INVESTMENT COMPANY INSTITUTE

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December 29, 2014

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ULC Unclaimed Property Act Drafting Committee
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Mr. Michael Houghton, Co-Chair
ULC Unclaimed Property Act Drafting Committee
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P.O. Box 1347
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Mr. Charles A. Trost, Reporter
ULC Unclaimed Property Act Drafting Committee
c/o Waller Lansden Dortch & Davis, LLP
Nashville City Center
511 Union Street, Suite 2700
Nashville, TN 37219-1760

Sent via email

Re: ICI Supplemental Submission Relating to the Uniform Unclaimed Property Act

Dear Messrs. Blackburn, Houghton, and Trost:

The Investment Company Institute is writing to provide the members of the ULC Drafting Committee (the "Committee") on the Uniform Abandoned Property Act (the "Act") additional input regarding revisions to the Act. The Institute's goal in working with the Committee on this very important initiative is to ensure, as much as possible, that the Act does not adversely impact the interests of mutual fund shareholders. Indeed, we want to ensure that when mutual fund shareholders who are saving for retirement, education, or a rainy day decide to access their account assets, their money will still be there for them. Accordingly, we very much appreciated having the opportunity to participate in the Committee's November 2014 meeting to provide testimony on behalf of mutual fund shareholders.

TENTATIVE COMMITTEE DECISIONS FROM THE NOVEMBER MEETING

Before turning to those issues that the Committee is still deliberating, we would first like to commend the Committee for some of the tentative decisions it made during the November meeting. These tentative decisions include, among others:

- **ABANDONMENT TRIGGER FOR MUTUAL FUND ACCOUNTS:** With respect to Issue 23 relating to the abandonment of an account, the Committee voted to conform the presumption for the abandonment of mutual fund accounts to the standard set forth in Rule 17Ad-17 of the U.S. Securities and Exchange Commission ("SEC") under the Securities Exchange Act of 1934. Pursuant to this rule, an owner of a securities account is deemed to be a "lost securityholder" if (1) at least two pieces of mail sent to the shareholder's last known address are returned to the holder as undeliverable and (2) the holder is unable to obtain a valid address on the owner of the account after conducting a mandatory search of at least two national databases within a specified period of time.[1] As noted in our previous submissions to the Committee,[2] we believe this is the appropriate presumption for mutual fund accounts in light of the obligation mutual funds have under the Federal securities laws to provide to their shareholders specified account information at least quarterly. As a result of this requirement, mutual funds are readily able to determine through a "returned mail" trigger when the holder no longer has a valid address on an owner of an account. By contrast, when the states utilize a "no contact" standard as the trigger for deeming an owner lost, our members have encountered situations where they have a valid address on an owner but are forced by state law to escheat the property because the owner of the account has not affirmatively contacted the fund company. This result is particularly troublesome – and adverse to the interest of shareholders – when the account is a long-term retirement or education savings account. Accordingly, we very much appreciate the Committee's proposed resolution of Issue 23 as it is in the best interests of mutual fund shareholders.

- **STOCK V. SECURITY:** The Committee acknowledged that the term "stock" as used in the Act needs to be broadened, where appropriate, to "securities." As noted during the meeting, because a share of a mutual fund represents a shareholder's pro-rata interest in a portfolio of securities, not an ownership interest in a company, mutual fund shares do not constitute "stock," but they are securities. Among other places, this issue arises in connection with the definition of "Property" in Section 1 (13)(iii) of the Act, in Section 2's presumption of abandonment, and in connection with Issue 36 relating to the voluntary escheatment prior to dormancy.

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[1] While there is no escheatment of property under the Federal securities law, a transfer agent must report to the SEC regarding its number of lost securityholders.

[2] *See* Letters from the undersigned to Messrs. Blackburn, Houghton, and Trost, dated July 14, 2014 and April 21, 2014.

- **TREATMENT OF RETIREMENT ACCOUNTS:** With respect to IRA accounts and other tax-advantaged retirement accounts, the Committee voted for the Act to provide that such accounts shall not be presumed abandoned until ten years from the *later* of (1) the date a mailing to the owner was returned by the U.S. Post Office as undeliverable (unless a subsequent mailing to the owner was not so returned); (2) the date of last contact by the owner with respect to the securities; and (3) the date, if determinable by the holder, that the owner of the account reaches age 70½. This provision was recommended by the American Bar Association ("ABA") and supported by the Institute. In our view, this provision will benefit investors by avoiding the premature escheatment of retirement accounts.

