RECOMMENDATIONS OF THE INVESTMENT COMPANY INSTITUTE TO THE UNIFORM LAW COMMISSION

APRIL 2014

1. "Purpose" Section

The Institute strongly recommends that a "purpose" section be added to the Act. Such section should expressly state that the purpose of the Act is to reunite those owners who are truly lost and cannot be found with their property. As such, all provisions in the Act should be interpreted in a way that will best serve the interests of a lost owner.

Comment: Mutual fund companies are becoming increasingly alarmed at the prospect of states requiring the escheatment of property in instances where the shareholder is not lost, has not abandoned the account, and the holder knows the owner's address of record to be valid. In such instances, while turning the property over to the state may result in additional revenue to the state, it is not in the owner's best interest and, more often than not, will adversely impact the shareholder. By including a "purpose" section in the Act, we hope to reinforce the original intent of the Act – *i.e.,* to protect the interest of lost owners by reuniting them with their property.

2. Owner Consent

The Institute strongly recommends that a provision be added to the Act that expressly provides an owner of securities the right to waive, with respect to any or all accounts of the owner held by the holder, the holder's obligation to comply with the abandoned property laws of the state where the owner is domiciled or where the property would be subject to reporting and escheatment.

Comments: While abandoned property laws were originally designed to protect the interest of lost owners of property, today, particularly with respect to mutual fund accounts and other long-term investing vehicles, such laws may actually disserve the interest of investors. This being the case, we believe that owners of property should have the right to voluntarily determine whether they want the protections of the states' unclaimed property laws. If an investor determines that he or she does not want the protection of such laws, he or she should have the right to opt out of, or waive, such protections. We note that the consequence of such waiver would mean that the holder of the property would continue to maintain the property on behalf of the owner until such time as the owner, or the owner's lawful beneficiary or representative, claims the property. As such, there would be no harm, whatsoever, resulting to an owner that waives the protections of the abandoned property laws.

3. Definition of "Holder"

The Institute recommends that, for purposes of accounts holding intangible securities, there be only one legal "holder" of the account and such person shall be the person that is either (1) required by Section 6042 of the Internal Revenue Code, and the rules thereunder, to make a return according to the forms or regulations prescribed by the U.S. Secretary of the Treasury or (2) the person who is legally responsible, pursuant to agreement or otherwise, to make such return on behalf of the person that is required by law to make the return.

Comment: This recommendation is to avoid the uncertainty that arises with intermediated mutual fund accounts regarding whether the fund or the intermediary holding the account is the "holder" of the account for purposes of abandoned property law. [*For more information regarding the intermediated nature of mutual fund accounts and its impact on escheatment, see the enclosed submission on this issue.*] With respect to IRA accounts, currently, with proprietary IRAs that are held by the custodian of the mutual fund, the fund assumes responsibility as a holder over such accounts. If the IRA is not a proprietary account, the fund does not assume such responsibility. Our recommendation would not preclude a fund's transfer agent from assuming the holder responsibility of the fund's custodian with respect to proprietary IRA accounts. Accordingly, our recommendation would maintain the status quo for these accounts. With respect to 529 college savings plan accounts, our recommendation would result in the state being the legal holder, though the state could delegate its tax reporting responsibility to the plan's transfer agent.

4. Dormancy Period Trigger for 529 Education Savings Plan Accounts

The Institute recommends that, with respect to 529 college savings plan accounts and other tax-advantaged education savings accounts, the dormancy period begin to run the later of (1) the date by which distributions must be taken out of the account (*e.g.,* age 30 for Coverdell accounts) or (2) 30 years from the date the account was opened or transferred to the current beneficiary, whichever is later.

Comment: This recommendation is to provide reasonable certainty regarding when holders are to begin the dormancy period for tax-advantaged educational savings accounts. When funds do not know the age of the beneficiary on the account, it seems reasonable to start the 30 year period from the date the account is opened. However, if the owner of the account has changed the beneficiary on the account, the dormancy period should begin to run no later than 30 years from the date the beneficiary was changed.

