

Escheatment and Unclaimed Property: How Shareholder Property is Turned Over to the States

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Executive Summary

Escheatment, the transfer of unclaimed property to US states and territories, is a complex undertaking for issuers and their transfer agents. Every year, issuers must file a separate report for unclaimed property for each state, most of which have differing requirements. Currently, states are holding at least \$35 billion in unclaimed assets, and it has been estimated that only 5% to 20% will ever be claimed.¹

This white paper provides an overview of escheatment related to the securities of registered shareholders, covering “lost” shareholders, varying state dormancy periods and due diligence requirements. While escheatment can apply to any type of holding, such as a bank account, this white paper focuses on securities-related assets such as stock and the cash associated with dividends.

Overview of the Escheatment Process

The 50 United States, Puerto Rico, Washington DC and the US Virgin Islands, collectively referred to throughout as the “states,” require that financial institutions, issuers and their transfer agents report when property is deemed to be “unclaimed” – also known as being “abandoned.” This property may be considered unclaimed based on the age of an outstanding check, unissued credit or due to the inactivity on an account.

In addition, some states also require that the shareholder of the property be considered “lost” – that the holder’s whereabouts are unknown during or at the end of the dormancy period.

In all cases, shareholders’ property may be escheated only after a period of inactivity passes on the account or asset. This “dormancy period” varies in length by each state.

Issuers and their transfer agents must conduct various due diligence mailings and database searches prior to the property being escheated, as required by the states or the Securities Exchange Commission (SEC).

After due diligence requirements have been satisfied, the issuer and its transfer agent file unclaimed property reports with the states and the property is turned over to the appropriate state.



¹ National Association of Unclaimed Property Administrators

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Escheatment and Unclaimed Property

Modern-day escheatment laws have their roots in English feudal laws, which dictated how land was returned to the crown. In the United States, escheatment laws similarly addressed tangible property such as real estate, but then grew in scope to include “intangible property” such as securities and dividends. Other types of intangible property include:

- > Unclaimed payroll checks
- > Dormant bank accounts
- > Dormant life insurance policy payouts
- > Bonds and interest
- > Traveler’s checks
- > Unused gift cards and retail vouchers
- > “Tangible” contents of unclaimed bank safety deposit boxes

Laws for unclaimed property differ from state to state, with many states basing their laws on one of the Uniform Unclaimed Property Acts. A small number of states have not followed this lead and base their laws on less recent statutes, which are antiquated in some cases. In general, the objectives of the laws are to:

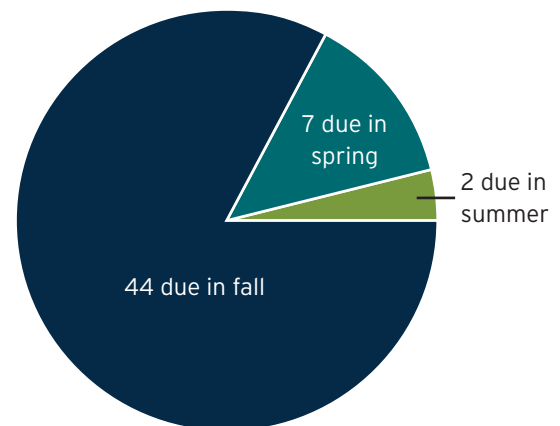
- > Reunite owners with property that is rightfully theirs
- > Protect the entity that transfers the property to the state from claims by the owner after the property is escheated
- > Ensure that any economic windfall is for the benefit of the citizens of the state and not the entity holding the unclaimed property

Filings must be prepared for each issue for each jurisdiction: the 50 United States, Puerto Rico, Washington DC and the US Virgin Islands. Some jurisdictions require reports known as “negative reports” when there is no property to be escheated, while others do not.

Securities property is ceded to each jurisdiction once a year, with seven jurisdictions receiving reports in spring, two in the summer and forty four in fall.

The last known state of residence of the property owner determines which state or territory has jurisdiction. If the owner’s address is unknown or the holder lives outside the US, the state of incorporation of the issuer is used to determine jurisdiction.

