission was addressing a particular problem that it had documented. By contrast, the ANPR does not discuss any review of mutual fund transfer agents acting fraudulently or misappropriating or misusing customer funds that would warrant the Commission imposing on transfer agents the same type of rigorous reporting requirements it imposed on broker-dealers in 2013.

It bears noting that, with respect to broker-dealers' financial statements, the SEC's 2013 rulemaking *did not involve revising the financial statements that broker-dealers have long been required to file*.[57] According to the SEC's Broker-Dealer Release,

> The financial report must contain the same types of financial statements that were required to be filed under Rule 17a-5 prior to these amendments (a statement of financial condition, a statement of income, a statement of cash flows, and certain other financial statements). In addition, the financial report must contain, as applicable, the supporting schedules that were required to be filed under Rule 17a-5 prior to these amendments (a computation of net capital under Rule 15c3-1, a computation of the reserve

[54] Release at p. 124.

[55] *See Broker-Dealer Reports,* SEC Release No. 34-70073 (July 30, 2013) ("SEC Broker-Dealer Rule Release"). While broker dealers were already subject to rigorous financial reporting requirements prior to the 2013 amendments, the new filing requirements were intended to complement the extensive regulations regarding broker-dealers' net capital, customer reserve accounts, and SIPC requirements. The imposition of these new requirements on broker-dealers address concerns that are not present with transfer agents due to the very different nature of the transfer agents' business.

[56] SEC Broker-Dealer Release at p. 5. [Emphasis added.]

[57] Instead these rules required broker-dealers to file a compliance report or an exemption report prepared by the broker-dealer as well as certain reports that are prepared by an independent public accountant and that cover the broker-dealer's financial report and the compliance or exemption report.

requirements under Rule 15c3-3, and information relating to the possession or control requirements under Rule 15c3-3).[58]

While, as discussed above, the Institute reserves judgment on the Commission requiring transfer agents to prepare and maintain financial statements, we oppose the Commission either requiring the filing of such financial statements or imposing upon transfer agents any of the rules adopted in the SEC Broker-Dealer Release that were specifically tailored to address inadequacies in the Commission's broker-dealer rules that the Commission identified through its 2009 review.

d. Regulation of "Paying Agents"

The ANPR discusses "paying agents" and the Commission considering establishing a regulatory regime for such persons. By way of background, "paying agent" is a term that Congress added to Section 17A(g) of the Exchange Act in 2010 when it enacted Section 763(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). This provision resulted from a constituent of a Congresswoman who, after being sent a check by his mutual fund company, was concerned that the company did not take additional steps to remind him to cash the check. He believed that Federal law should require "paying agents," such as mutual fund companies and others, to alert the payees on a check when the payee fails to cash the check within a specified period of time. Accordingly, at the Congresswoman's request, Section 763(b) was added to the Dodd-Frank Act to require the Commission to revise Rule 17Ad-17 to require a "paying agent to provide a single written notification to each missing securityholder[59] that the missing securityholder has been sent a check that has not yet been negotiated." This section 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."[60] The Commission implemented the requirements of Section 763(b) in December 2012 when it adopted a new subsection (c) to Rule 17Ad-17 to define "paying agent" and impose a duty on paying agents to notify a securityholder in writing of the securityholder's failure to cash a check.[61]

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[58] Id. at pp. 12-13.

[59] Generally speaking, Section 763(b) defines "missing securityholder" as a securityholder who fails within six months to cash a check sent by the paying agent.

[60] *See* Section 17A(g)(a)(D)(ii).

[61] The rule's definition of "paying agent" is identical to that in the statute. In lieu of using the statutory term "missing securityholder," the Commission's rule instead uses the term "unresponsive payee" to avoid confusion with the rule's provisions governing "lost securityholders." *See* Rule 17Ad-17(c)(2) and (3).

The ANPR's discussion of paying agents seems to confuse the role of paying agents with that of transfer agents[62] and conflates the role of paying agents. For example, the ANPR states that the "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" are "generally referred to as 'paying agent' services."[63] Our members would consider these to be "transfer agent" or recordkeeping services – not paying agent services. Consistent with Section 17Ad-17(c) and Rule 17Ad-17(c), they would consider their "paying agent" services to consist solely of sending the required notice to unresponsive payees. We recommend that, in future releases, the Commission's treatment of issues involving paying agents be consistent with Section 17A and not confuse the very limited role of paying agents under the law with the functions performed by transfer agents.[64]

The ANPR also speaks to the need for there to be "more specificity and a more robust set of standards against which *paying agent* activities can be measured" to better protect investors.[65] It mentions the Commission's intent "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."[66] With respect to mutual fund transfer agents, the only aspects of their operation that changed when Rule 17Ad-17(c) was adopted was ensuring they had processes and procedures in place to track when a mutual fund shareholder became an "unresponsive payee" and to make sure the required notice was sent to the unresponsive payee. In other words, the policies, procedures, and systems they used in their capacity as registered transfer agents to mutual funds were the exact same policies, procedures, and systems they used to perform the service required of them as a "paying agent." Accordingly, while the Commission may believe it necessary to adopt a regulatory regime for any paying agent that is not a registered transfer agent subject to Section 17A and the Commission's rules thereunder, for those transfer agents that are registered with the Commission and subject to the Commission's rules and oversight, we recommend that the Commission not adopt any additional regulations to govern the very limited "paying agent" aspects of their business.

We also note that Rule 17Ad-17(d) already requires "every recordkeeping transfer agent, every broker or dealer that has customer security accounts, and every paying agent" to "maintain records to demonstrate compliance" with the rule's requirements, including "written procedures that describe the

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[62] For example, Question 29 of the ANPR discusses the requirements of Rule 17Ad-5, which only applies to "transfer agents" and then asks the volume of requests under the rule the "paying agents typically receive annually." We find the Commission using the terms "paying agent" and "transfer agent" interchangeably to be quite confusing.

[63] Release at pp. 118-119.

[64] We disagree with the variety of statements in the ANPR describing the services paying agents provide. *See, e.g.,* pp. 121-122. These services, instead are provided by transfer agents in their capacity as a transfer agent.

[65] Release at p. 123. [Emphasis added.]

[66] Release at p. 125.

transfer agent's, broker's, dealer's, or paying agent's methodology for complying" with the rule. It further requires them to maintain these records in accordance with Rule 17Ad-7(i).[67] Accordingly, we recommend that the Commission refrain for adopting additional regulations to govern the paying agent aspect of a registered transfer agent's business.

e. Unclaimed Funds and Property

The ANPR's discussion of unclaimed funds and property is limited to noting that "the Commission's staff understands that transfer agents may hold residual funds from thousands to millions of dollars and securities for long periods of time ranging from over a month to several years before distributing the funds or securities either to the intended recipients or escheating the funds or securities to a state or territory."[68] The ANPR then announces the Commission's intention to propose new rules, or amend Rule 17Ad-12 "such as . . . (v) specific unclaimed property procedures."[69]

The Institute does not believe that "specific unclaimed property procedures" are warranted in light of the fact that, as recognized in the Release, it is state law – not Federal law – that governs unclaimed property and the escheatment of accounts. Indeed, there are no Federal laws governing escheatment. Mutual funds have extensive experience complying with the states' laws and have designed the systems necessary to ensure such compliance. We are concerned that, if the Commission were to engage in rulemaking in this area, such rulemaking is likely to increase the complexity associated with this area, which is already unnecessarily complex.[70] Accordingly, we recommend that the Commission avoid rulemaking on this topic.

f. Safeguarding Uncertificated Securities

The discussion of safeguarding uncertificated securities in the ANPR appears to be limited to stating that "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."[71] Mutual fund transfer agents deal, if not exclusively, than almost exclusively, with uncertificated securities. Because Rule 17Ad-12 is agnostic

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[67] Rule 17Ad-7(i) requires these records to be maintained for no less than three years, the first year in an easily accessible place.

[68] Release at p. 119.

[69] Question 27 seeks comment on "best practices with respect to safeguarding procedures specific to residual and unclaimed funds" prior to distribution or escheatment. Mutual fund transfer agents apply their safeguarding policies and procedures to all client funds and securities they handle – they do not alter these safeguards depending on the source or ultimate disposition of those funds and securities.

[70] State escheatment laws differ from state to state and the states' escheatment requirements differ with respect to the escheatment trigger, the dormancy period, and they type of property being escheated. For example, a state's escheatment requirements may difference depending upon whether the property deemed "abandoned" is a check or an account and, if an account, the type of account and account features.

[71] Release at p. 125.

regarding the form of securities it requires a transfer agent to safeguard, we are uncertain as to why the Commission believes this rule is insufficient to address uncertificated securities and why additional controls and limitations are necessary for such securities. As noted above, we believe the rule in its current form is sufficiently flexible to ensure that, regardless of the types of securities a transfer agent possesses relating to its transfer agent activities, its policies and procedures ensure the safeguarding of those securities.

3. Recommendations

To summarize the above discussion, the Institute recommends that:

- In lieu of rewriting Rule 17Ad-12 to replace the rule's existing flexible standards with rigid prescriptive standards that usurp a transfer agent's business judgment, the Commission instead require transfer agents to have written policies and procedures that are reasonably designed to ensure that client funds and securities are safeguarded from risk of theft, loss, or destruction.[72] Such policies should apply without regard to whether the securities held by the transfer agent are certificated or uncertificated.
- The Commission should not regulate the banking arrangements of mutual fund transfer agents.
- To the extent necessary for a documented regulatory purpose, the Commission requires transfer agents to create and maintain – but not file with the Commission – financial statements.
- With respect to paying agents, the Commission apply any new regulations involving the activities of paying agents to only those persons that currently are not registered with or regulated by the Commission as a transfer agent.
- The Commission adopt no rules relating to unclaimed property.

D. Restricted Securities and Compliance with Federal Securities Laws

1. Proposal

While this section of the ANPR is focused on restricted securities, some of the issues it discusses have broader application. These issues include the Commission's intent to:

- Adopt an anti-fraud rule for transfer agents that would prohibit any "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

[72] Should the Commission believe additional protection of shareholder records are warranted, it also may want to consider subjecting transfer agents to Regulation S-P. Currently, the rule only applies to broker-dealers, investment advisers, and investment companies. Due to the nature of their relationship with investment companies, mutual fund transfer agents are also subject to the regulation.

agent's performance of its duties and obligations under the Exchange Act and the rules promulgated thereunder;"[73] and

- Propose a new rule requiring each registered transfer agent to adopt policies and procedures reasonably designed to achieve compliance with applicable securities laws and rules and "to designate and specifically identify to the Commission on Form TA-1 one or more principals to service as chief compliance officer."[74]

The Commission seeks input on whether it should require transfer agents to: (1) maintain, implement, and enforce written compliance policies and procedures, similar to those required of broker-dealers (Question 45); (2) designate and identify a chief compliance officer ("CCO") (Question 46); (3) "undertake security checks or confirm regulatory and employment history for employees, certain third-party service providers, and associated persons, and require certain employees of the transfer agent to register with the Commission" (Question 47); (4) "obtain certain information concerning [the transfer agent's] issuer clients, clients' securityholders and their accounts, and security transactions" (Question 48); and (5) "maintain originals of all communications sent (including both paper and electronic) to or from the transfer agent related to its business" (Question 49).

2. Discussion

a. Adopting an Anti-Fraud Rule for Transfer Agents

As noted above, the Commission intends to propose a new anti-fraud rule for transfer agents. The ANPR does not explain why, in light of Rule 10b-5 under the Exchange Act, a separate anti-fraud rule is necessary for transfer agents.[75] If the Commission's rationale is that fraudulent conduct by a transfer agent may not be deemed to be fraud "in connection with the purchase or sale of any security," it would appear that the Commission lacks authority to promulgate such a rule. This is because an anti-fraud rule for transfer agents would need to be adopted consistent with the Commission's authority under the Exchange Act and Section 10(b) of that Act, which only authorizes the Commission to adopt rules prohibiting fraudulent conduct "in connection with the purchase or sale of any security." Pursuant to Section 10(b), the Commission has adopted Rule 10b-5. While we do not oppose the Commission's subjecting transfer agents to an anti-fraud rule, we are uncertain as to why Rule 10b-5 is inadequate to sanction transfer agents' fraudulent conduct and, if it is, whether the Commission has authority under the Exchange Act to adopt a broader anti-fraud rule.

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[73] Release at p. 131.

[74] Id.