- **CONFIDENTIALITY:** The Committee supported strengthening the confidentiality provisions in the Act to protect the privacy interests of owners. (Issue 76). While we support the Committee's action (which was recommended by the Institute), as discussed below, we recommend revisions to the provision adopted, which was advanced by the National Association of Unclaimed Property Administrators ("NAUPA"). Such revisions are necessary to avoid this provision being read to prevent a state administrator from sharing information resulting from an audit or examination of a holder's records *with the holder*. This result, which seems inappropriate, could impact a holder's due process rights.

- **ELECTRONIC COMMUNICATIONS.** We support the Committee revising provisions within the Act to accommodate electronic notices and communications. This issue arises in connection with Issues 39-41, which relate to Sections 9 and 12 of the Act.

<u>REMAINING ISSUES IMPACTING MUTUAL FUND SHAREHOLDERS</u>

Participants at the November meeting of the Committee were encouraged to submit additional comments regarding the issues being considered as part of this process. In response to that request, the Institute is submitting this letter to highlight the remaining issues that may adversely impact mutual fund shareholders. The following comments are intended to supplement the comments we previously provided to the Committee in our earlier submissions and to impress upon the Committee the importance of these issues to mutual fund shareholders.

I. Escheatment of 529 Plans [Issue 23]

Institute Position: The Institute continues to advocate longer dormancy triggers for 529 plan accounts, which are used to save for qualified higher education.

Discussion: At the recent meeting, the Committee determined to accept the ABA's proposal regarding the escheatment of 529 plans as a placeholder pending additional commentary. The ABA has recommended that, with respect to 529 plan accounts, the securities become presumed abandoned ten years from the *later* of (1) the date a mailing to the owner was returned by the U.S. Post Office as undeliverable (unless a subsequent mailing to the owner was not so returned); (2) the date of last contact by the owner with respect to the securities; and (3) the date, if determinable by the holder, that the owner of the account reaches age 85. While the Institute is not wedded to use of age 85 as a trigger, we support a long period of abandonment for these accounts inasmuch as they may be used throughout a person's life to pay for qualified higher education. In our previous submission to the Committee, the Institute recommended the abandoned trigger be 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. We continue to support this recommendation. Alternatively, we support the recommendation of the Unclaimed Property Professionals Organization ("UPPO") that the definition of "property" in Section 1(13) of the Act be revised to expressly exclude 529 plans.

II. Confidentiality of Information [Issue 76]

Institute Position: The Institute supports the confidentiality provision added to the Act by the Committee but recommends it be revised to provide holders access to information provided to the state administrators relating to an audit of such holder.

Discussion: As noted above, at the recent meeting, the Committee was supportive of including a provision in the Act relating to preserving the confidentiality and security of any information an administrator obtains. In particular, the Committee seemed supportive of NAUPA's proposed confidentiality provision. While we continue to support the Act including a confidentiality provision, upon further review of the NAUPA provision, we note that it would *preclude a holder that has been subject to a state audit from obtaining information from the state regarding such audit*. This is because the NAUPA provision would only permit the sharing of information with an apparent owner (or a person legally acting on the owner's behalf), state or Federal agencies, or other state administrators. By not providing an exception for holders, this provision is far too limiting and could adversely impact the interests of such holders. We see no reason why a holder that has been subject to an audit should be unable to obtain information relating to the audit that was provided to the state inasmuch as there should be no privacy or confidentiality concerns arising from such sharing. Accordingly, we strongly recommend, in connection with Issue 76, that the exceptions listed in proposed new subdivision (b) include "the holder holding the property presumed to be abandoned." This recommendation is consistent with the discussions of the Committee under Issues 51, 52, and 71 relating to providing holders due process rights under the Act.

III. Determinations of Holders' Liability [Issue 51]

Institute Position: The Institute supports the Act requiring an administrator to make a determination of a holder's liability in order to facilitate the holder's exercise of their due process rights.

Discussion: The Institute supports the Act expressly providing legal recourse, through an administrative or judicial proceeding, regarding determinations of a holder's liability. To facilitate this process, we concur with the recommendation of the American Council of Life Insurers ("ACLI") that the Act include a provision requiring states to make findings regarding a holder's liability. Such findings are crucial to a holder's legal recourse to challenge the findings. We also support the recommendation of Alston & Bird that the Act provide holders the option of challenging such findings through either an administrative or a civil proceeding.

IV. Opt Outs/Waivers [Issue 23]

Institute Position: The Institute continues to strongly support the Act enabling owners to waive application of the Act to the owner's property.