Reporting Due to States by Season



Lost Shareholders

Shareholders are considered to be “lost,” as defined by SEC Rule 17Ad-17, if:

- > Two successive pieces of mail are returned as being undeliverable within one month
- > The shareholder’s new address has not been received

Currently, 13 “lost states” require that the shareholder be lost prior to escheating their unclaimed property. “Non-lost states” do not require that mail to the holder be returned – property may be escheated solely as determined by dormancy and its unclaimed status. There are currently 40 non-lost states – this number has continued to increase as states have reinterpreted their statutes.

Once a shareholder is deemed lost, the SEC requires that the transfer agent perform a database search in order to find the shareholder’s new address, as described in the “SEC Search Requirements for Lost Shareholders” section found on page 6.

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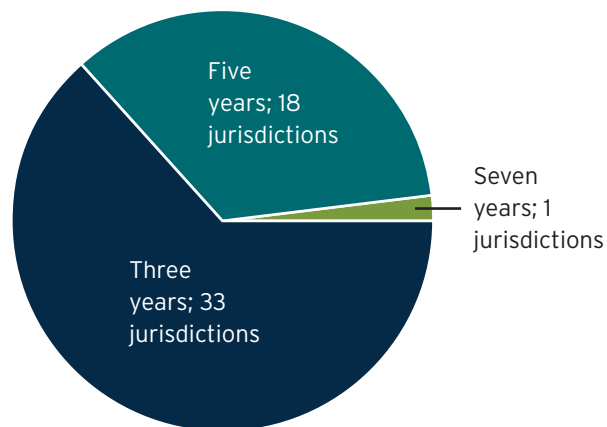
Dormancy Period and Last Contact Date

Shareholders' property may only be escheated after a period of inactivity passes on the account or asset. This "dormancy period" varies in length by each state.

There recently has been a trend for states to shorten their dormancy periods in order to accelerate the transfer of property to the state. Current dormancy periods are:

- > Three years: 33 jurisdictions
- > Five years: 18 jurisdictions
- > Seven years: 1 jurisdiction

Current Dormancy Periods



Dormancy periods start when the last contact from the shareholder is made. However, the type of shareholder action that constitutes a valid contact and "starts the clock" for the dormancy period also varies by each state's law.

State escheatment laws generally include some description of what type of contact can be used to determine the last contact date and thus when the dormancy period begins, but laws are not always clear or complete. Many statutes were written before the advent of modern communication systems, and often do not address telephone or Web/email use, which have been accepted in practice by state auditors as valid contacts.

Types of shareholder activity that can determine the last contact date include:

- > Cashing a distribution check or having a distribution credited to a bank account
- > Sending in a piece of correspondence that can be validated as coming from the shareholder or legal representative
- > Transferring shares into or out of an account (not including shares allocated as a result of dividend reinvestment, split or spin-off)
- > Voting a proxy
- > Making telephone calls – IVR or agent assisted – that can be validated as being from the shareholder or legal representative
- > Accessing a website where it can be validated that the contact is from the shareholder or legal representative

Within the 13 lost jurisdictions, dormancy requirements vary: Five lost jurisdiction requires escheatment only in cases where the account has been flagged as lost for the full dormancy period. The remaining 8 lost jurisdictions allow the property to be escheated as long as the account is flagged as lost by the time of the dormancy cut-off date.

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Due Diligence Mailings for Unclaimed Property

For property deemed unclaimed, states require that a “due diligence” mailing be sent to property owners before their property is escheated. The objective is to give notice that property will be turned over to the state unless the owner responds. These mailings are not required if the value of the property is under a certain amount, as determined by the state.

Puerto Rico does not require this mailing; Delaware and Pennsylvania formerly did not require a due diligence mailing, but recently updated its statute to join those who require it.

Property holders may return the due diligence notice or make contact with the issuer or its transfer agent by other means during the response period – typically within 30 to 45 days – in order to have the holder’s records updated and property retained.

States generally do not require due diligence mailings to be sent to shareholders who are lost or whose accounts have a known bad address.

SEC Database Search Requirements for Lost Shareholders

SEC Rule 17Ad-17 requires recordkeeping transfer agents to “exercise reasonable care” to ascertain the correct address of “lost securityholders.” To help fulfill these requirements, once a shareholder account is flagged as lost, transfer agents conduct two database searches:

- > The first SEC-required search is required within three to 12 months.
- > A second SEC-required search must be completed within six to 12 months after the first search, if the first search was unsuccessful.

