sifma

*Invested in America*

October 14, 2014

Rex Blackburn, Co-Chair
Michael Houghton, Co-Chair
Revise the Uniform Unclaimed Property Act Committee
Uniform Law Commission
111 N. Wabash Ave.
Suite 1010
Chicago IL 60602

Re: SIFMA Recommendations to Uniform Law Commission on Update to Model Unclaimed Property Act

Dear Commissioners Houghton and Blackburn,

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to comment on the Uniform Law Commission's effort to update the Model Unclaimed Property Act (The "Model Act"). SIFMA brings the unique perspective of broker dealers and hopes to materially assist the Uniform Law Commission in this important endeavor. The following sections outline the comments and recommendations of SIFMA members to assist the Uniform Law Commission in drafting an updated model rule that addresses the broker dealer community's unique position and challenges.

SIFMA notes that, while the comment below follows the structure of the Model Act, the following two issues are particularly impactful to SIFMA members: First, the Model Act should include the recognition of the complex holder analysis in context of broker dealers, specifically as it relates to broker dealers relying on specialized "clearing" broker dealers to custody customer assets. Second, as broker dealers have customers throughout the United States and globe, the Model Act should include a dormancy period of no less than 5 years for securities to help drive a workable uniform dormancy period for securities throughout the United States. As outlined below, states with dormancy periods below 5 years (when controlling for the size of those State's economies) generally collect no additional unclaimed property, and, importantly, the shorter dormancy periods result in materially greater costs due to the states returning higher percentages of reported property to rightful owners.

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[1] The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org .

## A. *MODEL UNCLAIMED PROPERTY ACT DEFINITIONS*

1. ***Definition of "Owner"***
Model Act should include a securities custody relationship to the list of accompanying examples.

> (11) "Owner" means a person who has a legal or equitable interest in property subject to this [Act] or the person's legal representative. The term includes a depositor in the case of a deposit, a beneficiary in the case of a trust other than a deposit in trust, a securityholder in the case of an accountholder at a broker dealer who may or may not be the holder of the securities, and a creditor, claimant, or payee in the case of other property.

Comment: Current Model Act examples include deposits, but not securities. Additional specificity solidifies the understanding that contact with an intermediary broker dealer that is not the "holder" may drive dormancy and the application of the priority rules.

2. ***Definition of "holder" in the context of Broker Dealers***
The Model Act should better define the concept of "holder," specifically by more fully describing who is "obligated to hold for the account of, or deliver or pay to, the owner property that is subject to this [Act]" by listing examples and providing more definitional granularity. In the context of broker dealers, the holder should be defined as the entity delegated the responsibility under the SEC's customer protection rules as they relate to the safekeeping and segregation of customer assets.

Comment: "obligated" requires additional specificity to provide clarity to impacted entities in the financial industry. Holder analysis is more complex in the context of broker dealers for reasons that include, but are not limited to, the relationship between clearing broker dealers and broker dealers who use the services of clearing broker dealers. For example, in the financial industry, many broker dealers rely on specialized broker dealers called "clearing firms" to handle the operational aspects of securities processing, transfer and custody obligations. Broker dealers who rely on the services of clearing firm are known as "introducing brokers." These obligations may include, but are not limited to, trade processing, interacting with a central counterparty to transfer custody of an asset, as well as the maintenance of certain capital requirements necessary to perform certain asset custodian tasks, which are often highly regulated. The relationship between introducing brokers and clearing firms is contractual, and varies from relationship to relationship. As such, the analysis of who is a "holder" in the context of unclaimed property in the financial industry is more complex than in many other industries.

3. ***Adding "Broker Dealer" as a Definition***
SIFMA recommends the addition of a "*broker dealer*" definition with the same meaning as it is defined in §3(4) & (5) of the Securities Exchange Act of 1934.[2]

Comment: the Model Act definition section does not include specificity regarding the broker dealer business model.

4. ***Definition of "Address"***
The definition section should address the application of priority rules where there is a state of record, even in the absence of a bona-fide street address.

> Sec. 4 (1) the last known address of the apparent owner, as shown on the records of the holder, regardless of existence of bona fide street address, is in this State;

Comment: A valid state of record should be the minimum requirement necessary to determine the applicable state statute governing the right to escheat. There currently exists ambiguity regarding the level of completeness an address must contain to be considered "known" for the purposes of applying the priority rules.

