Unclaimed Property

The Need For Federal Action

Summary

Certain states escheat—take custody of—their citizens' supposedly lost securities and securities accounts too readily, partially to bolster state revenues. This impairs the ability of those citizens to plan for their financial futures. Federal action is needed to solve this problem.

Our Recommendation

We recommend establishing a federal definition of "lost securities owner" to ensure state laws cannot permit the premature escheatment of securities. This would require states to verify that a securities owner is actually "lost" or has abandoned their account prior to escheatment.

Additionally, a federal standard for payment of post-escheatment claims made by securities owners would guarantee that owners are entitled to the fair market value of their securities, including applicable income and dividends, at the time a claim is made.

The Unclaimed Property Landscape: An Introduction and Background

When securities escheat to a state, the state will in most cases liquidate the securities to support the state's operating revenue. And when securities owners, who are frequently investors for long-term savings purposes, attempt to claim their property from a state, they typically are able to receive only the value of their securities at the time of escheatment, having lost out on any appreciation and income that would have occurred had the securities been left intact.

State laws that govern the escheatment of property are intended to ensure that holders of property do not harm owners by misappropriating the property for the holder's own use. These state laws are also intended to help reunite owners, or their heirs, with their property. States are supposed to act as custodians, holding owners' property for safekeeping to protect owners. Escheatment of property to states under state laws provides property owners with a single central place to search for, claim, and be reunited with their property. These laws also allow states to utilize the property value, on a temporary basis, in support of states' budgets—which is part of the reason for the aggressive approach to unclaimed accounts we have seen in recent years.

Unclaimed Property Mechanics

There are two prevalent triggers used by states in their abandoned, unclaimed, or lost property laws to deem a securities owner lost:

1. *Returned mail*—A securities owner will be considered lost only after mail is returned as undeliverable and a certain period of time has passed (the "dormancy period"). During the dormancy period, holders have an obligation to attempt to locate owners.
2. *Inactivity or no contact*—A securities owner is automatically deemed lost after not affirmatively contacting or interacting with a holder during the applicable dormancy period. In some states the dormancy period is as short as three years.

The Risks to Securities Owners

When an inactivity standard applies to escheatment of securities, securities owners face the risk of states taking owners' property prematurely. Some states' inactivity standards are overly stringent—for example, not including certain customer-initiated transactions (e.g., automated purchases and systematic withdrawals) in their definitions of "activity" and/or "contact."

Laws that apply an inactivity standard harm securities owners who do not actively interact with their investment accounts on a periodic basis but are not truly lost.

State laws that are constructed to allow for escheatment of securities to occur too readily cause real financial harm to securities owners instead of protecting them. When securities escheat to a state, the property is typically liquidated, which frequently leaves securities owners with a claim only for the value of the property at the time of escheatment. In the case of investments held for the purpose of long-term savings (e.g., retirement or education), the harm to the owner can be financially devastating.

Escheatment, and subsequent liquidation, takes the investment/redemption decision away from a securities owner and causes that owner to lose out on potential investment gains and income.

The Need for a Federal Definition of "Lost Securities Owner" and a Federal Standard for Payment of Post-Escheatment Claims

A number of state laws include an inactivity standard, and there has been momentum in recent years among states to change securities escheatment triggers under state law from returned mail to inactivity. States are incentivized (by the prospect of increased revenue) to make it easier for property to escheat.

Additionally, many states utilize contingency fee audit firms to audit holders' compliance with state unclaimed property laws. Audit firms are motivated to apply the most stringent interpretation of the escheatment standard available to them under a state's law, as it increases the fees they collect, which are typically assessed as a percentage of the remitted property proceeds. This gives rise to an inherent conflict because using an inactivity trigger for securities prioritizes a state's own interest in increasing revenue ahead of protecting securities owners.

Once securities are escheated to a state, securities owners face an additional risk of harm. States typically liquidate securities shortly after escheatment. A post-escheatment claim for securities might be made many years in the future, long after the state has liquidated the account and used the proceeds for its benefit. The more time that passes, the more potential harm a securities owner will incur, as they normally expect an investment to grow over time and potentially to earn income and dividends.

The Bottom Line

A federal standard is needed to prevent investor harm.

A federal definition of "lost securities owner" that includes a trigger of returned mail or unsuccessful delivery to deem owners of securities to be lost would ensure that investors are protected from a state's financially driven incentives. Thus, as long as a holder has a valid address (either a physical address or an electronic address, for owners who have elected for e-delivery of correspondence) for a securities owner, the securities would not be subject to escheatment under any state's law.

The only securities that would escheat to a state would be those for which a holder does not have a valid address for the securities owner for the duration of a state's applicable dormancy period. Such a federal standard should also require the payment of fair market value at the time of a claim, including applicable income, to the securities owner to alleviate the harm caused by a state's liquidation of escheated securities.

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