[75] Rule 10b-5 makes it unlawful for any person, directly or indirectly, "in connection with the purchase or sale of any security" to: employ any devise, scheme, or artifice to defraud; make any untrue statement of a material fact; and engage in any act, practice or course of business that operates or would operate as a fraud. We note that footnotes 394 and 395 cite examples of the Commission successfully sanctioning transfer agents for fraudulent conduct under Rule 10b-5.

b. Requiring Written Compliance and Supervisory Procedures

For over a decade, Rule 38a-1 under the ICA has required mutual funds and their transfer agents to adopt and implement compliance policies and procedures that are reasonably designed to prevent violations of the Federal Securities Laws.[76] As applied to the transfer agent, the rule requires the policies and procedures to apply to the extent of services provided by the transfer agent to the mutual fund. The fund's policies and procedures also must include policies and procedures that provide for the oversight of the transfer agent's compliance and procedures and their implementation. The fund's board must approve the policies and procedures of both the fund and the fund's transfer agent[77] Under the rule, the fund's CCO must provide a written report to the board, at least annually, that addresses the adequacy of the policies and procedures of the fund and the fund's transfer agent, the effectiveness of their implementation, and any material compliance matters, including those relating to the transfer agent's compliance with the Federal securities laws. Accordingly, for well over a decade, funds have been required to adopt, maintain, and keep current written policies and procedures that provide for the oversight of the fund's transfer agent and to ensure that such policies and procedures are reasonably designed to prevent violation of the Federal securities laws. They also have long been required to assess annually the adequacy and effectiveness of those policies and procedures.

We therefore support the Commission requiring all transfer agents to have written compliance policies and procedures that are reasonably designed to ensure the transfer agent's compliance with the Exchange Act and the rules thereunder that are applicable to transfer agents. We recommend, however, that the Commission exempt or exclude mutual fund transfer agents that are subject to Rule 38a-1 from such a requirement. We believe this exemption or exclusion is appropriate and necessary to avoid duplicative or inconsistent regulation and avoid any new rule disrupting the successful compliance regime for mutual funds and their transfer agents that has been in place for well over a decade.

We strongly oppose, however, the Commission requiring a transfer agent to file with the Commission an annual compliance report relating to its policies and procedures.[78] No other persons registered with the Commission, including mutual funds and investment advisers subject to Rules 38a-1 and 206(4)-7 are required to file their annual compliance report with the Commission, and we fail to see why the Commission would impose such a requirement on transfer agents.

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[76] This term is defined in Rule 38a-1(e)(1) to mean the Securities Act of 1933, the Exchange Act, the ICA, the Investment Advises Act of 1940, Title V of the Gramm-Leach-Bliley Act, any rules adopted by the Commission under any of the statutes, the Bank Secrecy Act as it applies to mutual funds, and any rules adopted thereunder by the Commission or the Department of the Treasury. As a result of Rule 38a-1, the regulatory requirements applicable to mutual fund transfer agents are significantly broader than those imposed on other transfer agents.

[77] According to the rule, the board's approval "must be based on a finding by the board that the policies and procedures are reasonably designed to prevent violation of the Federal securities laws by the fund, and by each . . . transfer agent of the fund." *See* Rule 38a-1(a)(2).

[78] Question 46 raises this issue.

c. Designating a CCO

Currently, the Commission only requires registered investment companies (mutual funds) and investment advisers to have CCOs.[79] With respect to a mutual fund's CCO, Rule 38a-1 under the ICA limits the CCO's role to two functions. First, the CCO must, no less frequently than annually, provide a written report to the fund's board that, at a minimum, addresses (1) the operation of the fund's compliance policies and procedures as well as those of the fund's investment adviser, principal underwriter, administrator, and transfer agent; (2) any material changes made to those policies and procedures since the date of the last report; (3) any material changes to the policies and procedures recommended as a result of an annual review conducted of the policies and procedures;[80] and (4) each material compliance matter that occurred since the date of the last written report. Second, the CCO must meet separately, no less frequently than annually, with the fund's independent directors.

With respect to an investment adviser's CCO, Rule 206(4)-7 under the Investment Advisers Act requires all registered investment advisers to designate a CCO whose responsibility is to administer the investment adviser's required policies and procedures. Unlike Rule 38a-1, the only compliance policies and procedures required by Rule 206(4)-7 are those "reasonably designed to prevent violation by [the adviser] and [the adviser's] supervised persons" of the Investment Advisers Act and the Commission's rules thereunder.

Given that Rule 38a-1 already establishes a sufficient regulatory structure to ensure that compliance matters are overseen, reviewed, reported on, and addressed on a regular basis, we would not support a rule requiring mutual fund transfer agents to have a CCO. Moreover, were the Commission to impose a CCO requirement on mutual fund transfer agents, we would be concerned with how such a requirement would be integrated with the successful compliance structure mutual funds and transfer agents have had in place for over a decade under Rule 38a-1.

d. Requiring Background Checks or Registration of Employees

In 1975, the Commission proposed the adoption of Rule 17f-2 under the Exchange Act. It did so to address findings from the Commission's Study of Unsafe and Unsound Practices of Brokers and Dealers relating to losses due to missing, stolen, counterfeit, and lost securities, which had "become a substantial problem."[81] The Commission's study determined that "the factors contributing to the

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[79] We note that FINRA Rule 3013 requires each of its members to designate and identify on the Form BD a principal to serve as a CCO. While the rule, itself, imposes no duties on the CCO, Supplementary Material .05 and .06 to the rule discuss the CCO's role and duties.

[80] While there must be an annual review conducted of the adequacy of the policies and procedures required by the rule and the effectiveness of their implementation, the rule places this responsibly on the fund, not on the CCO.

[81] *See Notice of Adoption of Temporary Rule 17(f)-2(T), Effective Immediately, Exempting All Persons from the Requirements of Section 17(f)(2) of the Securities Exchange Act of 1934, as Amended, Until April 1, 1976, and Notice of Proposed Rule 17f-2 Providing Exemptions from the Fingerprinting Requirements of Section 17(f)(2),* SEC Release No. 34-11872 (November 26, 1975) ("SEC 17f-2 Release") at p. 1.

increase in security thefts was the inability to identify security risk employees."[82] Rule 17f-2 addressed this concern by requiring "every partner, director, officer, and employee of a member of a national securities exchange, broker, dealer, *registered transfer agent,* and registered clearing agent [to] be fingerprinted" and to have such fingerprints submitted to the U.S. Attorney General for processing. [Emphasis added.] To ensure that the solution the Commission devised swept no broader than that necessary to solve the problem identified, the rule exempted persons who do not in any manner engage in the sale of securities, have access to the handling or processing of securities or monies or original books and records relating thereto, and who have no direct supervisory responsibility over persons engaged in these enumerated activities. It also exempted persons who were subject to fingerprinting requirements under other provisions of law. According to the Commission, these exemptions were "to avoid unnecessary duplication and to reduce administrative burdens" imposed on registrants.

The ANPR is noticeably silent on how the fingerprinting requirement of Rule 17f-2 has failed to address any concerns motivating the Commission to consider requiring background checks. It also is silent as to why, in the Commission's view, it is necessary to impose background checks on or require the registration of transfer agent employees. We are unaware of the Commission documenting instances of a transfer agent clients – *i.e.,* the issuers that engaged the transfer agent – being harmed by a transfer agent hiring employees they should not have. Until such time as the Commission can document *why* background checks are necessary and what purpose they would serve that is currently not served today, we oppose such checks.

We additionally oppose the Commission requiring the registration of transfer agent employees because we believe such registration is not necessary and its costs would surely exceed any public benefit. Broker-dealers are the only Commission registrants that must register any of their employees and they are only required to register their associated persons who are involved in the offer and sale of securities. This seems wholly appropriate because of the nature of such persons' activities, the responsibilities entrusted to them in connection with dealing with the broker-dealer's customers, and the public trust placed in them. The law additionally requires such persons to pass qualifying examinations in order to demonstrate a minimum level of competency and they are required to comply with ongoing continuing education requirements. Broker-dealers are charged with supervising the activities of such persons and conducting inspections of their locations. In other words, requiring the registration of broker-dealers' associated persons is but one piece of a larger regulatory regime that has been designed to protect investors in their interactions with associated persons. We fully support the manner in which broker-dealers and their associated persons are regulated.

We do not believe that registration of employees of transfer agents is necessary given their limited roles. Moreover, registration involves more than just filling out and filing a registration form and paying registration fees. It necessitates creating a regulatory structure – presumably within the Commission since there is no self-regulatory organization for transfer agents – within which the registration applications can be assessed against registration standards, providing due process to those

[82] Id.

applicants whose applications are denied, and rules to govern the registration process. Consistent with the regulatory regime imposed on individuals who are required to register under Federal or state law, registration would likely be accompanied by rules regulating the conduct of registered persons. In the absence of the Commission explaining what it hopes to accomplish by requiring the registration of transfer agent employees, how it proposes to implement a registration regime for such persons, and how the benefits of this new registration and regulatory regime would exceed its costs – which costs would be significant – we oppose the Commission requiring registration of transfer agents' employees.

e. Conducting Due Diligence on Clients and Clients' Shareholders

The text of the ANPR section relating to Restricted Securities does not directly discuss the Commission's proposal to require transfer agents to conduct due diligence on their clients and their clients' shareholders. Instead, these issues arise in the questions on which the Commission seeks comment. (*See, e.g.,* Questions 37 and 48.) The Restricted Securities section of the ANPR does discuss "some" transfer agents' concern "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" on a restricted security.[83] We presume the Commission is seeking comment on transfer agents conducting due diligence on their clients (*i.e.*, the mutual funds that engage them) and their clients' shareholders in the context of dealing with restricted securities. If so, this is not an issue impacting mutual fund transfer agents because mutual funds do not issue restricted securities. However, if the Commission is contemplating requiring *all* transfer agents, including mutual fund transfer agents, to conduct some undefined, yet broad-based, due diligence on their clients, we strongly oppose such a requirement.

With respect to mutual fund transfer agents, we note that the mutual funds conduct due diligence on the transfer agent before entering into an agreement with it. The services the transfer agent provides to the mutual fund are subject to the requirements of the ICA, including Rule 38a-1 thereunder, the Compliance Rule, discussed above. This being the case, we see no purpose that would be served by requiring additional due diligence; nor do we see how such a requirement would provide any benefit to the Commission or the public. With respect to requiring mutual fund transfer agents to conduct due diligence on their clients' clients (*i.e.,* mutual fund shareholders), we fail to see what purpose this would serve other than to duplicate the due diligence of shareholders required under the USA PATRIOT Act and FINRA's suitability and know-your-customer rules (FINRA Rules 2111 and 2090, respectively). Imposing this requirement on transfer agents would likely result in transfer agents obtaining far more non-public personal information ("NPPI") on their clients' clients than is necessary, which runs counter to transfer agents deliberately limiting the amount of NPPI they collect from their clients' clients to better protect such clients' privacy interests. Such a requirement would require transfer agents to enhance their existing systems to accommodate, validate, process, and store such information. In light of the fact that there are over 90 million mutual fund shareholders, such a

[83] Release at p. 129.

requirement would be unduly burdensome and expensive and its costs would outweigh any public benefit.

f. Revising the Recordkeeping Rules

Question 49 of the ANPR seeks comment on whether the Commission should 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." This section of the ANPR does not discuss the current recordkeeping requirements so we are uncertain as to why the Commission is contemplating imposing this requirement. The Definitions section of the ANPR, however, notes that the Commission's current recordkeeping rule, Rule 17Ad-6, was adopted in 1977 and "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."[84] That section of the ANPR expresses concern "that the scope of the recordkeeping and 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 . . ..*"[85]

The Institute concurs that Rule 17Ad-6 should be modernized to reflect better some of changes that have taken place in the industry over the years – for example, eliminating terms such as "tickets" that are no longer in use. Our recommendations regarding modernizing the rule are in Appendix II. We also concur with the Commission revising the rule to incorporate, as appropriate, records to reflect compliance with any new regulatory requirements the Commission imposes on transfer agents under the current rulemaking initiative.[86] We do not concur, however that the *scope* of the rule needs to be expanded unless and until the Commission can demonstrate: (1) that the rule's current requirements are no longer serving their dual purpose discussed above; and (2) how the current rules are inadequate to fulfill this dual purpose.

3. Recommendations

To summarize the above discussion, the Institute:

- Supports the Commission adopting an anti-fraud rule for transfer agents provided it documents why Rule 10b-5 is insufficient to sanction fraudulent conduct by transfer agents and determines it has legal authority to adopt such a rule.

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[84] Release at p. 147.

[85] Id. [Emphasis added.]