## *B. PRESUMPTIONS OF ABANDONMENT*

1. **Importance of Model Dormancy Periods in the Act**
Section 2 of the Model Act is a particularly important section, as—regardless of the actual time periods included—it helps to promote uniformity among state dormancy periods, prevents inefficiencies, and minimizes unnecessary complications for the holders of property for interstate owners. The broker dealer community faces the specific challenge of serving diverse customers from many corners of the country and globe.

2. **Five Year Minimum Base Dormancy Period**
The Model Act should define a minimum base dormancy period of 5 years to promote efficiency, reduce the unnecessary burden on individuals who have their property needlessly escheated, and reduce the cost to and administrative burden on the states and businesses.

According to NAUPA, in 2011, 26 states had a 5-year base dormancy period and 24 states plus the District of Columbia had a 3-year base dormancy period.[3]

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[2] SEA 1934 §3(4)-(5)
[3] "State UP Program Claims Paid 3 vs 5 year Dormancy," NAUPA, Submission to the Uniform Law Commission Committee to Revise the Uniform Unclaimed Property Act, 2014. Available at: http://www.uniformlaws.org/shared/docs/Unclaimed%20Property/Comments%20-%20NAUPA.zip.

**DORMANCY AND UNCLAIMED PROPERTY CLAIM FLOW (2011)**[4]

| | Total Real Gross State Product[5] | Cash Received | Claims Paid ($) | % Paid Out |
|---|---|---|---|---|
| 3-Year States | $8.3T | $2.89B | $1.1B | 38% |
| 5-Year States | $6.6T | $2.88B | $846M | 29% |

As described in the above graphic, 5-year base dormancy states had economies that were 20% smaller, yet escheated roughly the same amount of assets, and did so with 31% greater efficiency.

Comment: SIFMA believes that a uniform 5 year base dormancy period for assets generally held in broker dealer accounts should be included in the Model Act for two reasons. First, the inclusion of a base dormancy period in the Model Act will provide consistency among the states and reduce the operational burden to the states and holders. The operational and legal challenge of tracking more than 51 dormancy statutes and rules is unnecessarily burdensome and, as outlined in the above table, often does not lead to more efficient escheatment of assets. Second, states, holders, and owners bear significant additional costs where the dormancy period is less than 5 years. When the dormancy period is less than 5 years, significantly more reported assets are returned to the rightful owner, "Claims Paid" in the above table. This increases costs on holders reporting the property; the state's administrative costs both in receiving and paying out property; and the customer, who may lose significant value when property, such as tax preferred securities or appreciating equity shares, are liquidated by the state to the owners detriment.

3. **Complex Custody Relationships**

Section 2 of the Model Act should explicitly state that where the same beneficial owner has multiple accounts with a holder, such as a clearing firm, through multiple broker dealers, if the Holder can reasonably cross reference across accounts of the same beneficial owner, the dormancy should be measured by the date of most recent qualifying activity in any account.

Comment: Of specific concern to broker dealers, there are instances where an owner has accounts with multiple broker dealers who custody assets with the same entity, generally a clearing firm. The act should provide flexibility for holders to cross reference activity in multiple accounts with the same beneficial owner connected to the holder through different broker dealers, when practicable. However, given the operational complexity of many of these relationships, the statute *should not* require this cross reference, as it may be unfeasible in certain circumstances.

[4] Chained 2009 dollars.

[5] SIFMA queried the U.S. Department of Commerce Bureau of Economic Analysis Interactive Data and compiled the referenced information. BEA Database is available at: http://bea.gov/itable/. Last queried October 3, 2014.

## C. ELECTRONIC COMMUNICATION

1. **Clarity Regarding "Other Means"**

Section 2 (15)(c) states " the owner has not communicated in writing or other means." The Act should expand upon "other means" to include the following modern form of communication:

- Any electronic means where an owner contacts a broker dealer through a means that is documented and authenticated, including, but not limited to, the following:
  - Owner generated e-mail;
  - Owner log-on to a secure web-site using unique owner password
  - Documented phone calls with Owner;
  - The successful completion of any wire or Automated Clearing House (ACH) transaction;
  - Owner's documented access of a mobile application;
  - Documented instant messaging or other electronic communication with an owner;
  - Documented Interactive Voice Response (i.e., interaction with automated telephone service) record of owner;
  - Correspondence from owner directed to a broker dealer; and
  - Electronic confirmation of a security movement though third party clearing entity (e.g., DTCC ID Confirms).

