April 24, 2018

Brent J. Fields, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington DC 20549-1090
rule-comments@sec.gov

Re: Comment Letter re Concept Release on the Transfer Agent Rules; File No. S7-27-15

Dear Mr. Fields:

Carta, Inc. ("Carta")[1] appreciates the opportunity to comment on the Securities and Exchange Commission's ("SEC" or "Commission") Advanced Notice of Proposed Rulemaking, Concept Release and Request for Comment on Transfer Agent Regulations (the "Release").[2] The majority of the current rules governing transfer agent activities enacted in the 1970s (the "Transfer Agent Rules") were adopted under very different circumstances and are now severely outdated. The drafters of the Transfer Agent Rules could not have anticipated the tremendous technology advances of the last four decades, as well as the profound changes that have occurred in the securities markets — a situation which the Commission recognized when it issued the Release.[3]

---

[1] Carta is a transfer agent, registered with the Commission under Section 3(a)(25) of the Securities Exchange Act of 1934 ("Exchange Act"). Carta provides services to private and publicly-held companies, including among others, transfer agent services, capitalization and valuation, and brokerage services relating to employee stock option, dividend reinvestment and direct purchase plans.

[2] Securities Exchange Act Release No. 76743 (December 22, 2015), 80 FR 81948 (December 31, 2015).

[3] The Depository Trust & Clearing Corporation ("DTCC") wrote a comment letter that stated: "DTCC agrees with the Commission's observation that the regulation of transfer agents is critically outdated. The existing rules were developed in an environment where most securities transactions involved processing paper certificates, daily NYSE equity market volumes were in the 19.5 million range as compared to market volumes of over 1.5 billion shares today, and the market value of securities were a small fraction of current levels." *See* letter from Daniel E. Thieke, Managing Director, DTCC, to Brent J. Fields, Secretary, SEC (April 14, 2016) ("DTCC Letter"), at 1. The DTCC Comment Letter also stated that, "We believe that the outdated and limited scope of existing transfer agent regulation, particularly in comparison to other industry stakeholders, is a 'weak link' in the inter-connected network of actors who operate in the highly regulated National C&S System." *See* DTCC Comment Letter at 3. Carta agrees with DTCC's assessment of the state of the transfer agent industry and therefore urges the Commission to take the actions stated in our letter.

Carta has a unique perspective on these issues. Although we are a registered transfer agent, we are also, at our core, a technology company. As such, we are applying twenty-first century technology to the transfer agent business. Our clients benefit from this unique combination because we are able to offer them more effective transfer agent services at a cheaper price. As the Commission considers how the Transfer Agent Rules should be modernized, we ask that you keep the following points in mind.

We believe that a key goal of modernizing the Transfer Agent Rules should be to make certain the revised rules conform to other parts of today's comprehensive regulatory framework by offering investors operational and financial safeguards while also providing the entities that they interact with resiliency and reliability.[4] As another commenter noted, ". . . many aspects of the transfer agent regulatory program and the securities transfer process are interconnected . . . ."[5] This suggests, for example, that the revised rules should require transfer agents to have appropriate anti-money laundering and know your customer policies and procedures, that transfer agents have information security programs and business continuity programs, and finally, that transfer agents generally enhance the protections given to investors' funds and securities.

But the revised rules, no matter how comprehensive and effective they are, ultimately will mean nothing as long as firms that perform transfer agent functions are able to evade regulation by simply deciding they will not register as transfer agents.[6] Under the current rules and especially the way these rules are enforced, firms performing transfer agent services can simply "opt out" of the Commission's regulatory regime for transfer agents, even though as a matter of logic and more importantly, as a matter of customer protection and market integrity, they should be regulated as transfer agents. Carta strongly believes that all firms performing transfer agent functions should either be registered as transfer agents and be regulated by the Commission, or

---

[4] Other important market participants have come to the same conclusion regarding the inadequacy of the current transfer agent rules and the risks that they engender. The DTCC stated in its comment letter:

"[W]e believe that the safety and soundness of the National C&S System justifies the Commission's attention to the regulation of transfer agents . . . . we agree that with the Commission that, in order to ensure transfer agents' financial stability and operational fitness, transfer agents should be subject to reporting and substantive requirements to ensure their financial stability, more robust registration and reporting requirements, new measures to ensure that data, securities, and other assets are safeguarded in the event of threats, including cyber-attacks, insolvencies, and security lapses, and appropriate business continuity standards." *See* DTCC Letter at 2.

[5] Letter from Charles V. Callan, Senior Vice President Regulatory Affairs, Broadridge Financial Solutions, Inc. to Brent J. Fields, Secretary, Commission (April 14, 2016) ("Broadridge Letter"), at 1.