[86] For example, if the Commission decides to require transfer agents to maintain compliance policies and procedures, we support Rule 17Ad-6 being revised to include the policies and procedures as a required record.

- Recommends that any rule requiring transfer agents to have written compliance policies and procedures exempt or exclude mutual fund transfer agents that are subject to Rule 38a-1 from such a requirement.
- Supports the Commission revising the recordkeeping rules to require transfer agents to maintain copies of their written compliance policies and procedures.
- Opposes the Commission requiring transfer agents to: file compliance reports with the Commission; designate a CCO; conduct background checks of or register their employees (aside from the current requirements of Rule 17f-2); and conduct due diligence on clients or the clients' shareholders.
- Oppose expanding the scope of Rule 17Ad-6 except to close gaps or to accommodate records to document compliance with new regulatory requirements.

E. Cybersecurity, Information Technology, and Related Issues

1. Proposal

In the ANPR section on "cybersecurity, information technology, and related issues," the Commission discusses risks associated with cybersecurity and notes that "transfer agents are subject to many of the same risks of data system breach or failure that other market participants face."[87] It also discusses transfer agents' reliance on technology and automation for their core recordkeeping, processing, and transfer services, "especially the use of computers and networks to store, access, and manipulate data, records, and other information" and notes that, as a result, "modern transfer agents are vulnerable to a variety of software, hardware, and information security risks."[88] Additionally, it discusses Commission activities relating to cybersecurity issues including the adoption of Regulation SDR,[89] Regulation SCI,[90] Regulation S-ID,[91] and Regulation S-P;[92] guidance published by the SEC's

[87] Release at p. 136.

[88] Release at pp. 136-6.

[89] Regulation SDR addresses registration requirements, duties, and core principles for security-based swap data repositories and requires such repositories to adopt written policies and procedures reasonably designed to ensure that its core systems provide adequate levels of capacity, integrity, resiliency, availability and security.

[90] Regulation SCI 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 agencies and trading operations within specified time frames.

[91] Regulation S-ID requires firms to have policies and procedures to protect their clients from identity theft concerns. Contrary to the statement in the ANPR, Regulation S-ID was not mandated by Congress "to address cybersecurity risks faced by financial institutions." Release at p. 138. Instead, it was designed to protect clients from identity theft without regard to whether such theft results from a cybersecurity incident.

[92] Section 248.30 of Regulation S-P requires SEC-registered brokers, dealers, investment companies, and investment advisers to insure the security and confidentiality of customer records and information; protect against any anticipated threats or hazards to the security or integrity of such records and information; protect against unauthorized access to or use of such

Divisions of Corporate Finance and Division of Investment Management, and OCIE, and Examinations;[93] and the SEC Cybersecurity Roundtable, which was held in March 2014. It then notes that, "the Commission's efforts to address transfer agents' safeguarding obligations, including the adoption and application of Rule 17Ad-12, have focused primarily on funds and securities rather than on information systems or cybersecurity" and that the current rule "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."[94]

According to the ANPR, based on the Commission's staff's experience in 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 . . . and, as a result, have developed policies and procedures, controls, or best practices to mitigate risk."[95] Notwithstanding the efforts these firms have taken, "the Commission is concerned that widely varying safeguarding procedures and controls among transfer agents *could create uncertainty and risk in the market.*"[96] The ANPR expresses the Commission's concern with inadequate safeguarding of information leading to loss of information, theft of securities and funds, fraudulent securities transfers, or the misappropriation or release of private securityholder information to unauthorized individuals.

Against this backdrop, the ANPR announces the Commission's intent to propose new or amended rules to require transfer agents, "among other things," to create and maintain: (1) 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 back-up data protocols; (2) basic procedures and guidelines governing the transfer agent's "use of technology," including methods of safeguarding securityholders' data and personally identifiable information; and (3) "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."[97]

The Commission seeks comment on several issues including: (1) whether it should impose specific cybersecurity standards for transfer agents, including "certain minimum cybersecurity protocols, such as practicing good cyber hygiene, patching critical software vulnerabilities, and using

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records or information that could result in substantial harm or inconvenience to any customer; and ensure the proper disposal of consumer report information.

[93] Fn. 418 of the Release provides cites for the Commission's guidance.

[94] Release at p. 140. [Emphasis added.]

[95] Id.

[96] Id. [Emphasis added.]

[97] Release at p. 141.

multi-factor authentication" (Question 58); (2) whether it should require transfer agents to "demonstrate a certain level of operational capacity, such as IT governance and management, capacity planning, computer operation, development and acquisition of software and hardware, and information security" (Question 59); (3) what items, if any, it should require to be included in transfer agents' written business continuity plans (Question 60); (4) whether "the current processes and requirements for signature guarantees apply adequately in an electronic environment" (Question 66); (5) whether "the Commission should require transfer agents to have a minimum level of cybersecurity protection, and if so, what those levels should be" (Question 68); and (6) whether the Commission should require transfer agents "to maintain minimum insurance coverage for operational risks associated with transfer agent operations and services, including cyber security losses" (Question 69).

2. Discussion

a. Specific Cybersecurity Standards and Protocols

As a preliminary matter, members of the Institute – including both mutual funds and their transfer agents – have long taken seriously their obligation to protect the confidentiality and integrity of non-public consumer information against *any* type of threat – including cybersecurity threats. We are pleased that, as recognized by the Commission's Cybersecurity Roundtable in 2014, the financial services sector of the economy is "way ahead of the rest of our nation's cybersecurity."[98] According to Larry Zelvin, Director, National Cybersecurity and Communications Integration Center, U.S. Department of Homeland Security:

> As you look at the 16 critical infrastructures, finance probably wins the cybersecurity threat award. . . . So you are a massive target, and you're a target for two reasons in my mind. First is because you're where the money is. The second one is that you also represent our nation. There was a time when nations used to focus on their militaries. They would focus potentially on commerce overseas. Now they can focus on the commerce within your own nation.
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> [T]he financial sector . . . is way ahead of the rest of our nation's cybersecurity, reason being is – is you're getting attacked a lot. I'd encourage you on the information sharing we get there to share that information not only with the people you work with in business both nationally and internationally, but also with government because we have a lot of work to do with a number of sectors that you rely upon for your businesses *that we need to benefit from your experience.* [Emphasis added.][99]

[98] *See Cybersecurity Roundtable Transcript* at p. 13.

[99] Id. at pp. 12-13.

The transcript also quotes Mr. Zelvin as stating that, with respect to cybersecurity, the financial services sector is "doing extraordinary work. It's highly impressive."[100]

Notwithstanding the glowing comments from the Director of the Department of Homeland Security's Cybersecurity Center, the ANPR discusses the Commission's interest in adopting rules relating to transfer agents' cybersecurity responsibilities. The Institute strongly opposes the Commission doing so for three reasons:

First, as noted above, such rules are not necessary. The financial services sector, which includes mutual fund transfer agents and the 90 million mutual fund accounts they hold, is already "highly impressive" and it is so without *any* regulatory mandates. This is not surprising in light of the fact that a mutual fund's brand and success as a business are highly dependent upon investor confidence and cybersecurity concerns could easily destroy such confidence. The fact that cybersecurity remains a top risk issue for the financial services sector does not mean that it warrants a regulatory response. As noted at the SEC Cybersecurity Roundtable by a former SEC Commissioner, "I have a resistance to the idea that, when a matter becomes a really important matter of public policy, the SEC should be tasked with doing something about it."[101]

Second, according to the ANPR, the Commission is contemplating rulemaking in this area due to its concern "that widely varying safeguarding procedures and controls among transfer agents could create uncertainty and risk in the markets."[102] In other words, it appears that the Commission's concern is not that transfer agents have failed to implement cybersecurity safeguards but, rather, that the procedures and controls they have implemented are "widely varying." This statement in the ANPR is of grave concern to us because it implies that the Commission may be contemplating a "one-size-fits-all" approach to imposing safeguarding requirements. This is of concern to us because, when it comes to cybersecurity, this approach is likely to *increase* – not decrease – a transfer agent's cybersecurity risk profile.

To be effective, cybersecurity controls and procedures *should* vary from transfer agent to transfer agent consistent with the approach of the Framework for Improving Critical Infrastructure Cybersecurity, which was released by the National Institute for Standards and Technology (the "NIST Framework). The NIST Framework was issued in February 2014 as "a set of industry standards and best practices to help organizations manage cybersecurity risks."[103] Importantly, the NIST Framework, which is nationally recognized and endorsed by regulators, is not a prescriptive mandate. Instead,

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[100] Id. at p. 19.

[101] Comments of panelist Roberta Karmel, the Centennial Professor of Law at Brooklyn Law School. Id. at p. 50.

[102] Release at p. 140. The Commission should not equate "differing" procedures and controls with "inadequate" procedures and controls.

[103] NIST Framework at p. 1.

> The Framework enables organizations – regardless of size, degree of cybersecurity risk, or cybersecurity sophistication – to apply the principles and best practices of risk management to improving the security and resilience of critical infrastructure. The Framework provides organization and structure to today's multiple approaches to cybersecurity by assembling standards, guidelines, and practices that are working effectively in industry today.
>
> *The Framework is not a one-size-fits-all approach to managing cybersecurity risk for critical infrastructure. Organizations will continue to have unique risks – different threats, different vulnerabilities, different risk tolerances – and how they implement the practices in the Framework will vary. Organizations can determine activities that are important to critical service delivery and can prioritize investments to maximize the impact of each dollar spent*. Ultimately, the Framework is aimed at reducing and better managing cybersecurity risks.[104]

The Commission should be aware that the more standardized security is, the easier it is to defeat, particularly on a large-scale basis. It is for this reason that the Department of Homeland Security permits each nuclear facility in the United States to determine its own type and level of security rather than the Department imposing a "one-size-fits-all" standard on each such facility. In the view of the Department, a "one-size-fits-all" approach would be harmful because, if bad actors are able to compromise security at one facility, they could compromise it at all facilities.

Third, aside from observing that cybersecurity threats have evolved and continue to evolve, and that there are varying procedures and controls among transfer agents, the ANPR does not raise any problem that the Commission hopes to solve through additional rulemaking. Nor does it explain how or why the current safeguarding rule, Rule 17Ad-12, is inadequate to deal with the changing landscape. As discussed previously, this rule was deliberately designed to be flexible and change with both the times and the business of a transfer agent. In lieu of addressing specific threats or mandating specific controls, it requires all transfer agents to safeguard funds and securities "in light of all facts and circumstances, in a manner reasonably free from risk of theft, loss or destruction." It would seem as a transfer agent's business evolved, and the environment it operates within has evolved, so too should have its safeguarding procedures and controls under the rule. Accordingly, we do not believe that Commission rulemaking in this area is warranted.[105]

We note that concerns with the Commission regulating in this area were raised by panelists at the Commission's Cybersecurity Roundtable. When asked by a panel moderator "what the SEC should do in this space," the panelists' responses included the following:

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[104] NIST Framework at pp. 1-2. [Emphasis added.]

[105] We additionally note that, though transfer agents and cybersecurity have been an inspection priority for OCIE, we are not aware of OCIE documenting cybersecurity concerns or violations at registered transfer agents that would provide a basis for the Commission engaging in rulemaking on this topic.

> . . . the SEC should provide principle-based guidance and avoid any attempt to issue prescriptive rules as it relates to cybersecurity controls. Simply for that reason we've talked about so many times is the constantly changing threat landscape. Any prescriptive rules would be outdated potentially by the time they were written and by the time they were put into place.
>
> And we've seen this with Canadian regulators recently. The Office of the Superintendent of Financial Institutions recently issued their uncharacteristic more prescriptive rules. And complying with these rules may result in the use of time and resources without truly mitigating the current cybersecurity risks.
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> * * *
>
> I think all of us are so unique that trying to put anything more prescriptive into place would be extremely difficult. And I think at the end of the day it probably wouldn't have the desired effect.
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> * * *
>
> [I] agree with a lot of what's been said. The experts I talked to – their number one thing was please resist the urge to impose rigid or prescriptive requirements.[106]

Importantly, because the SEC is not the exclusive regulator of many in the financial services industry, including transfer agents, participants at the Roundtable strongly recommended that, in taking any steps to address cybersecurity concerns, all the Federal regulators of financial institutions work collaboratively on these issues and "actually talked to each other"[107] to avoid conflicting regulations and requirements. We share and echo the panelists' concerns.

b. Operational Capacity Standards

After discussing the Commission's concerns with cybersecurity procedures and controls (discussed above) and "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 and funds, fraudulent securities transfers, or the misappropriation or release of private securityholder information to unauthorized individuals," the ANPR announces the Commission's intent to propose new or amended rules requiring transfer agents to: "create and maintain appropriate procedures and guidelines related to a transfer agent's operational capacity, such

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[106] *Cybersecurity Roundtable Transcript* at pp. 91-92. These comments were made in response to a question by the panel moderator, David Grim, who, at the time was the Deputy Director in the SEC's Division of Investment Management. Since the Roundtable, Mr. Grim has been appointed the Director of this Division.