5. Dormancy Period Trigger for Tax-Advantaged Retirement Accounts

The Institute recommends that:

- The Act expressly recognize ERISA's preemption over state abandoned property laws; and

- The dormancy period begin to run on all tax-advantaged retirement accounts the later of: (1) the date by which distributions must be taken out of the account or (2) when the accountholder reaches the age of 70½.

Comment: With respect to our first recommendation, we believe including an express statement of federal preemption in the Act will avoid confusion and uncertainty regarding the states' lack of authority to require the escheatment of ERISA account. With respect to our second recommendation, consistent with the age at which the Internal Revenue Code mandates that owners take distributions from their IRA retirement accounts, we believe that age 70½ should be the "gold standard" for purposes of starting the dormancy clock on any tax-advantaged retirement account. This is reasonable because, as a retirement account, the account is intended to be maintained until the owner reaches the age of retirement or the age at which the owner make take distributions from the account without penalty. This approach will also provide the owner ample time to access the account, thereby avoiding states requiring that retirement accounts be escheated as soon as the owner reaches the age of 70½ if the owner of the account has been deemed under state law to have abandoned the account before the time the owner is required to take distributions.

6. Dormancy Period Trigger for UGMA/UTMA Accounts

The Institute recommends that, with respect to UGMA and UTMA accounts, which are governed by laws that differ from state-to-state, the dormancy period begin to run the later of: (1) the date by which the beneficiary turns age 30, if known, or (2) 30 years after the account is established.

Comment: The Institute believes that the age of 30 is the appropriate trigger to start the dormancy clock for UGMA and UTMA accounts because these accounts are established for the benefit of minors and the age of 30 provides the minor sufficient time within which to claim the account and take distributions. If the age of the beneficiary is unknown, we recommend the dormancy clock begin to run 30 years from the date the account was established.

7. Dormancy Period Trigger for Mutual Fund Shareholder Accounts

The Institute recommends that:

- The dormancy clock trigger for mutual fund accounts be identical to the returned postage ("RPO") standard found in the lost securityholder rule of the U.S. Securities and Exchange Commission ("SEC") (Rule 17Ad-17 under the Securities Exchange Act of 1934).

- If states elect to use a "no contact" standard as their trigger, contact shall be defined broadly to include: the mailing to the owner of any federally-required tax form that is not returned to the holder as undeliverable (*i.e.,* an RPO standard for tax forms) or any written, electronic, or personal contact between an owner or the owner's authorized representative and a holder that can be documented and that reflects an owner's awareness of the existence of the property including but not limited to: written

correspondence; facsimile transmission; telephonic contact; a completed transaction via Automated Clearing House ("ACH") or similar electronic funds processing method; change to the account information; purchase or sale of shares, including through automatic means; deposit of any interest, dividends, or uncashed checks; the voting of a proxy; or any account inquiry or action accomplished via the internet or other electronic means when made via the use of the owner's unique personal identification information.

- If the owner of the account fails to cash an instrument (*e.g.,* check) drawn on the account or representing proceeds of the account and such instrument is not re-deposited into the account pursuant to the instructions or agreement of the owner, the dormancy clock shall only begin running with respect to the uncashed check or instrument and not with respect to the owner's mutual fund account.

Comment: All mutual fund accounts are required by law to be maintained by a federally-registered transfer agent. SEC Rule 17Ad-17 under the Securities Exchange Act of 1934 imposes upon all federally-registered transfer agents a legal duty to search for any "lost securityholder." Generally speaking, the rule defines a "lost securityholder" as "a securityholder to whom an item of correspondence that was sent to the securityholder at the address contained in the transfer agent's master securityholder file has been returned as undeliverable . . .. " Once a securityholder becomes a "lost securityholder," the rule requires the transfer agent "to conduct two data base searches using at least one information data base service." The rule defines the term "information data base" to mean "any automated data base service that contains addresses from the entire United States geographic area, contains the name of at least 50% of the United States geographic area, contains the names of at least 50% of the United States adult population, is indexed by taxpayer identification number or name, and is updated at least four times a year;" or, any service or combination of services that would produce comparable results.

