Statement

UnRulemaking: Statement Regarding DST Asset Manager Solutions, Inc.

Commissioner Hester M. Peirce

Commissioner Mark T. Uyeda

Aug. 17, 2023

The Commission once again uses an enforcement action as a substitute for notice and comment rulemaking. It does so today in a case that finds a registered transfer agent, DST Asset Manager Solutions, Inc. ("DST"), failed to act reasonably in its efforts to locate lost securityholders. Specifically, the Order finds that DST "failed to take reasonable steps to find lost securityholders as prescribed by [Rule 17Ad-17 under the Securities Exchange Act of 1934], putting those securityholders' assets at risk of being handed over to state governments – escheated – as unclaimed assets."[1] Tucked into the Commission's Order is an undertaking that effectively imposes a substantive new disclosure requirement on mutual funds.[2] Accordingly, we dissent.[3]

The Order includes an undertaking requiring DST to "[r]equest that its mutual fund clients periodically send out notifications to their client shareholder base informing them of the risk of escheatment and educating them on steps to take to avoid dormancy, including updating their addresses and otherwise establishing contact with the funds or DST."[4] The Order also requires DST to certify, in writing, compliance with the undertaking. That certification must include "written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance," which the Commission staff can demand be supplemented with "further evidence of compliance."[5]

In other words, although disguised as a "request" from the transfer agent to its mutual fund clients, the additional disclosures referenced in the undertaking are effectively a requirement imposed by the Commission. If a mutual fund receives a request from its transfer agent that the Commission required the transfer agent to make, fund counsel reasonably will view it as tantamount to a Commission requirement. While the Order addresses only one transfer agent, its reach is broader. The undertaking implies that all mutual funds, with prompting from their transfer agents, should be sending periodic escheatment notices and conducting escheatment education for their shareholders.

Many mutual funds already include voluntary registration statement disclosure regarding escheatment. Thus, the Order creates the implication that mutual funds' existing disclosures regarding escheatment are inadequate, but offers no guidance about what would be adequate. Is an annual disclosure enough to satisfy the Order's undertaking to send out notifications periodically? How detailed should the disclosure be to appropriately educate fund shareholders? What documents should include the disclosure? Can such disclosure be satisfied using the layered disclosure approach currently used for prospectuses and annual and semi-annual reports? The Order offers no answers.

Commission rules already subject mutual funds to robust disclosure requirements.[6] The Commission may, consistent with the Administrative Procedure Act, engage in rulemaking to supplement or amend these existing requirements. But the Commission is a victim of its own misguided overambition. What is a regulator to do when it cannot fit one more rulemaking on the calendar? The answer appears to be "send enforcement to do the rulemaking." We dissent.

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[1] *In the matter of DST Asset Manager Solutions, Inc.,* Release No. 34-98153 (Aug. 17, 2023) ("Order"), at paragraph 1, available at https://www.sec.gov/files/litigation/admin/2023/ap-34-98153.pdf.

[2] *Id*. ¶ 10.b.

[3] We also take issue with the Order's strained reading of Rule 17Ad-17. Rules 17Ad-17(a)(1) requires transfer agents to "exercise reasonable care to ascertain the correct addresses" of lost securityholders. The rule further specifies that "[i]n exercising reasonable care to ascertain . . . such lost securityholders' current addresses," the transfer agent must "search by taxpayer identification number or by name if the search based on taxpayer identification number is not reasonably likely to locate the securityholder." The Commission reads this language to prohibit transfer agents, after identifying a potential better address for a lost securityholder through a search using the securityholder's taxpayer identification number, from systematically checking the likely accuracy of that address by trying to match it with the securityholder's name. This reading misconstrues the rule's language. The requirement that a transfer agent search by taxpayer identification number states the minimum to meet the "reasonable care" threshold. Nothing in the rule's text prohibits a transfer agent from taking additional steps in the "exercise of reasonable care to ascertain the correct address." Indeed, a reasonable transfer agent might believe that matching the address to the securityholder's first or last name is a reasonable precaution to protect securityholders' funds from being sent to someone who has stolen the securityholder's social security number. Presumably, it would be even harder to retrieve funds stolen in this manner than to retrieve funds escheated to the state. At all events, this case is a reminder that our transfer agent rules need refreshing. *See*, *e.g.*, Commissioners Luis A. Aguilar and Daniel M. Gallagher, Statement Regarding the Need to Modernize the Commission's Transfer Agent Rules (June 11, 2015), https://www.sec.gov/news/statement/modernize-sec-transfer-agent-rules ("The Commission has not significantly revised its transfer agent rules in almost 30 years, a period that has witnessed sweeping changes in the securities industry, particularly in transfer agents' activities. As a result, the Commission's anachronistic transfer agent rules and the services that the nation's roughly 450 transfer agents provide today are out of sync.") *and* Commissioners Michael S. Piwowar and Kara M. Stein, Statement of Support for the Need to Modernize the Commission's Transfer Agent Rules (June 11, 2015), https://www.sec.gov/news/statement/statement-support-modernize-sec-transfer-agent-rules ("the issue of transfer agent regulation is pressing and timely"). Eight years later, the need for change is even more "pressing and timely," but (as with the main issue we write about today) we cannot use enforcement actions to supplement or revise the rules on the books. We would do well to set other less pressing rulemaking projects aside in favor of working on modernizing the transfer agent rules.

[4] Order ¶ 10.

[5] Order ¶ 10.

[6] These requirements include registering their shares on Form N-1A, which sets forth disclosure requirements for a fund's prospectus and statement of additional information (Form N-1A, 17 CFR §§ 239.15A and 274.11A, available at https://www.sec.gov/files/formn-1a.pdf); transmitting annual and semi-annual reports to shareholders in accordance with the disclosure requirements set forth in Form N-CSR (Form N-CSR, 17 CFR §§ 249.331 and 274.128, available at https://www.sec.gov/files/formn-csr.pdf); disclosing portfolio holdings on Form N-PORT (Form N-PORT, 17 CFR § 274.150, available at https://www.sec.gov/files/formn-port.pdf); and disclosing proxy voting records on Form N-PX (Form N-PX, 17 CFR § 274.129, available at https://www.sec.gov/files/formn-px.pdf).