[107] Id. at p. 93.

as IT governance management, capacity planning, computer operations, development and acquisition of software and hardware, and information security."[108]

Because the ANPR contains no discussion regarding *why* it is necessary in the public interest for the Commission to require transfer agents to create and maintain procedures and guidelines relating to their "operational capacity," we are uncertain as to the reasons underlying the Commission contemplating rulemaking in this area. Moreover, because we are not aware of a similar operational requirements being imposed on other SEC registrants, we are uncertain as to what operational capacity standards or types of standards the Commission might be considering. Accordingly, because we have insufficient information to provide meaningful input on this issue, at this time we cannot support the Commission imposing operational capacity standards.

c. BCP Requirements

There is no discussion in the Release or ANPR explaining why the Commission believes it is necessary to impose a business continuity requirement on transfer agents. Nor are we aware of the Commission imposing on other SEC registrants requirements relating to business continuity. Should the Commission determine that it is necessary in the public interest to require transfer agents to have and maintain a business continuity plan, we strongly recommend that any such requirement be consistent with FINRA Rule 4370. FINRA Rule 4370, which was adopted over ten years ago, requires FINRA members to create and maintain a written business continuity plan that identifies "procedures relating to an emergency or significant business disruption." The plan must, at a minimum, address elements set forth in the rule.[109] The plan also must be updated to reflect any material changes to the member's operations, structure, business, or location. In light of the fact that FINRA's rule has been in place for some time, we understand that mutual fund transfer agents have looked to FINRA's rule for guidance in structuring BCP plans that they have voluntarily implemented. This being the case, to ensure regulatory consistency, we recommend that any rule the Commission adopts on this issue be consistent with FINRA's rule.

d. Signature Guarantees

Though not discussed in ANPR, Question 66 seeks comment on whether "the current processes and requirements for signature guarantees apply adequately in an electronic environment." The Institute encourages the Commission to update and modernize its signature guarantee rule, Rule 17Ad-15. We encourage it to do so, not because of concerns regarding the adequacy of signature

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[108] Release at pp. 140-141.

[109] The required plan elements are deliberately designed to provide FINRA members flexibility in how they design and tailor their plan to their needs. These elements are: (1) data back-up and recovery; (2) all mission critical systems; (3) financial and operational assessments; (4) alternate communications between customers and the member; (5) alternate communications between the member and its employees; (6) alternate physical location of employees; (7) critical business constituent, banks, and counter-party impact; (8) regulatory reporting; (9) communicating with regulators; and (10) how the member will assure customers' prompt access to their funds and securities in the event that the member determines that it is unable to continue its business. *See* FINRA Rule 4370(c).

guarantees in an electronic environment, but because transfer agents are struggling with how to accommodate and accept e-signatures and other electronic affirmations from a legal and regulatory standpoint. We understand that, as a result of the risk borne by the guarantor and the challenges presented in moving from a world in which signature guarantees were paper-based to one in which they are electronic, manual signature guarantees are becoming increasingly difficult to obtain as some guarantors, who used to be significant players in this space, are exiting the business rather than providing signature guarantees.[110] Additionally, as more securityholders enter into online banking relationships and are no longer tied to a physical bank, it is becoming challenging for them to obtain a security guarantee since banks typically require a relationship with a specific physical location in order to provide a signature guarantee. We believe that if the Commission were either to revise Rule 17Ad-15 or provide guidance on legal and regulatory issues relating to electronic signatures and electronic guarantees, it may result in guarantors being comfortable with issuing electronic guarantees and transitioning their business to the electronic world rather than exiting the guaranty business.

In addition to exploring solutions to facilitate signature guarantees in an electronic world, we encourage the Commission to explore expanding the purpose for which signature guarantees may be used. Currently, Rule 17Ad-15 limits their use to transferring ownership of a security. Mutual fund transfer agents, however, believe their value would be enhanced considerably if they could be used to process non-financial changes a securityholder makes to an account, such as when a securityholder needs to add or change the bank account on record for an existing account or add or change the designated power of attorney for a specified account. Revising Rule 17Ad-15 to permit, but not require, the use of signature guarantees for these and other non-financial transactions would enable a transfer agent to strengthen its identity theft program under the Commission's Identify Theft Red Flag Rules, which would be in the best interest of securityholders. Accordingly, we recommend that the Commission revise Rule 17Ad-15 to address these concerns.

e. Minimum Level of Cyber Protection

Questions 68 seeks comment on whether the Commission should "require transfer agents to have a minimum level of cybersecurity protection" and, if so, what those levels should be. Based on the context of the question, we presume the "protection" the Commission is referring to is insurance protection. We strongly oppose the Commission requiring transfer agents (or other registrants) to have cybersecurity insurance.

Insurance is a risk-management strategy – it is a way for the insured to transfer risk to another person, typically an insurance company. Accordingly, in assessing their risks and developing risk strategies, insurance is but one factor for a transfer agent to consider. Other factors might include: the nature of the risk, the impact of the risk, other risk-mitigation or avoidance strategies in place, the costs

[110] We understand, for example, that Bank of America and Wells Fargo no longer issue signature guarantees, while Merrill Lynch will issue them only for their brokerage clients. Considering the size and market share of these firms, their exit or restrictions have significantly impacted the ability of customers to obtain such guarantees. In considering rulemaking in this area, the Commission may want to explore the reasons firms have exited the business and design rules or provide guidance that addresses such concerns.

associated with the risk, and the costs associated with mitigating or transferring the risks. In other words, the decision regarding whether to purchase cyber insurance and, if so, for what and in what amount is a business decision that is best left up to each individual transfer agent. We question how the Commission could even begin to define or determine what "level" of cybersecurity insurance a transfer agent – or any SEC registrant – should have due to the complexities of the issues involved. For example, because it would be impossible for transfer agents to be insured against all possible cyber threats, what particular cyber risk or threat would the Commission choose to require them to insure against? Without knowing the risk profile of a transfer agent, its risk mitigation strategies, and how a particular cybersecurity risk might impact that transfer agent, we question how the Commission could determine that cybersecurity insurance is necessary or appropriate for that transfer agent. Given these and other unknowns, we question how the Commission could determine the appropriate coverage amount for such insurance. For example, Target, which was the subject of a significant data breach in 2013, apparently had $90 million in cyber insurance and yet, as demonstrated from a March 2015 article, to date, the breach has cost Target at least $252 million:

> You'd think that a behemoth retail chain like Target would have an insurance policy befitting its size, and before the 2013 data breach, its Cyber Insurance limits probably seemed high enough. But the figures for 2014's cleanup costs are in, and it looks like Target's policy only covered a fraction of its data breach expenses.
>
> Here is a rundown of Target's expenses, courtesy of a report by Advisen:
>
> - 2013: **$61 million** total; insurance covered **$44 million**.
> - 2014: **$191 million** total; insurance covered **$46 million**.
> - Total data breach expenses so far: **$252 million**.
> - Total covered by insurance so far: **$90 million**.
> - Total Target paid out of pocket: **$162 million**.
>
> * * *
>
> What's driving these costs? You may have heard that several banks are suing Target over the cost of replacing customer credit cards, but that's just the start of Target's money hemorrhage. Other costs stem from:
>
> - Investigating the breach.
> - Repairing security weaknesses.
> - Complying with breach notification requirements.
> - Offering credit-monitoring services for breached customers.
> - Hiring a legal defense team to respond to lawsuits.
> - Curbing reputational damage through PR measures and advertising.

> Target's Cyber Insurance can help cover these costs, but the policy's limits aren't high enough to bear the majority of the costs.[111]

Above are but a few of the considerations that, in our view, render it both impractical and inappropriate for the Commission to require cyber insurance. While cyber insurance may appear to the Commission to be an effective means to address cybersecurity concerns, the complexity of issues relating to cybersecurity should not be underestimated – nor should the value of cybersecurity insurance as a silver bullet be overestimated. We are concerned that, in requiring cyber insurance, the Commission would risk doing more harm than good. Indeed, any Commission rules on this topic would appear to replace a transfer agent's business judgment about how to run and operate its business effectively based on its own needs and situation with requirements that are not tailored to the transfer agent's business model, risks, and risk management strategies. In light of the protections of Rule 17Ad-12, the Commission's safeguarding rule, which would require transfer agents to take whatever steps are necessary "in light of their facts and circumstances" to protect funds and securities, we believe that any concerns the Commission would seek to address through cybersecurity insurance are already amply addressed by transfer agents in the manner they have determined best suits their facts and circumstances.

f. Insurance

Aside from cybersecurity insurance, the ANPR seeks comment on whether to "require transfer agents to maintain insurance coverage for operational risks associated with transfer agent operations and services, including cybersecurity losses." As with all insurance matters, we believe this is an issue best left to the business judgment and discretion of transfer agents and their clients. Indeed, we are not aware of the Commission requiring other registrants to maintain minimum insurance coverage and we are uncertain as to why they would single out transfer agents in imposing such a requirement.[112] Moreover, we think the Commission's inquiry fails to recognize the complexity of this issue. In order to be meaningful, any insurance required by the SEC would have to be specifically tailored to the scope and needs of the particular transfer agent's circumstances and risk profile – there is no generic insurance product that a transfer agent could purchase to satisfy a "minimum insurance" requirement. Insurance is written against well-defined risks and the pricing of an insurance policy is based, in part, on the risks presented by the insured. As such, insurance coverage does not lend itself to satisfying a generic insurance requirement. We therefore oppose the Commission requiring insurance and recommend, instead, that it leave matters involving insurance coverage to the business judgment and discretion of transfer agents.

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[111] *See Target's Cyber Liability Insurance Covered 36% of its Data Breach Costs. How Much Does Yours Cover?* Insureon Blog (March 24, 2015), which is available at: http://www.insureon.com/blog/post/2015/03/24/how-much-does-your-cyber-liability-insurance-cover.aspx.

[112] While the Securities Investor Protection Act (SIPA) requires all broker-dealers to be insured by the Securities Investor Protection Corporation (SIPC), such requirements were imposed by Congress – not the Commission. Also, SIPC insurance is not private insurance, but rather, government-created insurance for the exclusive use of broker-dealers that are required by SIPA to be members of SIPC.

While we would oppose the Commission requiring transfer agents to have insurance, we would not oppose the Commission considering a more targeted approach to protect to address concerns with larceny or embezzlement involving clients' funds or securities. In particular, we note that Rule 17g-1 under the ICA requires each registered management investment company to provide and maintain a bond "against larceny and embezzlement, covering each officer and employee of the investment company" who may "have access to securities or funds of the investment company." Because mutual funds typically do not have employees, we understand from our members that the fidelity bonds purchased by mutual funds pursuant to this requirement typically extend to employees of the fund's affiliated transfer agent and apply to any larceny or embezzlement they commit that impacts the fund. Unlike an insurance policy that must define with specificity the particular acts to be insured against and the extent to which they will be insured, a fidelity bond, such as that required by Rule 17g-1, protects the bond holder against any activities covered by the bond, *e.g.,* larceny or embezzlement. Accordingly, while, due to the complexities involved, we oppose the Commission requiring transfer agents to maintain "insurance coverage," we would not oppose the Commission considering requiring transfer agents to have fidelity bonds to protect issuers and their shareholders against "larceny and embezzlement" if the Commission determines such a requirement is necessary to protect investors.

We recommend, however, as with any new regulatory requirement the Commission considers imposing on registrants, that it be sensitive to the fact that any costs associated with the requirement will, to the extent possible, be passed on to mutual fund shareholders, thereby increasing shareholders' costs and reducing their return on investment. Accordingly, unless such a requirement is truly necessary to protect investors, we recommend that the Commission refrain from imposing such requirement.

3. Recommendations

To summarize the above discussion, the Institute:

- Supports the Commission adopting business continuity standards for transfer agents so long as it documents the need for such standards and the Commission's standards are consistent with those imposed on broker-dealers pursuant to FINRA Rule 4370.

- Supports the Commission reforming the signature guarantee requirements to both ensure their continued use in an electronic environment and expand their use to include non-financial transactions.

- Supports the Commission requiring transfer agents to have fidelity bonds covering any larceny or embezzlement by their employees if necessary to protect investors.