SIFMA notes that in many scenarios, the Owner is contacting a broker dealer who may not be the holder in the instance of complex custody relationships described above.

In addition, the Model Act should consider the non-return of tax documents (e.g., 1099), trade confirmations, and account statements contact for the purposes of determining dormancy.

Comment: "Other means" has the potential for wide interpretation. The Model Act should provide more specificity regarding what types of electronic communication qualify as "other means." Further, the Model Act should include within the concept of activity the contact of an owner with a broker dealer or other entity in complex custody relationships described above.

2. **Successful wire payment to owners account should constitute owner's interest in property**

Model Act Section 2(d)(i): with regard to defining client interest in a property, the Model Act should replace "evidence the distribution was received" with "evidence that a wire payment was delivered."

Comment: The Model Act should include more explicit language on what defines "evidence" with specific focus on wire payments. An account for which mail has returned undeliverable should not be considered escheatable if funds are successfully delivered to such an account, which would indicate an active account.

## D. WHEN A REQUIRED MINIMUM DISTRIBUTION IS DUE AND PAYABLE

Under the current definition of using the Required Minimum Distribution (RMD) date as a dormancy trigger, holders escheating certain tax-deferred assets (e.g., IRA , ROTH) are concerned that they may not be acting "in good faith" as required under the indemnity clause in the current Act. The Model Act should spell out that escheating tax deferred assets using the RMD date, where required, is within the definition of acting "in good faith," and thereby gives the reporting entity the indemnity offered by the Model Act.

Comment: Section 2 (14) states the RMD must be determinable by the Holder in order for it to become Due and Payable. However, any single Holder would not have access or knowledge of what other accounts the beneficiary may have, and thus could not make a determination which account would be required under US tax laws to take a distribution.

## E. DIFFICULT TO TRANSFER SECURITIES

1. **Freely Transferrable**

Section 8(b) of the Model Act should include the concept of "freely transferable". The Model Act should include that "securities that are not freely transferable to the state such as restricted, chilled, worthless, or lack a transfer agent, shall not be subject to state reporting until such a time the securities may become freely transferable."

(b) If the property reported to the administrator is a security or security entitlement under [Article 8 of the Uniform Commercial Code], the administrator is an appropriate person to make an indorsement, instruction, or entitlement order on behalf of the apparent owner to invoke the duty of the issuer or its transfer agent or the securities intermediary to transfer or dispose of the security or the security entitlement in accordance with [Article 8 of the Uniform Commercial Code], to the extent transfer of such

security is freely transferrable (e.g., restricted, chilled, worthless, no transfer agent).

Comment: Section 8(b) fails to include or discuss the inability of holders to transfer reportable property in a speedy manner or at all when hamstrung by certain operational challenges: restricted, chilled, worthless, foreign, no transfer agent. The transferability greatly impacts the broker dealer community due to the variety of securities that broker dealers hold on behalf of customers. The broker dealer community would prefer the option to not report such assets or place assets in an account in the states name with the broker dealer.

2. **Transfer exceeds value- Securities and FX**

To the extent the cost to the holders to transfer and/or liquidate otherwise reportable securities or foreign currency equals or exceeds the values of such securities or foreign currency, the Model Act should not require a holder to report this property.

Comment: While there is no materiality threshold in the escheatment of cash, because of the administrative costs of escheating securities, or the cost of converting FX balances, the materiality threshold for these property types should at least have a positive value after consideration of inherent administrative costs in the escheatment of these asset types. While certain other expenses are currently acknowledged by states, expenses specific to a broker dealer are absent, and these expenses are more material.

## F. STATE AS CUSTODIAN OF SECURITIES

Due to the unique nature of a security investment, and given that it is generally not a cash equivalent asset class, if the property being transferred to the administrator is a security or security entitlement, the administrator should return the same asset to the owner upon claim.