If a new address is not located as a result of the two mandated searches, the SEC requirements have been satisfied. Certain accounts are excluded from SEC search requirements:

- > Documented deceased accounts
- > Accounts of “non-natural” entities, such as businesses, partnerships, corporations, etc.
- > De minimis accounts where the total value of the lost shareholder’s account, including the value of the securities, is less than \$25

Due Diligence Process



Please see page 8 for a flowchart of the overall escheatment process.

¹ Type of contact considered to be valid varies by state

² Length of dormancy period varies by state

³ Mailings may not be required if the value of the property is below a certain amount, which varies by state

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Deep Searches

A more in-depth “deep search” to find lost shareholders and the owners of unclaimed property may also be undertaken prior to escheatment, usually by third-party vendors for shareholder-paid fees.

For “natural-person” accounts – living, individual shareholders – the SEC prohibits a transfer agent from using any service to locate a shareholder that results in a charge to the holder until after the two SEC-required database searches have been conducted.

For decedent or “non-natural-person” accounts, such as corporations, an in-depth search may be started immediately after the account is deemed lost. This search must be completed prior to the due diligence mailing that states require for unclaimed property.

Transfer Agents

Transfer agents often play a large role in the escheatment process because they are the keepers of the registered shareholder records and frequently perform mailings on the issuer’s behalf. They are therefore privy to information about the status of a lost shareholder, such as returned mail.

Transfer agents are also typically, but not always, designated by issuers to serve as the “escheat agent,” in order to perform escheat reporting and delivery on behalf of the issuer.

Records must be kept carefully by the transfer agent to comply with lost shareholder and escheatment regulations, and to ensure that shareholder property is not turned over to the state unnecessarily. Preliminary reports for common stock dividends, returned stock certificates, un-cashed checks and returned checks are available for review prior to the escheatment deadline. These are then presented to the issuer so that it can report the unclaimed property to the states and escheat or have the agent do the report and escheat on its behalf.

Unclaimed Property Audits

Statutes allow the states to perform audits of shareholder records to determine whether property should have been escheated, although generally the state must have reason to believe that the property should have been escheated. Because states are increasingly seeking to augment lagging revenues, audit volumes have recently increased.

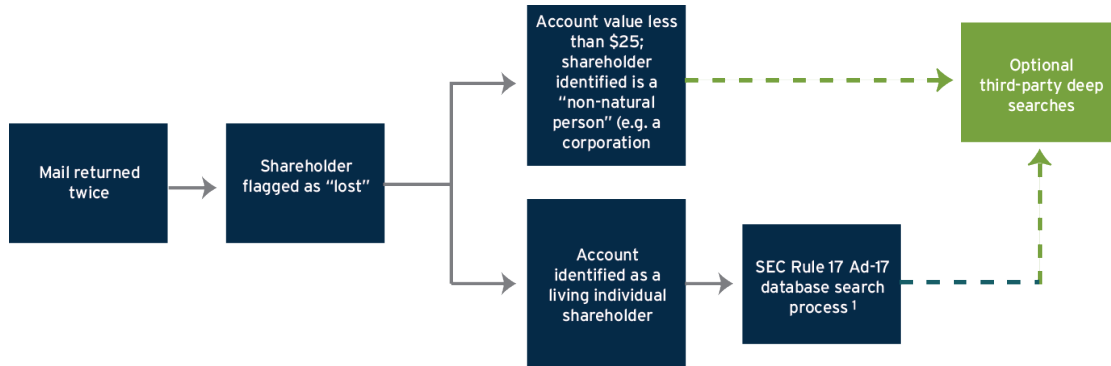
The audit can be performed by employees of the state or third-party audit contractors, and in many cases, third-party audit contractors often try to encourage additional states to create multistate audits.

Due to the sensitivity of the shareholder’s information, especially because these accounts are active, issuers subject to audit should consider not releasing information without the state signing a confidentiality agreement.