- Opposes the Commission imposing on transfer agents: specific cybersecurity standards or protocols; operational capacity standards; minimum level of cyber protection; and "minimum" insurance requirements.

F. Definitions, Application, and Scope of Current Rules

The ANPR discusses the Commission's intent to "propose certain amendments to Rule 17Ad-1 through 17Ad-21T to modernize, streamline, and simplify the overall regulatory regime for transfer agents and bring greater clarity, consistency, and regulatory certainty to the areas, as well as mitigate any unnecessary costs or other burdens resulting from now obsolete or outdated requirements."[113] We support the Commission proposing amendments to accomplish these goals. Our Appendices to this letter list those areas in the existing rules and forms that we believe warrant updating to make sure they keep pace with changes in the transfer agent and financial services industry as well as in the markets. We note, however, that most of the issues we raise in the Appendices are not discussed in the ANPR and most of the issues raised in the ANPR would not appear to accomplish the Commission's above listed goals of modernizing, streamlining, and simplifying the existing rules. Instead, they would expand the current scope of the rules, replace existing principle-based and flexible rules with prescriptive rules, regulate in areas that are either best left to a transfer agent's business judgment or areas in which the Commission could do more harm than good, and significantly increase both the complexity of transfer agents' business and their cost of doing business. These costs are likely to be passed on to shareholders. We hope that, in the next phase of this project as the Commission considers proposing rule text, it remain focused on the goals enunciated in the ANPR and give thoughtful consideration to our comments on and concerns in response to the ANPR.

IV. CONCEPT RELEASE

The Concept Release portion of the Commission's Release discusses issues beyond those discussed in the ANPR and seeks comment to identify possible regulations to address those issues. Three of the issues are relevant to mutual fund transfer agents: the processing of book-entry securities, the regulation of transfer agents to mutual funds, and third-party administrators to retirement plans. Our comments and recommendations on these issues are set forth below.

A. Processing of Book-Entry Securities

1. Issues Raised by the Concept Release

According to the Concept Release, while both mutual fund transfer agents and operating company transfer agents process large numbers of book-entry securities, "Mutual Fund Transfer Agents process them in larger numbers and have been doing so for a longer period of time."[114] The Commission's existing transfer agent rules, however, were written with certificated securities in mind. While the Commission has taken the view historically that, "absent an explicit exemption, all of the transfer agent rules apply equally to both certificated and uncertificated securities,"[115] the Commission is considering whether it should clarify the treatment of book-entry securities under it rules. In

[113] Release at p. 145.
[114] Release at p. 167.

[115] Release at p. 152.

connection with the Commission's consideration of this issue, it seeks comment on whether it should: (1) amend its rules in light of the "significant increase" in book-entry securities (Question 88); (2) modify the turnaround and processing requirements of Rules 17Ad-1 and 17Ad-2 (Question 90); and (3) require transfer agents to provide securityholders with account statements since they "no longer receive paper statements evidencing their holdings" (Question 96).

2. Discussion

The Institute encourages the Commission to revise its rules to recognize and accommodate the increasing use of book-entry securities. While, as recognized in the Concept Release, mutual fund transfer agents have long been accustomed to processing shareholders' transactions through book-entry securities, in doing so, they must determine whether the Commission's rules that apply to certificated securities apply to book-entry securities and, if so, how they apply. It would be helpful if, instead of mutual fund transfer agents having to resolve these issues, the Commission resolved them by revising its rules. In Appendix II, we recommend that the Commission revise Rules 17Ad-1, 17Ad-11, 17Ad-19, and 17f-1 to address these issues. We also recommend that the Commission revise its turnaround and processing requirements in Rules 17Ad-1 and 17Ad-2 to conform them to current processes.

The Commission seeks comment on whether transfer agents should provide securityholders account statements because they may not receive statements for their book-entry securities. As discussed in Section C, below, we recommend that the Commission consider adopting a rule similar to Rule 10b-10 under the Exchange Act to ensure that mutual fund shareholders receive confirmations relating to their mutual fund transactions.

3. Recommendations

The Institute recommends that the Commission update its rules to accommodate the treatment of book-entry securities. We additionally recommend that, in lieu of waiting to address this issue in connection with rulemaking in response to the Concept Release, it do so in connection with its rulemaking under the ANPR. Our comments in Appendix II are intended to assist the Commission in identifying the rules that need to be revised to accommodate book-entry securities.

B. Regulating Transfer Agents to Mutual Funds

1. Issues Raised by the Concept Release

The Concept Release discusses the growth that has taken place in the mutual fund industry since the Commission's transfer agent rules were last significantly revised in 1977 and the evolution of the industry, which has included:

- Fund intermediaries having arrangements with a mutual fund or the mutual fund's transfer agent "to perform the underlying shareholder recordkeeping and servicing for their customer's mutual fund positions;"[116]

[116] Release at p. 161.

- A shift to omnibus account arrangements, which has both "altered the landscape of recordkeeping and other services provided to fund investors" and "resulted in a lack of transparency of beneficial owners, their trading activities and related records;"[117]
- An increase in the "complexity" of fund processing as mutual fund products and the number of share classes offered has expanded;[118]
- The development of transfer agents evolving "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;"[119] and
- Mutual fund transfer agents assisting mutual funds with their compliance obligations including those involving "client on-boarding," anti-money laundering (AML) programs, customer identification programs, suspicious activity reporting, and late trading monitoring.

The Concept Release includes a detailed discussion of the growth of omnibus accounts, with broker-dealers performing sub-accounting services for mutual fund transfer agents and its impact on mutual fund transfer agents. According to the Concept Release, 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-account arrangements."[120]

In light of this discussion, the Commission seeks comment on whether it should regulate mutual fund transfer agents differently from the way it regulates transfer agents to operating companies

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[117] Release at p. 162.

[118] According to the Concept Release, the "collective effect of five factors" has resulted in transaction processing for mutual fund transfer agents becoming more complex or warranted imposing additional responsibilities on mutual fund transfer agents as compared to operating company transfer agents. These five are: (1) mutual fund transfer agents "receive cash and perform calculations as part of regular processing of transactions in shares of mutual funds to a greater extent than is involved in the day-to-day work of Operating Company Transfer Agents;" (2) they play a role in determining a shareholder's net asset value (NAV) per share; (3) they provide shareholders various account options such as exchange privileges or systematic withdrawal plans; (4) the use of different sales load structures and distribution methods; and (4) they function in a more central role in connection with clearance and settlement of transactions since there is no clearing corporation involved in mutual fund transactions and because they "interact with sub-transfer agents such as broker-dealers, who hold shares on behalf of their beneficial owner customer." *See* discussion of these factors on Release pp. 170-174. Contrary to the Release's statement, however, mutual fund transfer agents do not receive cash.

[119] Release at p. 165. Fn. 470 to the Release discusses the variety of services provided by mutual fund transfer agents to mutual fund shareholders.

[120] Release at p. 180. The Concept Release also discusses how the problems that arose in connection with breakpoints highlight "some of the issues faced by Mutual Fund Transfer Agents that are associated with recordkeeping and processing services provided by intermediaries." Release at p. 179.

(Questions 102-104, 106, 112, and 156);[121] whether existing compensation structures for transfer agents raise regulatory concerns (Question 111); and, with respect to omnibus arrangements and sub-accounting, whether the Commission should propose rules addressing transfer agents' oversight responsibilities and their "lack of visibility into the identity of beneficial owners and products serviced by intermediaries acting as sub-transfer agents" (Questions 120-122).

2. Discussion

a. A Separate Regulatory Regime For Mutual Fund Transfer Agents

As discussed above in connection with our comments on the ANPR, the Institute encourages the Commission to separate the regulation of mutual fund transfer agents from the regulation of other transfer agents. This recommendation is not based on the "complexities" of the business of mutual fund transfer agents.[122] Instead, it is based on other issues discussed in detail in the Concept Release: (1) the development of a sub-set of transfer agents that provide services exclusively to mutual funds; (2) the variety of responsibilities mutual fund transfer agents perform on behalf of a mutual fund to service the mutual fund's shareholders; and (3) the regulatory regime applicable to mutual fund transfer agents under the ICA, which does not apply to operating company transfer agents. Each of these issues is next discussed.

(1) Transfer Agents that Service Mutual Funds

As discussed in the Concept Release, since 1977, we have seen the emergence of a group of registered transfer agents that predominantly service mutual funds. This development is not surprising given the growth of the mutual fund industry and the fact that the services mutual fund transfer agents provide to mutual fund shareholders are far more extensive than those of transfer agents servicing owners of equity securities. Also, the regulatory regime within which mutual fund transfer agents operate (discussed below) requires them to comply with a variety of regulations that do not apply to operating company transfer agents. We believe the Commission's regulations governing transfer agents should expressly recognize these distinctions. This could be accomplished in one of two ways – by the Commission revising each of its discrete transfer agent rules to recognize these distinctions or by establishing a separate set of rules governing the operations of those transfer agents that predominantly service mutual fund shareholders. Our preference is for the Commission to establish a separate rule set

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[121] The Concept Release also notes that, due to the nature of their activities, mutual fund transfer agents processing mutual fund shares are exempt from the following regulatory requirements: (i) the turnaround and processing requirements of Rule 17Ad-2;(ii) the limitations on expansion under Rule 17Ad-3; and (iii) key recordkeeping requirements relating to the transfer agent's processing and performance obligations under Rules 17Ad-6(a)(1)-(7) ad (11).

[122] While FINRA has sanctioned some of its members for failing to comply with mutual fund prospectus requirements relating to breakpoints and fee waivers, we are not aware of any regulatory actions by the Commission for similar lapses by mutual fund transfer agents. *See Staff Report: Joint SEC/NASD/NYSE Report of Examination of Broker-Dealers Regarding Discounts on Front-End Sales Charges on Mutual Funds,* NASD, NYSE, SEC (2003). *See, also, FINRA Orders an Additional Five Firms to Pay $18 Million in Restitution to Charities and Retirement Accounts Overcharged for Mutual Funds,* FINRA Press Release (October 27, 2015).

tailored to mutual fund transfer agents. This is because it would make it easier for transfer agents to discern which of the Commission's rules apply to the transfer agent's activities, thereby facilitating the transfer agent's compliance as well as the Commission's review of the transfer agent's compliance during an inspection. Such rule set both should include each of the rules in the Commission's current transfer agent rules that apply to a mutual fund transfer agent's business and recognize regulatory obligations imposed on mutual fund transfer agents under other laws governing their operations, such as the ICA.

If the Commission pursues a rule set tailored to mutual fund transfer agents, we recommend that it define "mutual fund transfer agent" to include all transfer agents that provide services predominantly or primarily to investment companies that are registered under the ICA. The use of the term "predominantly" or "primarily" is necessary to accommodate those mutual fund transfer agents whose business may include providing recordkeeping services to other issues, such as issuers of municipal fund securities.[123] While a mutual fund transfer agent primarily services mutual fund shareholders, some also provide transfer agent services to the states' 529 college savings plans. We are concerned that, if "mutual fund transfer agent" is defined to refer to those transfer agents that exclusively service mutual funds, such rule set would not be available to all mutual fund transfer agents.

(2) The Unique Services Provided by Mutual Fund Transfer Agents

The Concept Release does an excellent job of describing the variety of services that mutual fund transfer agents provide to mutual funds and mutual fund shareholders that operating company transfer agents do not provide. Some of these are core transfer agent functions; others are not. We believe these differences further evidence the appropriateness of a separate set of rules for mutual fund transfer agents. These services may include, among others: client on-boarding, working the with mutual fund's administrators on pricing issues, ensuring that shareholders purchasing and redeeming shares receive the correct net asset value, processing exchange transactions and transactions involving automated purchases or redemptions, operating call centers to service fund investors, ensuring compliance with prospectus requirements relating to the purchase and sale of fund shares,[124] and providing required documents and information to mutual fund shareholders (including, for example, prospectuses, confirmations, shareholder reports, and tax forms). Mutual fund transfer agents also must deal with issues relating to omnibus accounts and oversight of sub-accounting relationships, which are discussed below. These issues are likely irrelevant to an operating company's transfer agent.

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[123] The term "municipal fund security" is defined in Rule D-12 of the Municipal Securities Rulemaking Board, which regulates the offer and sale of municipal fund securities, to mean a municipal security issued by an issuer that, but for the application of Section 2(b) of the Investment Company Act of 1940, would constitute an investment company within the meaning of Section 3 of the Investment Company Act of 1940. As such, the term includes securities issued by the states' 529 college savings plans. Because of the similarity of 529 plan securities to mutual funds, many state sponsors of these plans hire mutual fund transfer agents as the plan's recordkeeper.

