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### What Boards Should Know About Shareholder Escheatment

By **Bruce Treff** and **Jennifer English\***



*Bruce Treff*

The Dodd-Frank Wall Street Reform and Consumer Protection Act requires the Securities and Exchange



*Jennifer English*

Commission to revise its regulations that apply to a transfer agent's search for certain missing fund shareholders by amending Section 17 of the Securities Exchange Act of 1934. The revised regulations were required by July 21 (along with many other required rulemakings under the Dodd-Frank Act) but the SEC has not yet adopted them. The SEC proposed amended Rule 17Ad-17 under the Exchange Act earlier this year, which forms the basis for this article. The SEC has proposed that transfer agents be given a year to comply with any final regulations because they will likely need time to develop or modify their systems.

One of the Dodd-Frank Act's overarching objectives is investor protection. The Proposed Amended Rule's stated objectives are "to help reduce the number of lost and missing securityholders and to further the [SEC's] mission of protecting investors. Essentially, the Proposed Amended Rule would reunite shareholders with their property in the form of fund shares before this property is transferred (or escheated) to the appropriate state. The SEC has

focused on this area in the past. In 1997, the SEC adopted a rule designed to protect investors in situations where transfer agents have lost contact with investors (referred to within the rule as "securityholders").

Currently, Rule 17Ad-17 under the Exchange Act requires transfer agents to conduct database searches for lost securityholders, or those shareholders who may no longer receive either communications from a fund or its service providers or interest and dividend payments. Generally, shareholders most commonly lose contact with funds when they either fail to notify a fund's transfer agent of a corrected or new address or if a deceased shareholder's estate fails to provide a fund's transfer agent with the name and address of the estate's trustee.

The Proposed Amended Rule adds the concept of "missing securityholder." Section 17A(g)(1)(D)(i) of the Exchange Act provides that a shareholder is considered to be a "missing securityholder" if a check sent to the shareholder is not negotiated before (i) the transfer agent sends the next regularly scheduled check or (ii) six months after sending a non-negotiated check, whichever happens first. If a check is not negotiated by a "missing securityholder," a transfer agent must notify them that a check has been sent that has not yet been negotiated. This notification must occur in writing no later than seven

months after the non-negotiated check was first sent. If the value of the non-negotiated check is less than \$25, no notice needs to be sent.

The Proposed Amended Rule would require that transfer agents maintain records necessary to demonstrate compliance with the amended rule, as well as maintain written procedures that describe their methods for compliance.

Such procedures will be of interest to fund directors. Transfer agents are one of several service providers for which fund boards must adopt compliance policies and procedures under Rule 38a-1 of the Investment Company Act of 1940, as amended. Specifically, funds are required to “[a]dopt and implement written policies and procedures reasonably designed to prevent violation of the Federal Securities Laws by the fund, including policies and procedures that provide for the oversight of compliance by [the] ... transfer agent of the fund.” These policies and procedures (or a third-party report that describes the service provider’s compliance program as it relates to the types of services provided to the fund, discuss the types of compliance risks material to the fund, and assess the adequacy of the service provider’s compliance controls) must be approved by the fund’s board of directors, including a majority of directors who are not interested persons of the fund. This approval must be based on a finding by the board that the policies and procedures are reasonably designed to prevent violation of the Federal Securities Laws by the fund’s transfer agent.

Directors will want to ensure that their fund chief compliance officer is aware of any new rules with respect to the operation of the policies and procedures of the fund’s transfer agent. Fund CCOs will need to consider amendments to procedures made in accordance with final rules as they are changes to the transfer agent’s policies and procedures. If these changes are deemed material, CCOs must include a summary of the changes in their annual report to the board.

Transfer agent CCOs should also incorporate final

rules into their testing scripts and monitor the day-to-day implementation of related policies and procedures. For example, a transfer agent’s CCO might want to ensure that his or her organization (i) understands rulemaking and legislation (at the state and federal level), (ii) adopts and implements any necessary and appropriate procedures, (iii) trains staff members who are responsible for following said procedures, (iv) ensures that systems are operating, as necessary, and (v) maintains appropriate records to demonstrate compliance with the applicable regulatory requirement.

As required by the Dodd-Frank Act, the Proposed Amended Rule would have no “effect on state escheatment laws.” Each state has its own laws regarding unclaimed property and funds must comply with the laws of all states in which it has shareholders (technically, there are 54 jurisdictions of which a fund may need to be aware). Recently, as states face budgetary issues and, in some cases, economic crisis, they have increasingly looked to unclaimed property as a potential source of revenue and entities that must comply with state escheatment laws have progressively seen more audit and rulemaking activity.

One example of state activity that directly impacts funds is a recent amendment to California’s unclaimed property law. As of January 1, 2011, funds were required to notify fund shareholders at the time of account opening “that his or her property may be transferred to the appropriate state if no activity occurs in the account within the time period specified by state law.” Some funds have included this language in their prospectus, some have included it in their account opening documents and others have included the language in both places.

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*\*Bruce Treff is a managing director and Jennifer English is a senior v.p. of Citi Investor Services. Their views may not represent the view or opinion of Citigroup or any affiliate and are not intended to be legal advice.*