Discussion: The Institute continues to strongly support the Act including an express provision that will permit owners of property – particularly owners of financial accounts – the ability to waive, via a contract with the holder, the protections of any and all states' Acts. [Issue 23] We believe such a provision is necessary to provide owners of financial accounts control over the disposition of their accounts and enable them to avoid being adversely impacted by the states' escheatment laws. As noted in our previous submission, to protect owners from undue influence by holders, we fully support the states imposing reasonable conditions on the disclosures that must be provided by a holder to an owner when entering into a waiver contract.

V. Purpose Section

Institute Position: The Institute supports the Committee including a "purpose" section in the Act and recommends that all sections in the revised Act be consistent with the Act's stated purpose.

Discussion: The Institute is pleased that the Committee is considering including a "purpose" section in the new Act, which will provide that the purpose of the Act is to protect the interests of owners and facilitate the return of unclaimed property to the rightful owner. Should the Committee include such a provision in the Act, we believe that every section of the Act should be consistent with the Act's purpose. So, for example, the Act should not enable states to refuse to accept property that is subject to escheatment under the Act. While NAUPA noted during the recent meeting that states would like the ability to refuse to accept property if it would cost the state more to accept the property than the property is worth, this seems inconsistent with the role of state administrators under the Act. Indeed, if the purpose of the Act is to reunite lost property owners with their property, the costs to the state of accepting abandoned property should be irrelevant. Moreover, as noted at the recent meeting, the states may have greater resources available to them to locate lost owners and therefor may have greater success in finding the property's owner than the holder of the property.

VI. Imposition of Regulatory Requirements Through the Unclaimed Property Law [Issue 4]

Institute Position: The Institute opposes the Act being a vehicle for states to impose on financial services firms regulatory requirements that more properly fall within the purview of such firms' primary regulators.

Discussion: During the recent meeting there was a detailed discussion regarding life insurance proceeds and whether the Act should impose upon life insurance companies a duty to utilize the Death Master File ("DMF"). While this discussion was wholly focused on life insurance, the Institute strongly opposes the Act authorizing state unclaimed property administrators to impose upon financial services firms – including insurance companies, mutual fund companies, broker-dealers, and investment advisers with custody of customers' assets -- substantive duties that are unnecessary to identify, report, and escheat abandoned property. In our view, it is wholly inappropriate for unclaimed property administrators to use their authority under the Act to impose upon financial services firms substantive legal requirements regarding their operations when such requirements exceed those imposed by such firms' primary regulators.

Of particular concern to the Institute is that these new regulatory standards appear to be coming from contingent-fee auditors and directed towards increasing the amount of money they derive from escheated property. These demands are not being made in the interest of protecting shareholders who are owners of property. We are quite concerned that these demands are spreading beyond the insurance companies to mutual fund companies. Indeed, we are aware of such companies being told by contingent-fee auditors that they must *prove that a shareholder is alive*, if the shareholder's name appears on the DMF. This is of significant concern to the Institute for three reasons:

First, *mutual fund companies have no obligations under any of the four Federal securities laws and each of the states' securities laws that govern their operations to prove that shareholders are alive*. In our view, it is inappropriate for state administrators through their contingent-fee auditors to be imposing these additional demands;

Second, these requests wholly ignore the states' triggers for presuming property abandoned. Depending upon the state's law, property is deemed abandoned using a returned mail or "no contact" standard. Neither standard required the holder to prove a shareholder is alive; nor are we aware of any state that uses a standard for deeming property abandoned that requires the holder to affirmatively determine and document that every owner is, in fact, alive.

Third, as noted in other submissions to the Committee, the DMF has serious accuracy issues and is not a reliable source of death information. [*See Life Insurance, Unclaimed Property and the Death Master File; Toward a Uniform National Framework.*] While mutual fund companies utilize the DMF in connection with fraud inquiries, *they do not rely on the DMF as a reliable source of information.* Instead, if they get a "hit" on the DMF, they utilize other means to determine the validity of information obtained for the DMF.

The Institute opposes the Act being used to further the interests of contingent-fee auditors – at the expense of mutual fund shareholders and other owners – by authorizing states to mandate use of the DMF. In our view, the Committee should consider the potentially significant costs to holders and owners resulting from mandated use of the DMF. These costs not only include the costs to shareholders from the risks of premature escheatment of long-term accounts, but also the costs to holders that would be associated with such a requirement. In light of the of the fact that there are over 90 million mutual fund shareholders, attempting to impose additional regulatory requirements though the states' abandoned property laws will result in significant costs to an already heavily-regulated industry. And yet, because these demands are being made outside of any formal legislative or rulemaking process, the public – including shareholders and the holders of their accounts – are denied the ability to provide public commentary on these new demands. We strongly encourage the Committee to avoid including anything in the Act that could result in mandating that holders search the DMF and affirmatively prove that those owners whose names appear on the DMF are, in fact, alive.