Our first recommendation is intended to conform state law to the standard in Rule 17Ad-17 for determining when the owner of a mutual fund account is a "lost securityholder." In the event we cannot persuade the ULC that this is an appropriate trigger for mutual fund accounts, or the ULC elects to provide states the option of their dormancy trigger (*i.e.,* RPO v. no contact), the second recommendation ensures that any "no contact" standard is drafted broadly enough to recognize the variety of means – including automated account deposits/redemptions – by which shareholders can express interest in the account. It would also define contact to be delivery of federal tax forms.

Our last recommendation is intended to avoid states requiring the entirety of an account to escheat merely because the owner of the account failed to cash a check drawn on the account. It is to address situations in which a shareholder's failure to cash a check (*e.g.,* a check for a de minimis interest or dividend payment) results in a state escheating the entirety of the account and not merely the check.

7. **Length of the Period of Dormancy (between the shareholder becoming lost and the property escheating)**

With respect to mutual fund accounts, the Institute recommends that the dormancy period between the time a shareholder becomes lost (or is deemed to have abandoned the

account) and the time the account is subject to escheatment be a minimum of seven (7) years.

Comment: While states have been shortening the dormancy periods over the years, we believe that a longer dormancy period – *i.e.,* a minimum of seven years – is more appropriate for mutual fund accounts, which are typically passive investment vehicles held by owners to meet long-term goals. Indeed, according to Institute data, 93% of mutual fund owners are saving for retirement; 48% are saving for emergencies; and 27% are saving for education. [*See 2013 Investment Company Fact Book,* 53rd Edition, ICI] In other words, unlike other financial institution accounts, mutual fund shareholders invest in mutual funds to satisfy long-term goals or to have a "rainy day fund." As such, we believe it is important to preserve their property in the hands of the holder for as long as possible so that when the owner claims the property for retirement, education, a "rainy day," or other purposes, it is still in possession of the holder. Importantly, **when the holder maintains the property in the name of the shareholder, the shareholder benefits from *all* growth in the account whether through appreciation of portfolio assets or reinvestment of dividends.** When the property is turned over to the states, this is not always the case and, not only does the shareholder lose out on such appreciation and growth but, in many cases, the shareholder incurs significant penalties when a tax-advantaged account is transferred from the owner's name to the name of the state. Accordingly, while states may be well-intentioned in trying to return escheated property to the shareholder, they may, in fact, be doing harm to an investor by assuming ownership of a mutual fund account.

8. Sale of Securities

The Institute recommends that the Act prohibit states from selling shares of a mutual fund account. Instead, states should be required to maintain the account on the holders' books and records until the state locates the owner. In particular, we recommend that, at the time a mutual fund account must be escheated, escheatment consist of transferring the account on the fund's books and records from the name of the shareholder to the state as trustee for the shareholder.

Comment: This recommendation is intended to protect the owner's interest in the account to the maximum extent possible under state escheatment laws. While the recommendation will not protect a shareholder from any adverse tax consequences and penalties that arise when a tax-advantaged account is transferred into the name of the state, it will at least ensure that any appreciation in assets is credited to the owner of those assets. Under our recommendation, once the shareholder is found, the account can be transferred back into the name of the shareholder on the fund's books and records. If the shareholder is not found, any heirs or other persons entitled to the property can claim the account proceeds and receive the benefit of such growth or appreciation.

9. Treatment of Beneficiaries

The Institute recommends that, in the event a mutual fund holder is notified and provided evidence of the death of an owner of a mutual fund account, the beneficiaries on the account should be treated as the new owner of the account and the account should only be

subject to escheatment once a dormancy trigger is reached for a beneficiary and the appropriate dormancy period has passed.

Comment: This recommendation is to ensure that holders have the amount of time to search of a beneficiary as they do to search for the deceased owner of the account, thereby avoiding premature escheatment of an account with known beneficiaries.

