

February 2, 2016

## SEC Seeks Comments on Changes to Rules Governing Mutual Fund Transfer Agents

On December 22, 2015, the SEC published an [Advance Notice of Proposed Rulemaking, Concept Release, and Request for Comment on Transfer Agent Regulations](#) (the “Release”) seeking public comment regarding the SEC’s transfer agent rules.<sup>1</sup> The SEC notes that the “first transfer agent rules were adopted in 1977 and remain essentially unchanged [while] transfer agents now operate in a market structure that bears little resemblance to the structure in 1977.”

The Release includes an Advance Notice of Proposed Rulemaking (the “Advance Notice”) covering specific areas, including transfer agent registration and reporting requirements and transfer agent safeguarding of funds and securities, along with requests for comment. The Release also contains a Concept Release and Request for Comment (the “Concept Release”) that addresses areas of specific SEC interest, including transfer agents to mutual funds (“Mutual Fund Transfer Agents”), along with requests for comment. The Advance Notice and the portion of the Concept Release applicable to Mutual Fund Transfer Agents are summarized below.

### Advance Notice Proposals

The Advance Notice states that the SEC is requesting comment on a variety of specific topics concerning transfer agent regulation for the purpose of the SEC proposing new or amended rules. The most significant of the topics are as follows:

1. **Disclosure.** The SEC intends to propose amendments to the transfer agent registration form and annual report form (Form TA-1 and Form TA-2) to require new disclosure of financial information, conflicts of interest, the issuers and securities for which a transfer agent is providing transfer agent and other services, and the specific services being provided or expected to be provided for each issuer or security.
2. **Safeguarding of Issuer and Securityholder Funds and Securities.** The SEC intends to propose new rules in view of transfer agents’ expanded role in handling investor funds and securities (“paying agent” services) and the increase in the types of transactions facilitated by transfer agents. The new or amended rules will require transfer agents to segregate client funds, expand transfer agent annual reporting and independent audit requirements, and require transfer agents acting as paying agents or custodians to prepare and maintain policies and procedures reasonably designed to comply with new or amended possession and control requirements for the safeguarding of customer funds and securities.
3. **Cybersecurity, Information Technology and Related Issues.** The SEC intends to propose amendments to the transfer agent rules to address cybersecurity risks. Specifically, the SEC intends to propose new or amended rules requiring transfer agents, among other things, to create and maintain: (a) a written business continuity plan that identifies procedures relating to an emergency or significant business disruption; (b) basic procedures and guidelines governing the transfer agent’s use of information technology, including methods to safeguard securityholder data and personally identifiable information; and (c) appropriate procedures and guidelines related to a transfer agent’s operational capacity, computer operations and information security.

<sup>1</sup> The transfer agent rules are promulgated under the Securities Exchange Act of 1934 and principally consist of Rules 17Ac2-1 *et seq.*, 17Ad-1 *et seq.* and 17f-1 *et seq.*

## Concept Release – Questions Regarding Mutual Fund Transfer Agents

**Industry Changes.** Unlike the Advance Notice, in the Concept Release, the SEC does not present specific rule proposals affecting Mutual Fund Transfer Agents. Instead, the breadth of questions posed in the Concept Release suggests that the SEC is examining Mutual Fund Transfer Agents *de novo* to determine whether rule revisions are necessary. The SEC cites multiple factors as underlying its examination of the rules regulating Mutual Fund Transfer Agents, including: the growth of the mutual fund industry since 1977 (including the emergence of exchange-traded funds or “ETFs”), the related growth of specialized transfer agents exclusively focused on servicing mutual funds, the proliferation of fund share classes, the growth in intermediary omnibus account arrangements and the increased complexity of mutual fund share processing.

