

February 27, 2019

## OCIE Reminds Investment Advisers of Transfer Agent Compliance Risks

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The handling of shareholder funds by transfer agents (“TAs”) has long been an examination priority of the SEC’s Office of Compliance Inspections and Examinations (“OCIE”). <sup>[1]</sup> Recently, OCIE issued a Risk Alert (the “Alert”) highlighting common compliance issues and best practices for TAs.<sup>[2]</sup> For investment advisers (“Advisers”) utilizing TA services, a review of the Alert can provide important insight into TA compliance risks.

Two rules form the basis of TA obligations with respect to safeguarding client assets. The Safeguarding Rule requires any registered TA in possession of shareholder funds or securities to ensure, in light of all the facts and circumstances, that the funds or securities are held in safekeeping and protected from misuse.<sup>[3]</sup> The Lost Securityholder/Unresponsive Payee Rule requires that TAs who maintain an official list of individual securityholder accounts search for lost securityholders and send notices to unresponsive payees.<sup>[4]</sup> With respect to these rules, OCIE has highlighted the following as common regulatory deficiencies:

- Misappropriation and theft of shareholder funds and the theft of physical certificates;
- Failing to adopt adequate account reconciliation controls and procedures, leading to the commingling of client assets and TA operational funds;
- Failing to secure access to vaults, computers, and other areas where client assets may be accessed;
- Failing to conduct lost securityholder searches on a timely basis or at all;
- Failing to send written notifications to unresponsive payees on a timely basis or at all;
- Failing to adopt written policies and procedures designed to ensure compliance with the rules; and
- Failing to maintain records of compliance with the rules.

To address these common regulatory deficiencies, OCIE encouraged TAs to consider implementing the following best practices:

- Use segregated and specifically designated accounts for client assets to prevent commingling of those assets with the TA’s operational funds;
- Segregate duties among different employees so that one person does not have too much control or access over shareholder funds and securities;
- Establish timeframes for each step in the payment and certificate movement processes;
- Store physical certificates in video-monitored, locked vaults that are accessible by limited personnel;

- Conduct periodic audits of blank certificates and cancelled certificates;
- Use passcodes and ID badges to restrict non-employees from entering the TA's office;
- Establish and maintain written procedures that outline how the TA identifies and records lost securityholders;
- Maintain logs of unissued and uncashed checks, and copies of dated, returned mail;
- Discontinue mailing checks to lost securityholders; and
- Establish and maintain written procedures outlining escheatment services provided to issuers and the requirements of each state.<sup>[5]</sup>

Advisers rely on TAs to perform critical services. While the Alert highlights serious compliance deficiencies that are common among TAs, it also provides a roadmap for evaluating the compliance practices of TAs. An Adviser can work with legal counsel to further reduce the risk associated with TA services, regardless of whether the Adviser's relationship with its TA is new or ongoing.

If you have any questions about the Alert or the regulation of TAs generally, please feel free to contact us.

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#### Footnotes

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<sup>[1]</sup> *Transfer Agent Safeguarding of Funds and Securities*, SEC Office of Compliance Inspections and Examinations (Feb. 13, 2019), <https://www.sec.gov/files/OCIE%20Risk%20Alert%20-%20Transfer%20Agent%20Safeguarding.pdf>.

<sup>[2]</sup> *Id.*

<sup>[3]</sup> *Id.* The Safekeeping Rule specifically requires that "(1) the securities are held in safekeeping and are handled, in light of all facts and circumstances, in a manner reasonably free from the risk of theft, loss, or destruction; and (2) the funds are protected, in light of all facts and circumstances, against misuse." *Id.*

<sup>[4]</sup> *Id.* A "lost securityholder" is a securityholder for whom the TA no longer has a correct address. Exchange Act Rule 17Ad-17(b)(2). An "unresponsive payee" is person who failed to cash a check mailed to him or her by the TA. Exchange Act Rule 17Ad-17(c)(3).

<sup>[5]</sup> *Transfer Agent Safeguarding of Funds and Securities*, *supra* note 1.