10. Recordkeeping

The Institute recommends that the period of time for which holders are required to maintain records be identical to the state's audit period and statute of limitations but, in no event, should a holder be required to maintain records relating to escheated property for more than seven (7) years after the property has been turned over to the state. With respect to the records required to be maintained, we recommend that they be limited to those records that: (1) were used by the holder to determine that the dormancy period has been triggered (*e.g.,* evidence of the dormancy trigger); and (2) evidence that the holder has complied with the state's due diligence (*i.e.,* providing any required notice to the property owner), reporting, and property transfer requirements.

Comment: This recommendation is intended to provide a date certain by which the holder is no longer required by law to maintain documents relating to escheated property. We recommend that the recordkeeping period correspond to both the state's audit period as well as the statute of limitations. This seems appropriate because the holder should ensure that, so long as the state can audit for compliance, the holder is able to produce the relevant records for the auditors. Because the statute of limitations limits any actions against the holder, there would appear to be no public purpose served by requiring the holder to maintain records beyond the statute of limitations period. We also recommend that, regardless of the state's audit period or statute of limitations, holders not be required to maintain records longer than seven years from the time property escheats to the state. We note that a seven year recordkeeping period is longer than the recordkeeping period imposed under the federal securities laws for records of a mutual fund complex. While it would not seem necessary in the public interest for mutual fund holders to be required to maintain their state escheatment records longer than all other records required of them under the federal securities laws, we support a seven year recordkeeping period as a reasonable period to accommodate state interests. With respect to our recommendation regarding the records that a holder must maintain, we believe that the list contained in our recommendation would ensure that a state has access to all material documents necessary to determine compliance with the state's abandoned property law.

11. State Use of Audit Firms

The Institute strongly recommends that the Act prohibit states from engaging third-party audit firms on a contingent-fee basis. In addition, with respect to third-party auditors, we recommend that: (1) such auditors be prohibited from estimating potential holder liability; (2) there be an expeditious, independent process available to holders to resolve disputes between the holder and the third-party auditor; (3) the law clarify that an auditor cannot require records of a holder beyond those expressly required by the law of the state the auditor is representing in the audit; and (4) such auditors be required by law to maintain the confidentiality of any information obtained from the holder to the same extent as the state would have to under state law. The Institute additionally recommends that the Act prohibit states from retaining multiple auditors or audit firms to audit a holder for the same period of time.

Comments: Our recommendation relating to prohibiting contingent-fee audits is based on both the significant conflicts of interests that arise from such arrangements, which disserve property owners, but also the overly aggressive tactics employed by such auditors to increase the monies they will earn from the audit. We submit there is no public purpose to be served by compensating such auditors on a contingent-fee basis. Indeed, we are not aware of other regulatory audits that are conducted on a contingency-fee basis and we are not aware of any state that compensates its own auditors on such basis. We see no reason to have a different standard for third-party auditors. With respect to our additional recommendations:

- We recommend prohibiting auditors from estimating liability. In our view, a holder should only be liable under the state's abandoned property law for property that the auditor can demonstrate has been abandoned and should have been transferred to the state. Permitting the use of estimation to determine liability is both unfair and inappropriate inasmuch as it imposes liability upon a holder based solely on speculative information. If the holder has failed to maintain documents necessary to determine that the holder has complied with state law, the state should assess administrative penalties on such holder, not liability based on some speculative or hypothetical standard.

- We recommend that there be an expeditious, independent process available to holders to resolve disputes. This recommendation is to ensure that holders are provided due process protections in connection with disputes concerning their abandoned property liability. The process should be expeditious to ensure timely resolution of disputes; it should be independent to ensure that conflicts of interest do not impact the process; and it should ensure that the interests of property owners are paramount.

- We recommend that the law clarify that the auditor cannot require records beyond those that the holder is expressly required to maintain pursuant to state law. This recommendation is to ensure that auditors, in the name of their convenience, do not attempt to compel holders to create or produce records that are not expressly required by the law of the state the auditor is representing.