[6] Section 3(a)(25) of the Exchange Act defines a "transfer agent" generally as any person who engages on behalf of an issuer of securities or on behalf of itself as an issuer of securities in (A) countersigning such securities upon issuance; (B) monitoring the issuance of such securities with a view to preventing unauthorized issuance, a function commonly performed by a person called a registrar; (C) registering the transfer of securities; (D) exchanging or converting securities; or (E) transferring record ownership of securities by bookkeeping entry without physical issuance of securities certificates.

be regulated by another appropriate regulatory agency, such as a bank transfer agent regulated by bank regulators.

Transfer Agent Regulation Should Be Extended to Transfer Agents for Pre-IPO Issuers Meeting Certain Criteria

Carta believes that the best practice for the pre-IPO markets would be to extend the Commission's transfer agent regulatory regime to this marketplace to protect investor/stakeholder assets from theft, loss, fraud, and destruction.[7] Such rulemaking would further the SEC's efforts of preventing unregistered securities distributions, particularly in the microcap market, or of putting more rigor around a transfer agent's paying agent activities.[8]

The Commission could, for example, require any pre-IPO company with not less than a specified number of record holders (*e.g.*, 20) and that raises more than a certain amount of funds (*e.g.*, $10 million) to place those shares with a registered transfer agent (i.e., for record ownership) as a safeguard against possible abuse. The Commission could adopt this rule under its rules regulating private sales of securities (*e.g.*, Regulation D). Without such regulation, investments in pre-IPO companies are vulnerable to abuse by unscrupulous individuals who can misallocate or even steal funds and securities of such companies — obviously harming investors including employees who have received equity compensation.

Where Applicable, the Revised Rules Should Conform the Existing Transfer Agent Regulatory Structure to the Regulatory Obligations of Other Market Participants, Particularly Broker-Dealers

In the Release, the Commission addressed the risks that certain transfer agent services pose to the public, and particularly highlighted activities it describes as "paying agent" services, i.e., custody of funds or securities from issuers or securityholders, distribution of cash and stock dividends, bond principal and interests, mutual fund redemptions, and other payments to securityholders.[9] The Commission also asked whether it should require transfer agents to file reports of an independent public accountant on the transfer agent's compliance and internal controls.[10] These

---

[7] See, *e.g.*, Patrick Ferrell v. Michael Koulouis Docket No. 1800-CIV- 00453 (San Mateo Cty, CA 2018). (In a dispute between two co-founders of a private company, the plaintiff alleged that his 30.1 percent ownership interested in the company was vested and owned by him while defendant alleged that plaintiff merely owned options that had never vested due to his resignation from the company.)

[8] *See* Release at 81979–84.

[9] *See* Release at 81981. For example, Request for Comment No. 22 of the Release asks: "What are the current best practices with respect to the creation, maintenance, and reconciliation (or other use) of financial or other records that might bear upon the safety of customer funds and securities?" Carta notes that the DTCC agreed with the enhanced regulation of paying agents and observed: "The goal is to avoid the disruption, uncertainty, and, ultimately, the litigation that will ensnare all actors where transactions are left uncompleted because the necessary funds were not available as expected." *See* DTCC Letter at 9.

[10] *See* Release at 81981.

suggestions are solid steps in the right direction — but Carta believes they are too limited and too focused on paper-based processes.

In its Request for Comment No. 45, the Commission asks: "Should the Commission require transfer agents to maintain, implement, and enforce written compliance and/or supervisory policies and procedures, similar to those required of broker-dealers? Why or why not? If so, what policies and procedures should be required?"

As noted above, the Commission should require that, where applicable, the revised transfer agent rules mirror those elements of the regulatory obligations of other market participants, particularly those of registered broker-dealers.[11] For example, transfer agents should be required to have written supervisory policies and procedures in the following significant areas: 1) anti-money laundering and know your customer ("AML/KYC"); 2) information security; 3) business continuity; and 4) safekeeping of customer funds and securities.

Anti-Money Laundering/Know Your Customer

Carta believes that transfer agents should have basic AML/KYC policies and procedures in addition to the existing Office of Foreign Assets Control ("OFAC") requirements.[12] We believe this makes sense given the increasingly international nature of capital markets, and we think that all transfer agents should also be required to have basic, risk-based, AML/KYC and OFAC policies and procedures in place.[13]

The Commission points out in its release that transfer agents for mutual fund complexes often perform the due diligence on investors holding record ownership of mutual fund shares.[14] There is typically no similar obligation imposed on transfer agents for operating companies, by rule or agreement. This inconsistency creates an exception to controls on the US financial system that may allow exploitation of transfer agents by persons otherwise intended to be excluded, such as terrorists and other criminals. We see no reason to permit transfer agents to perform order taking

[11] We note that in some limited cases the Release uses existing broker-dealer rules as a model for the transfer agent rules it is proposing. *See, e.g.*, Release at 81980.