Comment: The protection of an owner's fully paid-for securities is a fundamental concept to the foundation and integrity of US Capital Markets. Owners of a security generally purchase securities under an expectation that vigorous securities laws will protect their property, and that there is no possibility of an unauthorized and arbitrary sale of their investment. Regardless of whether states choose to liquidate the shares in its custody, should a claim from the owner be made, the original quantity of securities, not the value of those securities at liquidation, should be returned to the rightful owner intact.

## G. OWNERS CONSENT TO "GIVE-UP" PROPERTY

The Model Act should acknowledge that a Holder need not report property where the owner has proactively, voluntarily, explicitly, and irrevocably requested to "give-up" all rights and claims of an asset. As the owner no longer has any legal claim to the asset, it should not be deemed as Due and Payable under section 2 of the Model Act.

Comment: Broker dealer customers often seek to divest worthless securities especially with regard to worthless securities that may be illiquid. SIFMA understands that states do not view their escheat program as an operational means for the proactive abandonment of assets that otherwise have little or no value. This should not to be misconstrued as "private escheat".

## H. REPORT DELIVERY

The Model Act should direct the use of a secure electronic portal for reporting, which should include ability to transfer files to the state electronically using industry standard security protocols.

Comment: Broker dealers have security concerns regarding the transmission of reports which contain non-public and personally identifying information (e.g., SSN, Date of Birth, Address, Tax ID) to states in potentially unsecure formats (e.g., compact disks).

## I. DESTRUCTION OF PROPERTY

Comment: As worthless securities in some instances realize value at a future point in time, often after many years, the timing of state destruction of worthless property should not be unduly short.

## J. AUDITS

Comment: SIFMA supports fair audits that respect relevant state laws and regulations. However, SIFMA members have material concerns with the manner in which many audits are executed. Specifically, SIFMA members are concerned with often unscientific and aggressive extrapolation of property due states where a holder does not have records beyond those required by relevant record retention laws and statutes, outlined below. The Model Act should address extrapolation, and encourages states to address extrapolation in an open and democratic manner. Auditors with a pecuniary interest in maximizing the property reported to the state should not have license to develop novel and bespoke extrapolation methods. To address these concerns, SIFMA suggest the development of a working group that brings together the broker dealer community with representative of the auditing community and the states to discuss books and records requirements and challenges specific to the broker dealer community.

## K. RETENTION OF RECORDS

The Model Act should align broker dealer record retention requirements with existing record retention requirements from the primary regulators of broker dealers SEC and SROs.

Comment: The primary regulators of broker dealers, the Securities Exchange Commission and Financial Industry Regulatory Authority, have very specific and regularly monitored rules regarding document retention period requirements and these dates do not align with the state unclaimed property rules and laws. Further, recordkeeping is a unique challenge to broker dealers due to the volume of sensitive data transmitted to customers in the form of statements, confirmations, and a myriad of other communications. As stated above, SIFMA suggest the development of a working group that brings together the broker dealer community with the auditing community and the states representatives to discuss books and records requirements and challenges specific to the broker dealer community.

## L. PENALTIES

The Model Act should outline fair penalties for failure to report that are designed to enhance compliance. These penalties should consider mitigating factors such as operational challenges. Further, as stated above, the Model Act should address extrapolation models, and stress that auditors and states should not use extrapolation as a form of penalty.

Comment: To the extent states are using penalties, they should be uniform, easy to understand, and applied with due process.

## M. Cybersecurity

The Act should include a new section dealing with requirements for maintaining the confidentiality of business records similar to those imposed on taxing authorities. As stated above, broker dealers have information security concerns regarding the transmission and storage of reports which contain non-public and personally identifying information (e.g., social security number, date of birth, address, tax identification number).

Comment: The security of private customer information is a paramount concern to broker dealers. Further, broker dealers have a legal responsibility to ensure private customer information is maintained securely for their customers per the provisions of the Gramm Leach Bliley Act (GLBA). Broker dealers expend significant time and resources to ensure sensitive customer data is stored and transmitted in a manner that protects it from unauthorized disclosure. It's our expectation that the states, once they obtain this information, will do the same. The Model Act should include effective and

documented state controls for the storage, request and transmission of highly sensitive consumer data.

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SIFMA appreciates the opportunity to comment on the Model Unclaimed Property Act. SIFMA looks forward to participating in the drafting process and would welcome the opportunity to discuss these comments with the ULC. If you have any questions, please reach out to me at (212) 313-1127.

Sincerely,

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