- Consistent with our Recommendation 14, below, relating to confidentiality, we recommend that third-party auditors be required to maintain the confidentiality of any information they obtain from the holder. Holders of mutual funds accounts are subject to requirements under federal law that require them to maintain the confidentiality of all

non-public personal information ("NPPI") on their accountholders. These same laws require the holder to ensure that any person they share NPPI with maintain the confidentiality of such information to the same extent as the holder must maintain it. We understand that it is not uncommon for mutual funds to have great difficulty in obtaining confidentiality agreements from auditors. To avoid such difficulty and protect the interests of holders and owners, we strongly recommend that the Act include provisions providing for the confidential treatment of NPPI provided to an auditor in connection with an audit.

- With respect to our last recommendation, which is intended to address multiple concurrent audits, we note that, when states enter into agreements with a variety of third-audit firms, it is not uncommon for mutual funds to receive audit requests from more than one firm, each of which is auditing for the same period of time. We recommend that, to the extent states utilize multiple audit firms, the Act provide that the state shall ensure that no more than one audit firm is authorized to audit a particular holder for a specified period of time.

12. State Notice/Filing Formats

The Institute recommends that the Act relieve any holder that has an obligation under federal law to search for a lost securityholder from sending a state-mandated notice prior to escheating a mutual fund account to the state. In addition, the Institute recommends that: (1) holders not be required to include any sensitive or non-public personal information in any due diligence letter or other notices sent to a property owner; (2) holders not be required to send any due diligence or other notices to an address the holder knows to be no longer valid; (3) states permit the use of electronic signatures on notices; (4) states eliminate any requirement that reports of abandoned property filed with the state be notarized; (5) states permit notices to be sent via first class mail or, for those property owners who have consented to electronic delivery of account information, via electronic delivery; and (6) states require that any data submitted to the state on an abandoned account be sent via secure means (*e.g.,* via a password protected website or an encrypted compact disk or other similar media).

Comments: As discussed above, SEC Rule 17Ad-17 under the Securities Exchange Act of 1940 imposes very specific responsibilities on federally-registered transfer agents (which includes all mutual fund transfer agents) to search for any lost securityholder. Accordingly, by the time the mutual fund has determined that the securityholder is lost for purposes of federal law, the mutual fund knows that the address it has on the owner of the account is not valid. As such, there would not appear to be any public interest served by requiring the holder of the mutual fund account to send a notice to a bad address. For this reason, we recommend that the Act recognize the steps already undertaken by federally-registered transfer agents and relieve such transfer agents of an obligation to send a due diligence letter to a bad address. With respect to our remaining recommendations:

- (1) and (2) are intended to better protect owners from potential identity theft consistent with our duty under the federal Identity Theft Protection Programs that all mutual funds are required by law to have;

- (3) would update the law to recognize the increasingly widespread use of electronic signatures;

- (4) would eliminate a vestige of the previous law that would appear to serve no public purpose today, particularly in light of the fact that a notarization does not vouch for the legitimacy or correctness of the information contained in a report but rather for the identity of the person signing the report;

- (5) is to avoid the expense associated with states imposing onerous requirements (*e.g.,* overnight delivery, certified/registered mail) in connection with sending out notices. We note, in support of this recommendation, that the IRS permits tax forms and tax information to be sent via first class mail; and

- (6), like (1) and (2), is intended to protect owners from potential identify theft. In addition, however, we note that under federal law, mutual funds (and all federally-registered financial institutions) have a duty to protect the non-public personal information of their customers, including shareholders, and are limited in how such information may be shared with third-parties, including states and their third-party auditors. Our recommendation is intended to ensure that, when information is transferred from the fund to the state or the state's auditor, the information is transmitted through secure means.

13. Statute of Limitations

The Institute recommends that, with respect to holders that are mutual funds, the Act limit states or state auditors seeking information on owners or accounts of owners whose property has been escheated to the state to a period of seven (7) years from the date the property escheated to the state.