VII. Contingent-Fee Auditors [Issue 60]

Institute Position: Due to the abuses and conflicts of interest associated with paying third-party auditors on a contingent-fee basis, the Institute recommends that the Committee give additional consideration to the Act banning or imposing conditions upon the use of contingent-fee arrangements with third-party auditors.

Discussion: The Institute continues to oppose the Act accommodating states paying third-party unclaimed property auditors on a contingent-fee basis. While we appreciate that states may not have the resources to conduct their own audits, we fail to understand why, in retaining auditors, states appear to have defaulted to paying such auditors on a contingent-fee basis. In support of the Act not prohibiting or limiting contingent-fee arrangements with third-party auditors, NAUPA has raised two arguments.

NAUPA's first argument is that, because these auditors are not paid by the owners of escheated property, the use of contingent-fee auditors is not adversely impacting such owners. We respectfully, and strongly, disagree with this view for two reasons. First, the exorbitant fees being paid to these firms are coming from some source of revenue. If it is not from the owners directly out of the escheated property, it is being paid by them – and other citizens -- out of the public fisc. Second, while owners may not be paying the auditors directly, this does not mean they are not adversely impacted by such auditors in other ways. Based on our members' experience with such auditors, the auditors take very aggressive stances on behalf of the states. One recent article noted that the contingent-fee auditors used by the states "are known for taking liberties with unclaimed property laws, harassing holders and inflating the values of assessment."[3] And yet, when the Institute (and others) have contacted the states' unclaimed property administrators to discuss the application of the states' laws that these auditors are attempting to enforce – *the state administrators are unable to explain the specific provisions of their law applicable to mutual fund accounts (including retirement and IRA accounts) and, instead, defer to the judgment of their third-party auditors.* While we heard at the recent meeting that the states are "in the driver's seat" on these audits and the auditors take their direction from the states, the Institute has found on more than one occasion that this, in fact, is *not* the case and states are, in fact, deferring to the judgment of their third-party auditors. Accordingly we respectfully disagree that the fees paid to these auditors are not costing the state anything.

NAUPA's second argument is that, if the states are unable to pay auditors on a contingent-fee basis, they would be unable to attract auditors. To our knowledge, however, NAUPA has not provided any evidence supporting this claim. Nor has NAUPA explained, particularly in the current economic environment, why auditors would be unwilling to work in return for fair and reasonable compensation. In our view, the tens of millions of dollars paid by the states to contingent-fee auditors on an annual basis do not constitute fair and reasonable compensation.[4]

Should the Act accommodate states paying abandoned property auditors through the use of contingent-fee agreements, the Institute concurs with NAUPA's recommendation at the meeting that the contingent-fee arrangements with such auditors be subject to public disclosure.

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[3] *See "An End to the Madness? Delaware Bill Introduced to End Contingent Fee Unclaimed Property Audits,"* Inside Salt, McDermott Will & Emery (May 20, 2104), which is available at: http://www.insidesalt.com/2014/05/an-end-to-the-madness-delaware-bill-introduced-to-end-contingent-fee-unclaimed-property-audits/.

[4] According to a recent article regarding the fees paid by one state, Delaware, to Kelmar, a firm that conducts contingent-fee audits on behalf of the state: "In fiscal year 2013 . . . Kelmar received more than $53 million in state work. The next highest-paid state auditor last year earned just $2.2 million." *See "Abandoned Property: Millions for Markell-linked firms,"* Jonathan Starkey, *The News Journal* (May 20, 2014), which is available at: http://www.delawareonline.com/story/news/local/2014/05/17/sunday-preview-markell-supporters-reap-millions-state-work/9218179/.

Additionally, however, we continue to believe that the Act should impose conditions on such agreements along the lines of those recommended by the Institute and others under Issue 60 in order to address the abuses and conflicts of interest associated with such agreements.

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We very much appreciate the opportunity to share these additional comments with the Committee. We look forward to attending the February meeting of the Committee and contributing to the discussion of the remaining issues to be resolved. In the meantime, if you have any questions concerning our comments or recommended revisions, please do not hesitate to contact me. I may be reached by phone (202-326-5825) or email (tamara@ici.org).

Regards,

/s/

Tamara K. Salmon
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