[124] Ensuring compliance with a mutual fund's prospectus requirement involves, in part, ensuring compliance with the fund's minimum investment amounts, sales load structures, and breakpoint and other discounts offered to shareholders.

(3) Regulations Applicable to Mutual Fund Transfer Agents

Providing further justification for a rule set designed specifically for mutual fund transfer agents is the regulatory regime in which mutual fund transfer agents operate. As discussed in our comments on the ANPR, the ICA and the rules thereunder impose certain regulatory requirements on mutual fund transfer agents that are not imposed on operating company transfer agents. Some of these are discussed in the Release; others, such as Rule 38a-1 under the ICA are not. As noted in our comments on the ANPR, Rule 38a-1 requires mutual fund transfer agents to have written compliance policies and procedures to ensure their compliance with the Federal securities laws. It also requires that: the adequacy and effectiveness of these policies and procedures be tested at least annually; a report be provided to the fund's board annually regarding the review; and the report identify any material compliance matters.

Other rules under the ICA require that a fund's board review the fund's contract with an affiliated mutual fund transfer agent; the transfer agent's fees be included in the fee table in the fund's prospectus; the transfer agent (on behalf of the fund) redeem mutual fund shares as required by the ICA; the transfer agent's custody arrangements comply with the ICA's requirements; and the transfer agent ensure that any non-public personal information it maintains on mutual fund shareholders is protected as required by Regulation S-P. In addition, many mutual fund companies have delegated the implementation and operation of their customer identification programs as required by a joint rule of the Commission and the U.S. Treasury and AML programs pursuant to rules of the Treasury that a mutual fund is required to have to the mutual fund's transfer agent. Also, many mutual fund transfer agents have assumed on behalf of their issuer clients: responsibility for establishing and maintaining a Red Flag Program that is designed to detect, prevent, and mitigate identify theft in connection with the opening of a covered mutual fund account; and responsibility for ensuring compliance with the Commission's redemption fee rule and its rules prohibiting late trading. Again, transfer agents for operating companies have none of these obligations.

b. Compensation Structures; Conflicts of Interests

Question 111 of the Concept Release seeks comment on how mutual fund transfer agents are compensated today, whether their compensation raises any regulatory concerns, and whether compensating mutual fund transfer agents based on the fund's net assets creates any conflicts of interest. Generally speaking, mutual fund transfer agents are compensated either through: a basis point fee, in which the fee paid by the fund to the transfer agents is based on the fund assets held in shareholders' accounts; a flat-fee, in which fees are paid on a per-account basis; or a combination of the two. The manner in which a transfer agent is compensated and the amount of such compensation is a matter of negotiation between the fund and the fund's transfer agent subject to board oversight.

Mutual fund boards owe a fiduciary duty to the fund to serve and protect shareholders' best interests. In fulfilling their fiduciary duty, fund boards consider the specific services to be provided by the fund's transfer agent, the quality of those services, the fees to be paid, and the reasonableness of

those fees – fees that are required to be disclosed in the mutual fund's prospectus. They also inquire whether these fees raise any conflicts of interest. In entering into arrangements with transfer agents, funds are well aware that the fund's transfer agent may serve as the point of contact between the fund's shareholders and the fund and they are intent on making sure that the transfer agent they hire will provide fund shareholders the level and quality of service necessary to maintain the fund's brand and reputation.

We do not believe that the compensation of mutual fund transfer agents is a topic that warrants Commission rulemaking. Mutual fund directors generally oversee the reasonableness of fees paid out of fund assets and the relationship between funds and their service providers, including the fund's transfer agent. Accordingly, this is an area best left to the business judgment and discretion of fund boards. For these reasons, we do not believe that it is necessary for the Commission to involve itself in this process or to attempt to replace the business judgment and discretion of a mutual fund board. We recommend that the Commission refrain from regulating mutual fund transfer agents' fees, fee structures, or fee arrangements.

c. Omnibus Accounts

According to a white paper published by PricewaterhouseCoopers in 2015,[125] "omnibus accounts now prevail in the industry." Because an omnibus account is opened on the records of the mutual fund in the name of an intermediary, the fund's transfer agent typically does not have information identifying or otherwise relating to the beneficial owners of the subaccounts held within the omnibus account.[126] While this lack of transparency initially presented challenges to mutual fund transfer agents as they transitioned to this new type of account, over the past few years they have adapted to omnibus accounts and successfully integrated them into their processing systems. The "lack of visibility" into records maintained by intermediaries that is mentioned in the Concept Release is an accepted feature of the omnibus account. If the mutual fund transfer agent had such visibility, it may be compelled to conduct redundant "shadow" processing or recordkeeping on the associated records, thereby creating duplicative systems, processes, and staffing and rendering wasteful the sub-accounting fees that funds pay to intermediaries to perform these same services.[127] It is not necessarily greater visibility into subaccounts that transfer agents need to promote the Commission's objectives. Rather, it

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[125] *See* PricewaterhouseCoopers LLP, *Evolution of the Mutual fund Transfer Agent: Embracing the Challenges and Opportunities*, PricewaterhouseCoopers, LLP (July 2015) ("PwC" Whitepaper") at p. 6. Footnote 460 of the Release cites this white paper.

[126] Those omnibus intermediaries that are broker-dealers are registered with and subject to the rules of the Commission and FINRA. They also are subject to regulatory oversight by the Commission and FINRA. Agreements between mutual fund transfer agents and the holders of these omnibus accounts require the omnibus account holder to comply with the fund's legal requirements to shareholders as set forth in the fund's prospectus. As noted above, FINRA has sanctioned broker-dealers that have failed to comply with fee waiver disclosures in fund prospectuses.

[127] The customers underlying an omnibus position are customers of the broker-dealer – not of the mutual fund or its transfer agent – and are serviced exclusively by the broker-dealer.

is the ability to conduct oversight of the intermediary's performance of the sub-accounting services as discussed below.

Aside from this, the greatest challenges mutual funds and their transfer agents have with omnibus accounts today result from the Commission engaging in rulemaking that fails to consider such rulemaking's impact on omnibus accounts. This first occurred in March 2005, when the Commission adopted a redemption fee rule, Rule 22c-2 under Section 22 of the ICA.[128] As adopted, this rule required mutual funds to enter into agreements with *each* intermediary that holds mutual fund shares on the records of the mutual fund transfer agent on behalf of others, including with intermediaries the mutual fund transfer agent did not know existed.[129] Due to the impossibility of this requirement, at the request of the Institute and others, in February 2006, the Commission revised the rule to require mutual funds to have agreements *only* with those intermediaries that hold accounts directly with the fund and that are, therefore, known to the fund and its transfer agent.[130]

It also occurred in July 2010 when the Commission adopted a pay-to-play rule for investment advisers. This rule, Rule 206(4)-5 under the Investment Adviser Act, required mutual funds to keep a record of *all* government entities that hold an ownership interest in the mutual fund's shares. While mutual funds can identify those government entities that hold accounts with them directly, there is no way for them to identify a government entity that owns mutual fund shares through an omnibus position. Recognizing the impossibility of the rule's requirements in an omnibus environment, the Institute implored the Commission to provide advisers relief in connection with omnibus accounts. Within days of the rule's compliance date, the Commission finally provided the Institute no-action relief that acknowledged and assuaged our members' concerns.[131]

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[128] *See Mutual Fund Redemption Fees*, SEC Release IC-26782 (March 11, 2005). When the rule was originally proposed, it would have required intermediaries to provide mutual funds a file each week regarding all transactions effected by shareholders within an intermediary's account. Due to the cost and burdens associated with this requirement, and the fact that it would result in "shadow recordkeeping" by mutual funds, which would serve no public purpose, we were pleased that the Commission determined not to include this requirement in the final rule. Indeed, mutual fund transfers agents are not interested in getting volumes of data or a pass-through of securityholder information from intermediaries and omnibus account holders. (We note that the Concept Release raises this issue in Question 99.) Instead, as discussed below in connection with the overseeing the sub-accounting services provided by intermediaries to mutual fund shareholders, they are interested in receiving or having access to *meaningful* information that would enable them to oversee those intermediaries.

[129] For example, assume that ABC Broker-Dealer held an omnibus account at a mutual fund and that one of the accounts serviced by ABC was a retirement plan that, in turn, held the assets of several retirement plan participants. As adopted, the Commission's rule would have required the mutual fund to have a written agreement with ABC Broker-Dealer *as well as with* the retirement plan – even though the mutual fund was wholly unaware that the retirement plan had an ownership interest in the ABC omnibus account.

[130] *See Mutual Fund Redemption Fees,* SEC Release IC-27255 (February 28, 2006).

[131] *See* Investment Company Institute, Pub. Avail, September 13, 2011.

In other words, mutual fund transfer agents have adjusted to the increasing prevalence of omnibus accounts by revising their systems and processes to accommodate these accounts. As such, we do not believe there is a need for the Commission to adopt any rules relating specifically to omnibus accounts. We strongly recommend, however, that the Commission takes these accounts into consideration when proposing any new substantive regulatory requirements that may implicate omnibus positions. We also strongly recommend that the Commission address issues arising in connection with overseeing intermediaries that provide sub-accounting services as next discussed.

d. Oversight of Intermediaries that Provide Sub-Accounting Services

The challenge our members have with omnibus accounts is not the existence of the accounts themselves, but the ability of a mutual fund to oversee the sub-accounting services provided by intermediaries to shareholders within an omnibus position. This challenge, however, is a challenge for mutual funds and not necessarily for mutual fund transfer agents because, at the end of the day, the fund's board must ensure processes are in place to oversee the fund's relationships with its intermediaries.[132] Depending on its structure, the board likely depends on the fund's CCO, adviser, principal underwriter, or transfer agent to obtain and provide the board the information necessary for the board to consider in evaluating these relationships. In other words, this is not a transfer agent concern, it is a mutual fund concern.

As explained in the PwC whitepaper, as a result of omnibus accounts,

> . . . intermediaries are performing some or all of the investor servicing and recordkeeping functions that transfer agents would have previously handled under the direct model.[133]
>
> Despite the omnibus model's many efficiencies, it has made it more difficult for mutual fund managers and their boards to monitor the quality and accuracy of transaction processing, service levels, and compliance with regulatory requirement and prospectus guidelines. Since a single transfer agent no longer exclusively performs or maintains all the core functions – customer service, transaction processing, recordkeeping, and shareholder communications – that agent can no longer supply a fund's management and boards with all the detailed information associated with those functions without gathering data from intermediaries.[134]

Some mutual funds continue to struggle with having intermediaries provide meaningful information that is necessary for them to oversee and assess the sub-accounting services provided by

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[132] According to footnote 508 of the Release, the relationship between the fees intermediaries receive for their "sub-transfer agent" services and the fees they receive pursuant to a mutual fund's 12b-1plan are beyond the scope of the Release.

[133] We note that omnibus accounts are an evolution from broker-controlled individual accounts (*e.g.,* supermarket and networked accounts) rather than from accounts held "under the direct model."

[134] PWC Whitepaper at pp. 6-7.

intermediaries and the fees associated with those services. This is particularly true of small and medium-size funds that may lack the market power or economic leverage to obtain this information.

Our concerns with our members having access to the information they need to oversee their relationships with intermediaries were heightened when the Commission's Division of Investment Management published a Guidance Update relating to mutual fund distribution and sub-accounting fees.[135] This Guidance, which was published in January 2016, outlined the staff's views on issues that may arise when funds make payments to intermediaries that provide shareholder and recordkeeping services for investors whose shares are held in an omnibus account. This Guidance included recommendations regarding the type of information fund boards should consider in connection with paying fees to intermediaries and assessing the services provided by intermediaries. The information discussed in the Guidance is a good first step towards identifying the information that fund boards may want to consider in overseeing these relationships. But, it is just a first step. Until such time as the Commission *requires* mutual funds to obtain, or *requires* intermediaries to provide, the information funds need to oversee the sub-account services financial intermediaries provide to the fund's shareholders, some funds will lack the leverage necessary to obtain such information and this will remain a challenge for them.

We urge the Commission to address this concern and assist funds in having full access to the meaningful information they deem necessary to oversee intermediaries that provide sub-accounting services to mutual fund shareholders. This is particularly important in light of the IM Guidance. We would welcome the opportunity to work with the Commission on identifying the meaningful information mutual funds deem necessary to perform their oversight responsibilities.