Comments: This recommendation is to provide holders finality with respect to any legal actions resulting from an owner's account escheating to a state. We believe that seven years is a reasonable period of time based on the recordkeeping requirements imposed on mutual funds by both the Internal Revenue Service and the federal securities laws. (*See, e.g.,* SEC Rule 31a-2 under the Investment Company Act of 1940, which provides a six-year record retention period for records maintained by or on behalf of a mutual fund and SEC Rule 17a-4 under the Securities Exchange Act of 1934, which provides a six-year record retention period for customer account records maintained by broker-dealers.)

14. Confidentiality

The Institute recommends that states, or their representatives, that receive non-public personal information on any owner of property be required to maintain the confidentiality and security of such information to the same extent as the holder is required to do by law. The Act should also prohibit any auditor retained by the state from sharing any information obtained from a holder or in connection with an audit with any person other than the state on whose behalf the auditor conducted the audit. The Institute also recommends that, to the extent an auditor is the subject of a breach that might impact or compromise non-public

information obtained from a holder, the auditor should have a legal duty to notify the holder of such breach. Finally, the Institute supports the rights of states to share information among themselves as necessary to enable states to reunite owners with their property.

Comments: These recommendations are intended to ensure that, when states and auditors receive non-public personal information from a holder, they have the same duty to protect and preserve such information as the holder that provided the information to them. With respect to imposing upon auditors a duty to notify a holder of a breach, such requirement will enable the holder to take steps to protect shareholders' interest from potential identify theft. The Institute supports the provisions in the Act enabling states to share information with each other in order to facilitate reuniting owners with their property.

15. Voluntary Escheatment

The Institute supports holders having the ability to voluntarily escheat property to a state prior to expiration of a dormancy period, provided that the holder has determined that the owner of such property has, in fact, abandoned the account and voluntary escheatment would not adversely impact the owner's interest in such account.

Comment: Enabling holders to voluntarily escheat property would provide them the ability, in the event a shareholder cannot be found, to turn the property over to a state at an earlier date in the hopes that the state can locate the shareholder. Prior to doing so, however, we believe that the holder should be required to ensure that voluntary escheatment will not adversely impact the owner's interest in the property.

16. APO/FPO Addresses

The Institute recommends that all accounts with a valid APO or FPO or similar address, indicating the owner of the account receives U.S. mail via the Army Post Office or the Fleet Post Office, be exempt from the Act.

Comment: The use of an APO or FPO address indicates that the account is owned by active military personnel who, due to their service to this country, may be unable to take the steps necessary to prevent the escheatment of their property. As such, an account with such an address should be excluded from the states' escheatment authority. We additionally note that, to the extent the owner of the account dies intestate in a Veterans Hospital, the states' authority to escheat the property may be preempted by federal law.

17. Default State of Escheatment

The Institute recommends that with respect to intangible property, in the event the records of the holder do not reflect the last known address of the owner, the Act should provide that the property shall escheat to the principal place of business of the holder. In the event the principal place of business of the holder is not within the United States, such property shall escheat to the state where the holder is domiciled.

Comments: Currently, in the event the records of the holder do not reflect the last known address of the apparent owner and it is established that the holder is domiciled in a state, the property escheats to the state of the holder's domicile. With respect to mutual fund accounts, this becomes problematic because an owner may not know where the mutual fund is domiciled. Indeed, unlike operating companies, many of which are domiciled in Delaware, most mutual funds are organized as Maryland or Massachusetts business trusts, not as Delaware corporations. Likely the owner of an escheated account would not know, and therefore not attempt, to search for their mutual fund account in Maryland or Massachusetts. Instead, they may likely search for the property in the state that is the principal place of business of the mutual fund complex. With respect to mutual fund accounts, inasmuch as every holder would have one principal place of business, which would be readily apparent from regulatory filings with the SEC, an owner could easily determine the state to which an account was escheated. We believe that it is far more likely for an owner to be reunited with their property under our recommended approach than under the current Act.