**Exemptive Rule 17Ad-4.** The SEC provides an additional rationale for examining its regulation of Mutual Fund Transfer Agents. In 1977, in Rule 17Ad-4(a), the SEC exempted Mutual Fund Transfer Agents from certain of the transfer agent rules: turnaround and processing requirements (Rule 17Ad-2), limitations on expansion to perform new transfer agent functions or activities (Rule 17Ad-3), and recordkeeping requirements related to the transfer agent’s processing and performance obligations (Rules 17Ad-6(a)(1)–(7) and (11)). One of the principal justifications for the Rule 17Ad-4(a) exemption was that, in 1977, most equity securities were certificated, while most mutual fund shares were uncertificated. Accordingly, in 1977, the SEC deemed the “redemption of fund shares” as being “significantly different from the transfer of ownership of stocks and bonds on the issuer’s records.” The SEC notes that, today, most equity securities are either immobilized at the Depository Trust Company or uncertificated, which may suggest that the processing of mutual fund shares is now more like the processing of equity securities issued by operating companies than was supposed in 1977. This raises the question of whether the SEC should amend or eliminate the Rule 17Ad-4(a) exemption.

**Request for Comments.** In view of all of these developments, the SEC believes it is appropriate to examine the regulation of Mutual Fund Transfer Agents. The Concept Release presents a variety of questions/issues on which the SEC seeks comments, including some that may spill over into other topical areas of fund regulation (**regulation of “as of” trading and the use/ oversight of intermediaries that serve as sub-transfer agents**). The principal questions/issues presented in the Concept Release are summarized below:

1. Whether Mutual Fund Transfer Agents and transfer agents that service operating company equity and debt securities should be regulated by the SEC uniformly or differently.
2. Mutual Fund Transfer Agents providing more detailed information on Form TA-2 about the type of issuers they are servicing and the types of work they are performing for those issuers (*e.g.*, information regarding whether a transfer agent is servicing investment companies or pension plans, the disclosure of the name of each issuer serviced during the reporting period).
3. Whether the Rule 17Ad-4(a) exemptions should be retained or amended.
4. The need for the transfer agent rules to be amended to address ETF Mutual Fund Transfer Agents expressly.
5. Information regarding how Mutual Fund Transfer Agents are compensated today, and whether the structure or terms of their compensation raises regulatory concerns, including conflicts of interest.
6. The frequency with which Mutual Fund Transfer Agents serve as fund administrators for the same mutual fund, and whether this dual role create conflicts of interest for either the mutual fund or the Mutual Fund Transfer Agent.

7. The ancillary information or systems that Mutual Fund Transfer Agents or intermediaries rely on to ensure accurate processing and recordkeeping of mutual fund shares, and whether the recordkeeping rules should be modified or expanded to address such records.
8. Whether the SEC should specifically address “as of” transactions in transfer agent rules, including adopting rules that govern which party, the mutual fund or the Mutual Fund Transfer Agent, incurs losses or retains profits resulting from “as of” transactions that correct processing errors.
9. Whether a greater number of “as of” transactions are indicative of potential processing problems at a Mutual Fund Transfer Agent or of potentially risky mutual fund trading practices that may dilute the interests of long-term investors.
10. Whether the use of intermediaries as sub-transfer agents introduces new or additional risks to the prompt and accurate settlement of securities transactions.
11. Whether the SEC should propose rules governing how Mutual Fund Transfer Agents oversee sub-transfer agents to mutual funds.
12. What oversight functions, if any, do Mutual Fund Transfer Agents typically perform for intermediaries performing sub-transfer agent services to beneficial owners of mutual fund shares (including the types of initial versus ongoing due diligence), and what obstacles do Mutual Fund Transfer Agents face in performing the oversight function?
13. The problems, if any, that are created by Mutual Fund Transfer Agents’ inability to see the identities of beneficial owners serviced by sub-transfer agents. Could these issues be addressed solely by the SEC through revisions to the rules governing transfer agents, or would other regulatory changes be necessary, including potential involvement of other regulators (*e.g.*, banking regulators and the Department of Labor for retirement plan recordkeepers) to assist with transparency?

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The Advance Notice indicates that the SEC will be issuing revised rules to update the regulation of all transfer agents. Perhaps, not surprisingly, the proposed regulations are likely to include enhanced safeguarding of issuer and securityholder funds and securities (analogous in spirit to the 2009 adviser custody rules) and cybersecurity enhancements. The Concept Release’s breadth indicates that, for the first time since 1977, the SEC is reassessing how it regulates Mutual Fund Transfer Agents.

We expect a significant number of comments on the Advance Notice and the Concept Release from various industry participants and other interested parties. These comments must be filed with the SEC **no later than February 29, 2016**.

If you would like to learn more about the issues in this Alert, please contact your usual Ropes & Gray attorney.