3. Recommendations

To summarize the above discussion, the Institute recommends that the Commission:

- Create a separate rule set specifically tailored to mutual fund transfer agents;
- Leave issues relating to a mutual fund's compensation of its transfer agent up to the discretion and business judgment of the fund's board;
- Refrain from adopting rules relating to a mutual fund's omnibus accounts and, instead, address any issues relating to the lack of transparency associated with such accounts when necessary in connection with revising or adopting substantive rules; and
- Take steps necessary to ensure that mutual funds have access to meaningful information that they need to oversee effectively the sub-accounting services provided by fund intermediaries.

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[135] *See Mutual Fund Distribution and Sub-Accounting Fees,* IM Guidance Update No. 2016-01 (January 2016) ("IM Guidance"). Many of the issues the IM Guidance discusses "were brought into focus by a recent sweep examination of a number of mutual fund complexes, investment advisers, broker-dealers and transfer agents." IM Guidance at p. 1.

C. Regulating Third-Party Administrators of Retirement Plans

1. Issues Raised by the Concept Release

The Concept Release discusses in detail the types and variety of services provided by the third-party administrators ("TPAs") of issuer-sponsored benefit plans, such as retirement plans. It notes that TPAs provide transfer, recordkeeping, administrative, and other services to the plan and to the plan's participants. Importantly, however, because such persons "do not perform *statutory* transfer agent functions," they may not be required to register with the Commission or any other regulatory association.[136] The Release notes the staff's understanding "that the majority of TPAs are not registered as transfer agents, although some do so voluntarily." It also discusses instances in which the Commission has brought enforcement actions against certain TPAs for acting as unregistered broker-dealers because they engaged in netting and execution services.

The Concept Release seeks comment on a variety of issues relating to TPAs including: whether they should be subject to Commission regulation (Questions 125) and, if so, what such regulation should include (Questions 126-131); whether there are concerns with TPAs that are not registered with any Federal financial regulator (Question 135); what fees TPAs charge, directly or indirectly, to investors, how these fees are disclosed, and whether the Commission should regulate such disclosure (Question 138); and, whether reforms to the confirmation requirements of Rule 10b-10 are necessary for TPAs and "a mutual fund that attracts self-directed investors" (Question 139).

2. Discussion

We are quite pleased that the Commission has included this issue in the Concept Release. We concur with the Commission that it should provide clarity and consistency regarding the activities of TPAs vis-à-vis those of broker-dealers and transfer agents. We also recommend that the Commission prioritize closing the regulatory gaps that enable TPAs to operate with no regulatory oversight.

This regulatory gap has long been a concern of the Institute. In December 2005, the Institute wrote to the Acting Director of the Division of Market Regulation, which is now known at the Division of Trading and Markets, urging the Commission to require TPAs to register with the Commission as transfer agents and to adopt "appropriately tailored regulatory requirements" for TPAs.[137] Our letter discussed the services TPAs provided to retirement plan participants and noted that such activities "are not subject to any regulatory requirements or oversight." It urged the

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[136] Release at p. 191. [Emphasis added.] Pursuant to Section 3(a)(25) of the Exchange Act, the term "transfer agent" means any person, *who engages on behalf of an issuer of securities or on behalf of itself as an issuer of securities* in specified activities, including monitoring the issuance of securities, registering the transfer of securities or the transfer of ownership, or exchanging or converting securities. In performing their functions, TPAs engage on behalf of retirement plans – *not* on behalf of an issuer.

[137] *See* Letter from Elizabeth Krentzman, General Counsel, ICI, to Mr. Robert L.D. Colby, Acting Director, Division of Market Regulation, U.S. Securities and Exchange Commission, dated December 23, 2005.

Commission to regulate TPAs to "address this anomaly" through requiring the registration and regulation of TPAs, noting that such registration and regulation would "impose appropriate regulatory responsibilities on TPAs" in connection with their activities. We continue to believe that the Commission should require the registration and regulation of TPAs – and we believe that it should do so sooner rather than later given this regulatory gap and the fact that the services provided by TPAs are substantially similar to those provided by transfer agents (*i.e.,* maintaining the records of the beneficiaries of the plan trust). As such, they should be subject to a substantially similar regulatory regime.

We recognize that some TPAs' activities may be subject to oversight by the sponsor of the retirement plan[138] that, under the Employee Retirement Income Security Act ("ERISA"), has a fiduciary duty to plan participants. Rules adopted by the Department of Labor ("DoL") under ERISA also require that the fees incurred by retirement plan participants, including any recordkeeping fees paid to a TPA, be disclosed to plan participants as and when required by DoL rules.[139] While regulations adopted by the DoL under ERISA may govern certain aspects of the TPA's activities, these regulations do not impose any registration requirements on TPAs, nor do they subject TPAs to a regulatory regime and regulatory oversight (including inspections) that is comparable to that of mutual fund transfer agents. Accordingly, notwithstanding ERISA and the DoL's rules, we continue to believe that TPAs should be subject to registration and regulation.

In contemplating this issue, we recommend that TPAs be subject to regulation and regulatory oversight that is tailored to their activities, whether this be by the DoL or the Commission. Due to the limited nature of their activities, however, we do not believe that they should be registered with and regulated by the Commission under the rigorous – and expensive – regulatory regime imposed on broker-dealers under the Exchange Act. We also recommend that, prior to deciding to regulate TPAs, the Commission consider any regulatory requirements of the DoL that are applicable to such persons to determine whether Commission regulation is needed and, if so, to ensure regulatory consistency and avoid regulatory overlap.

3. Recommendation

To summarize the above discussion, the Institute:

- Recommends that prior to determining whether to regulate TPAs under the Exchange Act, the Commission take into account whether, as a result of ERISA and any applicable rules of

[138] While TPAs interact with mutual fund transfer agents in connection with effecting trades in the account of the retirement plan that is held with the mutual fund, mutual fund transfer agents have no responsibility to oversee the activities of TPAs, nor do they have any transparency into the TPAs business or records. This is appropriate in light of the fact that, to the mutual fund transfer agent, the plan account maintained by the TPA at the mutual fund's transfer agent is registered in the name of the plan and is but another shareholder account.

[139] *See Fact Sheet: Final Rule to Improve Transparency of Fees and Expenses to Workers in 401(k)-Type Retirement Plans,* DoL (February 2012).

the DoL thereunder relating to retirement plan sponsors, such regulation is necessary and, if so, ensure that it not be inconsistent with or duplicative of the DoL's regulation of TPAs..

D. Rule 10b-10

1. Issue Raised by the Concept Release

The Concept Release seeks comment on whether reforms to the confirmation requirements of Rule 10b-10 under the Exchange Act are necessary for those mutual funds that attract self-directed investors.

2. Discussion

We appreciate the Commission raising this issue and we support the Commission ensuring that every mutual fund investor – whether it holds share directly with a mutual fund company or through an account at a financial intermediary – receives a confirmation. Rule 10b-10 of the Exchange Act requires only "broker-dealers" to provide each customer a confirmation "at or before the completion" of a transaction that involves the purchase or sale of a security. This confirmation must include the details of the transaction as set forth in the rule. Because this rule only applies to broker-dealers and not to issuers who sell or redeem shares directly with investors, the rule does not require such issuers to provide a confirmation that meets the requirements of Rule 10b-10. Notwithstanding this, we understand that mutual funds that sell or redeem shares directly with investors do, in fact, provide their shareholders confirmations that comply with the requirements of Rule 10b-10. Accordingly, the members of the Institute support the Commission adopting a rule, similar to Rule 10b-10, that would require mutual fund transfer agents to provide a confirmation of a mutual fund transaction to a shareholder who would not receive a confirmation from a broker-dealer pursuant to Rule 10b-10. For the sake of regulatory consistency, such requirement should mirror the requirements of Rule 10b-10 but only require the confirmation to include information that would be relevant in connection with a mutual fund transaction.

3. Recommendation

To summarize the above discussion, the Institute:

- Supports the Commission adopting a rule that would require delivery of a confirmation to any mutual fund shareholder who holds a mutual fund account directly on the books and records of a mutual fund transfer agent and not through a financial intermediary, so long as the requirements of such rule are consistent with those of Rule 10b-10 but tailored to mutual fund transactions.

E. Additional Request for Comment

1. Issues Raised by the Concept Release

The final section of the Concept Release poses additional issues on which the Commission requests comment. These include: (1) whether the Commission's transfer agent rules accomplish the

Commission's regulatory objectives (Question 150); whether the role transfer agents play in the proxy process is useful for efficient, accurate, and timely communications between issuer and their securityholders (Question 164); and whether a self-regulatory organization ("SRO") for transfer agents "would be useful or appropriate" (Question 166). In response to these issues, we offer the following comments.

2. Discussion

The Institute believes that the Commission's transfer agent rules accomplish the Commission's regulatory objectives with respect to core transfer agent functions. The long-standing successful track record of mutual fund transfer agents under the current rules supports this view. As discussed in our comments on the ANPR and in the recommendations in our Appendices, we recommend that certain of the rules be updated to conform them to changes in the industry and to the manner in which mutual fund transfer agents interact with and service mutual fund shareholders. In connection with any rulemaking in response to comments received on the ANPR, we strongly recommend, as discussed in our comments in Part I of this letter, that the transfer agent rules remain, to the maximum extent possible, flexible. We also recommend that the Commission not impose overly prescriptive regulatory mandates and that it limit such rulemaking to core transfer agent functions and not address issues that are unrelated to such core functions.

For example, we do not believe regulatory action related to proxies is warranted under the Commission's transfer agent rules. The Institute has previously expressed support for the Commission undertaking a comprehensive review of the complex system of proxy voting.[140] We also have expressed concerns with the fees that issuers pay to banks, broker-dealers, proxy solicitors, and tabulators for the distribution of proxy materials to shareholders who invest in mutual funds in "street names."[141] However, we believe that any regulatory review of these issues should take place in the context of proxy and shareholder report delivery and not in connection with modernizing the transfer agent rules.

With respect to consideration of an SRO for transfer agents, we question whether the Commission has lawful authority to create such an SRO. We note that, until the Maloney Act added Section 15A to the Exchange Act in 1938, the Commission lacked authority to create a registered

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[140] *See* Letter from Karrie McMillan, General Counsel, ICI, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission, dated October 20, 2010, commenting on *Concept Release on the U.S. Proxy System,* SEC Release Nos. 34-62495; IA-3052; IC 29340 (July 14, 2010).

[141] *See* Letter from Dorothy Donohue, Deputy General Counsel – Securities Regulation, ICI, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission, dated June 20, 2013, commenting on Securities and Exchange Commission, Self-Regulatory Organizations; New York Stock Exchange LLC; Notice of Filing of Proposed Rule Change Amending NYSE Rules 451 and 465, and the Related Provisions of Section 402.10 of the NYSE Listed Company Manual, Which Provide a Schedule for the Reimbursement of Expenses by Issuers to NYSE Member Organizations for the Processing of Proxy Materials and Other Issuer Communications Provided to Investors Holding Securities in Street Name and to Establish a Five-Year Fee for the Development of an Enhanced Brokers Internet Platform, SEC Release No. 34-68936 (Feb. 15, 2013).

securities association (*i.e.,* an SRO) for brokers and dealers. Moreover, as enacted, Section 15A only authorizes the creation of "an association of brokers and dealers" – not transfer agents. As such, it would appear that the Exchange Act would need to be revised by Congress in order for the Commission to have authority to create and SRO for transfer agents. The Institute would oppose such changes to the Exchange Act, particularly if the SRO could be vested with authority to oversee mutual fund transfer agents.

We note that, when consideration of an SRO for investment advisers was considered by Congress, the Institute was actively involved in the debate. In particular, in June 2012, the Institute submitted a statement for the record in connection with a bill that would have authorized an SRO for investment advisers.[142] Significantly, the bill would have exempted advisers to mutual funds from SRO registration and oversight. As noted in our Statement, the SEC must continue to be the primary regulator of investment advisers to registered mutual funds because of the broad oversight that it provides to registered funds, their advisers, and fund services providers, and of the benefit of direct oversight of fund advisers by the Commission. The Commission is the only regulator that can adequately oversee compliance with both the ICA and the Investment Advisers Act of 1940. Our Statement also noted that requiring fund advisers to be members of an SRO could result in the Commission deferring oversight responsibilities to an SRO, which would detract from the SEC's ability to obtain a complete picture of the fund and its service providers and to assess potential risks.