[12] In addition, Request for Comment No. 48 asks in part, "Should transfer agents be required to perform a form of due diligence on their clients and the transactions they are asked to facilitate, similar to the know-your-customer requirements applicable to broker-dealers?" *See* Release at 81984.

[13] Carta notes that the Securities Industry and Financial Markets Association ("SIFMA") was also concerned that operating company transfer agents, those not associated with mutual funds, are not currently subjected to the same stringent regulatory framework that governs similar activities when performed by broker-dealers. SIFMA therefore supported increasing customer protection rules, including potential licensing, specialized recordkeeping, and regulatory reporting for certain functions performed by operating company transfer agents. *See* letter from Thomas F. Price, Managing Director, Operations, Technology & BCP, SIFMA, to Brent J. Fields, Secretary, Commission (April 14, 2016) ("SIFMA Letter") at 2.

[14] *See* Release at 81995.

and paying agent services on behalf of issuers, while not requiring them to perform basic AML/KYC due diligence on investors, e.g., identifying "high risk" investors, performing enhanced due diligence checks on them, and, where appropriate, filing suspicious activity reports (commonly known as SARs). This is of particular importance, given the rise in large, privately held issuers, with valuations often exceeding one billion dollars.

Information Security

In the Release, the Commission stated its intent to propose amendments to the transfer agent rules to address how technology in general and cybersecurity risks affect transfer agents' activities, including requiring transfer agents to: 1) create and maintain a written business continuity plan; 2) create and maintain basic procedures and guidelines governing the use of information technology, including methods of safeguarding securityholders' data and personally identifiable information; and 3) create and maintain appropriate procedures and guidelines related to a transfer agent's operational capacity such as IT governance and management, capacity planning, computer operations, development and acquisition of software and hardware, and information security.[15]

Carta generally agrees with the DTCC that the issue of cyber security is a "prime example" of how the marketplace and risks have evolved since the transfer agent rules were enacted and why new regulations are necessary: "DTCC believes that transfer agent activities, particularly the activities of FAST Agents, are vulnerable to significant cybersecurity risks."[16] The DTCC goes further and suggests using certain aspects of Regulation Systems Compliance and Integrity ("Regulation SCI") as a basis for regulating transfer agents, *e.g.*, transfer agents should be required to notify the SEC, DTCC, and relevant issuers in the event of systems disruptions, and provide necessary updates.[17] Although Carta believes Regulation SCI has provided valuable operational safeguards to the national clearance and settlement system, we also think that the regulation is too cumbersome to apply to transfer agents generally. If the Commission were to apply aspects of Regulation SCI to transfer agents, Carta proposes that the Commission apply those requirements solely to the largest transfer agents, where there is a risk that the operational failures would materially impact the national clearance and settlement system.

The DTCC also recommended that transfer agents be required to implement safeguards and protections similar to those required for broker-dealers by FINRA in its February 2015 Report on Cybersecurity. Specifically, the DTCC recommended that transfer agents do the following with regard to cybersecurity: 1) have a comprehensive governance framework; 2) do risk assessments; 3) adopt technical controls to protect their software, hardware, and data; 4) have incident response plans regarding escalation and response to cybersecurity incidents; and 5) have

[15] *See* Release at 81985

[16] *See* DTCC Letter at 12.

[17] *Id.*

appropriate vendor management and outsourcing policies and procedures in place.[18] Carta agrees with the DTCC on these recommendations.

Business Continuity

Carta agrees with the proposal, noted above, to require transfer agents to adopt and implement business continuity programs. Transfer agents are currently an essential part of the national clearance and settlement system. In the event that one or more large transfer agents in particular were to become temporarily un-operational, that could cause significant problems to the national clearance and settlement system. However, just as in the case of registered broker-dealers, even the temporary cessation of business activities by smaller transfer agents may cause investors to lose access to their investments.[19] Carta therefore recommends that the Commission adopt a rule, based on FINRA Rule 4370, to require registered transfer agents to implement a business continuity program.

Safekeeping of Customer Funds and Securities

In the Release, the Commission requested comment about whether it should require transfer agents to file reports disclosing how they maintain custody of issuer or securityholder funds and securities similar to the information broker-dealers are required to report quarterly or, in the alternative, whether they should provide specific guidelines or requirements for paying agent and custody services.[20] In addition, the Release stated that the Commission intended transfer agents to comply with specific minimum best practices requirements related to safeguarding funds and securities, including: 1) maintaining security vaults; 2) installing theft and fire alarms; 3) developing specific written procedures for access and control over securityholder accounts and information; 4) enhanced recordkeeping requirements; 5) specific unclaimed property procedures; and 6) segregation of client funds.[21]

In light of the important custody and paying agent role performed by transfer agents, and the significant dollar amount of such activity noted in the Release, Carta agrees with each of the proposals above regarding safekeeping funds and securities. Carta's views in this area are made even stronger by DTCC's discussion of the custodian role performed by transfer agents participating in DTCC's FAST program.[22]

---

[18] *See* DTCC Letter at 13.