While the Institute's Statement related to an SRO for advisers, our comments have equal application to any consideration of an SRO for mutual fund transfer agents. As discussed previously, such transfer agents are subject to the ICA and the Exchange Act. In recognition of this, when OCIE conducts an inspection of a mutual fund, its review typically includes both the fund's adviser *and* its transfer agent. We believe this is appropriate in light of the external management of mutual funds, their reliance on service providers to conduct business, and the integrated nature of a mutual fund issuer, transfer agent, and investment adviser within a mutual fund complex. It would be ineffective and inefficient for the Commission, or an SRO on behalf of the Commission, to consider regulating and overseeing individual registrants within a mutual fund complex without taking into account the integrated nature of their roles within the complex and the impact the ICA has on their activities. For these reasons, we strongly oppose requiring mutual fund transfer agents to register with and be subject to an SRO's rules and oversight.

3. Recommendations

To summarize the above discussion, the Institute recommends:

- In proposing any rules or rule amendments in response to the ANPR or Concept Release, the Commission take a principles-based approach that will provide registrants and the

[142] The Institute's statement ("Statement") was submitted in connection with a hearing held by the U.S. House of Representatives Committee on Financial Services on H.R. 4624, the Investment Adviser Oversight Act of 2012. The statement is available at http://www.ici.org/pdf/12_house_inv_adv.pdf.

Commission maximum regulatory flexibility and enable transfer agents to tailor the regulatory requirements to the transfer agent's business;

- The Commission refrain from adopting rules under Section 17A of the Exchange Act that are unrelated to the core functions of a transfer agent (*e.g.,* rules relating to proxies); and
- The Commission not pursue establishing an SRO for transfer agents.

* * * *

V. CONCLUSION

The Institute very much appreciates the opportunity to provide these comments to the Commission in response to the Release. We appreciate the Commission's interest in reforming, modernizing, streamlining, and simplifying the overall regulatory regime for transfer agents and bringing greater clarity, consistency, and regulatory certainty to transfer agents. We support its interest in mitigating any unnecessary costs or other burdens resulting from obsolete or outdated requirements. As the Commission proposes any rules addressing the issues raised in the ANPR, we strongly encourage it to consider the Rule Considerations discussed in Part I of this letter to ensure that such rules serve their intended purpose. We also recommend that the Commission, in connection with the next phase of this rulemaking initiative when it proposes rule text, provide commenters a longer comment period that is more commensurate with the scope and importance of this initiative.

With respect to the Concept Release, we are pleased that it includes some issues of vital concern to mutual fund transfer agents. We encourage and support the Commission's interest in addressing these issues and, as stated above, we stand ready, willing, and able to assist it in this endeavor. If you have any questions concerning these comments or would like additional information on any issues discussed in this letter, please do not hesitate to contact Tamara Salmon of the Institute by phone (202-326-5825) or email (tamara@ici.org).

Sincerely,

David Blass
General Counsel

Attachments:

Appendix I
Appendix II

Cc: Stephen Luparello, Director
Christian Sabell, Associate Director
SEC Division of Trading and Markets

David Grim, Director
Diane Blizzard, Associate Director, Rulemaking
SEC Division of Investment Management

APPENDIX I

RECOMMENDED REVISIONS TO THE COMMISSION'S TRANSFER AGENT FORMS TA-1 AND TA-2

As stated in the Institute's letter, we support the Commission's effort to update the transfer agent forms to ensure they keep pace with changes in the industry and capture information of regulatory value to the Commission. Below are the items on Forms TA-1 and TA-2 that we recommend be updated or clarified. As with the comments in our letter, these recommendations represent the perspective of mutual fund transfer agents only.

I. Form TA-1

We recommend that additional questions be added to Form TA-1 to assist the Commission in understanding the *types* of issuer clients (e.g., mutual funds, operating companies) and the operating model of the transfer agent (i.e., internal, hybrid or external). The remaining questions to be completed on the form could then be segregated into appropriate categories based on the responses to these new questions. As discussed in our letter, we oppose the form requiring a transfer agent to list each of its clients.

II. Form TA-2

Similar to our recommendations above for Form TA-1, we recommend that questions be added to TA-2 to assist the Commission in understanding the *types* of issuer clients and the transfer agent's operating model. To eliminate current confusion, we also recommend that the Commission clarify how hybrid transfer agents and the external transfer agent they sub-contract with should complete Form TA-2. With the current form, it is unclear whether each party must only report data for the functions they perform or, instead, whether both parties must respond to each question on the form. We are concerned that such confusion may lead to duplicative reporting, which is likely to cause confusion regarding which entity is completing the reported functions.

Our Recommendations related to specific items on the Form are as follows:

A. **Item Q 2(a)-2(d)** – We recommend that the Commission clarify definition of "service company" in this item to affirm that intermediaries that use omnibus structures and also perform sub-accounting services are not covered by the definition.

B. **Item Q 2(d)** – We recommend that this item define "transfer agent functions".

C. **Item Q 4(a)** – We recommend that the Commission confirm that both sides of a transfer *(i.e.*, the transfer *from* an owner and the transfer *to* a specified owner) should not be counted in response to this question. Additionally, we recommend that the Commission clarify whether responses to this question should include transfers processed via DTCC's Fund/SERV system.

D. **Item Q 4(b) and 5(a**) – We recommend that the Commission clarify the difference between Items 4(b) and 5(a) and how a transfer agent should respond to each question.

We additionally recommend that the Commission clarify the reporting timeframe (e.g., December 31st) applicable to Item 4(b).

E. **Item Q 5(d)(i-vi)** – We recommend that the Commission clarify how various fund types (*e.g.,* Business Development Companies, Real Estate Investment Trusts, Operating Partnership Units) should be categorized in response to this question.

F. **Item Q 7(a)** – We recommend that the Commission clarify whether the response to this item should correlate with the number of securityholders reported in response to Item 5(b).

G. **Item Q 7(b)** – We recommend that the Commission clarify whether the response to this item should correlate with the number of securityholders reported in response to Item 5 (c).

H. **Item Q 7(c)(i)** – We recommend that the Commission clarify how issues that did not pay a dividend or distribution during the calendar year should be treated in response to this item. In particular, we recommend that the Commission clarify whether an issue that did not pay a dividend or distribution should be excluded from the response.

I. **Item Q 8** – We recommend that the Commission define the term "record difference" and clarify whether a record difference is a discrepancy between the master record and the certificate file or, instead, is a discrepancy between the master record and the transaction history record.

J. **Item Q 9(a)** – We recommend that the Commission confirm that only non-redeemable securities should be included in response to this item.

K. **Item Q 10(a)** – We recommend that the Commission confirm that all transactions involving the purchase or redemption of a mutual fund, regardless of trade origin, should be included in response to this item.

L. **Item Q 10(b)** – We recommend that the Commission clarify what it considers to be an "as of" transaction for mutual fund transfer agents.

M. **Item Q11**– We recommend that the Commission delete Item 11 from the Form as it no longer appears to render meaningful information to the Commission. If the Commission decides to retain this Item, we recommend that it clarify the term "Addresses Obtained from Database Search" as used in this item. In particular, we are uncertain as to whether it means potential addresses obtained from the searches or, instead, confirmed addresses in which the transfer agent updated the address and reestablished contact with the shareholder. We caution that tying searches to later changes (initiated by the shareholder) solely for reporting purposes would create a new reporting requirement that would be quite burdensome.

APPENDIX II

RECOMMENDED REVISIONS TO THE COMMISSION'S TRANSFER AGENT RULES

As stated in the Institute's letter, we support the Commission's effort to modernize, streamline and simplify the regulatory regime for transfer agents. We also strongly support the Commission addressing how and when its transfer agent rules apply to uncertificated or book-entry securities, including those held in a direct registration system ("DRS") or issued by registered investment companies, such as mutual funds. We also support the Commission consolidating all definitions into one rule and recommend that such definitions recognize and accommodate current processes, procedures, and technology.

Listed below are the rules that we recommend that the Commission update to ensure they keep pace with changes in the transfer agent and financial services industry, as well as in the markets. We strongly urge that any amendments proposed be flexible enough to take into account the differences among transfer agents in their operations as well as the ever-evolving technologies, system improvements, and enhanced processing efficiencies that will continue to develop over time.

As with the comments in our letter, these recommendations represent only the perspective of mutual fund transfer agents.

I. RULES IN NEED OF CLARIFICATION

We recommend that the Commission revise the following rules to better clarify and modernize their requirements:

A. Rule 17Ad-4 – We recommend that the Commission clarify the various exceptions outlined within the rule so that it is apparent which types of securities (e.g., open-end mutual funds, closed-end fund) qualify for an exception from 17Ad-2. Additionally, we recommend that the Commission eliminate the rule's exemption for smaller transfer agents.

B. Rule 17Ad-6 – We recommend that the Commission revise outdated terminology used in this rule (*e.g.*, log, tally, blotter) to reflect modern mechanisms and concepts. The Commission should also revise the rule to (1) specify how long transfer agents must maintain telephone recordings of shareholder interactions and (2) clearly define the types of records to be maintained.

C. Rule 17Ad-7 – We recommend that the Commission clarify the definition of "readily accessible place" in light of current and evolving technologies and processes. We also strongly recommend that the Commission eliminate the "source code" element of the escrow requirement given current practices.

D. Rule 17Ad-9 – We recommend that the Commission change the term "certificate detail" to "security detail." We would also not oppose the Commission requiring uncertificated securities to include the security's CUSIP number.

II. RULES IN NEED OF MODERNIZATION

We recommend that the Commission revise the following rules to conform them to changes in the industry since they were adopted or last revised:

A. **Rule 17Ad-1** – We recommend that the Commission revise the definitions in the rule to reflect the use of book-entry securities and the declining use of certificates. To accommodate current processing methods, we also recommend that the Commission eliminate the distinction between routine and non-routine items as well as revise the definition of "transfer" and "received for transfer."

B. **Rule 17Ad-2** – We recommend that the Commission eliminate the distinction regarding whether items are received before or after noon for purposes of the provisions relating to turnaround times and the processing of transactions. We also recommend that it revise the turnaround times outlined within the rule to accommodate book-entry shares, modern technology, and processing systems. Finally, we recommend that the Commission consider whether financial and non-financial transactions should have different turnaround standards.

C. **Rule 17Ad-5** – In light of the fact that the vast majority of inquiries are received electronically today (*e.g.*, email or website) or via the telephone rather than by mail, we recommend that the Commission broaden the scope of this rule beyond "written inquiries and responses" and make clear that however the inquiries and requests are initiated, the Commission considers the inquiry or request to be an owner's indication of interest in his property. We also recommend that the Commission revise the rule's provisions relating to the information the requestor must provide in order to accommodate book-entry securities. Finally, the Commission should expand the definition of "item" to include presentation of an item by an individual, an intermediary, or other person with appropriate authority to act on behalf of the individual shareholder.

D. **Rule 17Ad-9** – In addition to revising this rule as recommended above, we also recommend that the Commission update the definition of the term "record difference." In addition, in light of the prevalence of book-entry securities, we recommend that the Commission define whether a record difference includes an "out-of-balance" between the master securityholder file and history files of a shareholder record rather than merely a discrepancy between the master securityholder file and the certificate detail.

E. **Rule 17Ad-10** – We recommend that the Commission revise this rule's reference to "prompt posting" to accommodate book-entry securities and specify how the rule applies to such securities and related transaction types (*e.g.*, purchase, redemption, transfer). Additionally, we recommend that the Commission consider eliminating the concept of "buy-ins" for mutual fund transfer agents.

F. **Rules 17Ad-11 and 17Ad-19** – We recommend that the Commission revise the definitions within these rules to recognize book-entry securities and the declining use of certificates.

G. **Rule 17Ad-16** – Because mutual funds do not utilize an "appropriate qualified registered securities depository," we recommend that the Commission revise this rule to address mutual fund transfer agents. [Alternatively, if the Commission adopts a separate rule set for mutual funds, we recommend that it not include provisions relating to securities depositories in such rule set.] We also note that, currently, mutual fund transfer agents have processes and procedures in place to proactively communicate any assumption or termination of transfer agent services for an issuer to shareholders, intermediaries, and other service providers and industry stakeholders. These communications typically are multifaceted and may include supplements to the prospectus, email communications, faxes to interested parties, and letters to shareholders. Should the Commission see the need to require notice when mutual fund transfer agent services are assumed, transferred or terminated, we recommend that it propose a new rule that requires a notice to interested parties and that is consistent with current practices.

H. **Rule 17f-1** – We recommend that the Commission revise this rule in light of the dramatic increase of book-entry securities and the rapid decline in the use of certificates, which has rendered moot many requirements within this rule.

III. RULES CONSIDERED TO BE OBSOLETE

The Institute agrees with the Commission that rules 17Ad-18 and 17Ad-21T are obsolete and should be rescinded.