[19] Carta notes that SIFMA also recommended that the Commission act to bring certain aspects of transfer agent regulation, such as cybersecurity and business continuity planning, in line with financial industry standards. *See* SIFMA Letter at 2.

[20] *See* Release at 81979–81.

[21] *See* Release at 81980.

[22] *See* DTCC Letter at 4–5.

Transfer Agent Depositories ("TADs")

Carta disagrees with DTCC's assertion that the current CSD model, which evolved in the 1960s, is the best model for the U.S. markets. On the contrary, we believe direct ownership as set forth in the TAD model offers a viable alternative for how securities should be held in the future. The technological constraints of the 1960s and 1970s have fallen away and so the TAD system, which was not practical in 1975, is actually very practical now. The implementation of a TAD system would increase efficiency and reduce costs by allowing direct ownership of securities and eliminating or at least reducing payments to the expensive intermediary that DTCC has become. The market structure that existed in the 1960s has fractured and been remade in these last twenty years. But the DTCC still exists and still consumes a great deal of resources through payments for every trade.[23]

Carta understands that it would be unsettling to quickly do away with the current system of indirect shareholder ownership. However, as the Commission considers the evolution of the U.S. markets, it should draft rules that encourage the gradual evolution of a TAD system. The U.S. securities markets, including the transfer agent portion, should not be held hostage to the practical limitations of the past. The Commission should instead encourage changes in market structure that benefit all market participants and do not simply reinforce the inefficiencies of the past.

Enhancing Competition, Increasing Efficiencies of Transfer Agent Markets, And Reducing Costs for Transfer Agent Customers

Request for Comment No. 1 asks: "[with regard to transfer agents, please comment on] their ease or cost of entry and exit, the cost to issuers of switching transfer agents, and the frequency of any such switching."

Carta has anecdotal evidence that the costs of switching transfer agents can be quite high as existing transfer agents attempt to lock in their customers and prevent them from moving to other transfer agents. We have learned, for example, that it is a common practice for transfer agents to impose unjustifiably high charges, even as high as $10,000 or $20,000 on issuers that want to switch from one provider of transfer agent services to another. Even worse, some transfer agents do not allow issuers access to their records until they pay any funds the transfer agent determines are "outstanding." Issuers have no real bargaining power in these instances and thus are forced to pay these unjustifiably high fees.

The Release recognizes this when it states: "For example, it is the Commission staff's understanding that some transfer agents, after having been terminated by the issuer, have substantially delayed the handing over of securityholder records to successor transfer agents by

[23] *See, e.g.*, letter from Jesse Hill, Principal, Government and Regulatory Relations, Edward Jones & Co., LP to Brent J. Fields, Secretary, Commission (August 19, 2016) ("Edward Jones Letter"). *See also* the SIFMA Letter, complaining about the imposition of DTCC Direct Registration System ("DRS") fees on broker-dealers by transfer agents.

demanding that the issuer pay a substantial 'termination' fee before the transfer agent would agree to hand over to the securityholder records that it had been maintaining . . ."[24]

Carta supports the proposal in Request for Comment No. 10, which asks if the Commission should amend Forms TA-1 and Form TA 2 to require transfer agents to disclose information regarding fees imposed or charged by transfer agents for various services or activities. We recommend that any such rule be very clear that transfer agents disclose in advance any fees charged to customers when they later leave the transfer agent for another transfer agent and also provide a reasonable explanation of such fees.

Finally, Request for Comment No. 16 asks: "transfer agents are not required by rule to pass through specified records to successor transfer agents. Are issuers or transfer agents aware of instances where records have not been passed from one agent to the next, or agents have not done so in a prompt manner?" Carta believes the Commission should adopt a rule allowing issuers to easily change transfer agents without paying a penalty fee and prohibiting transfer agents from withholding issuer records, including for non-payment of fees. The rule should require transfer agents to provide to successor transfer agents, upon request, all records maintained by the original transfer agent required by SEC rule or regulation in a format that is generally accepted by issuers, transfer agents and broker-dealers.

If you have any questions or require further information, please contact Julius Leiman-Carbia, Esq. at [redacted] or Deanna Fong at [redacted].

Respectfully submitted,

Henry Ward
Chief Executive Officer

[24] *See* Release at 81978.