These audits can be time consuming and expensive, with some lasting as long as several years. Historically auditors concentrated on single property type, but more recently states have begun more comprehensive programs that examine multiple property types.

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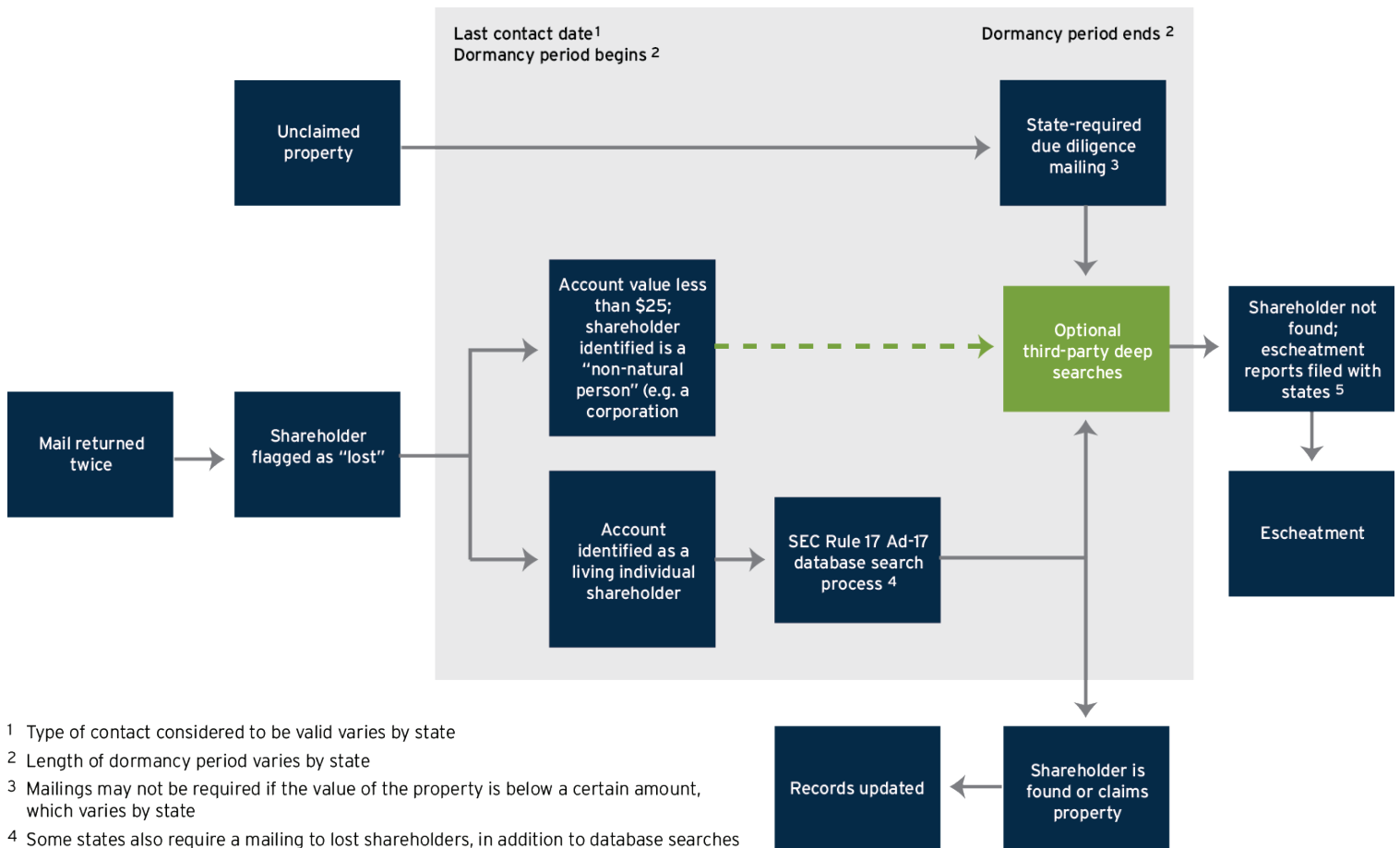
SEC Database Search Process



Please see page 8 for a flowchart of the overall escheatment process.

1 Some states also require a mailing to lost shareholders, in addition to database searches

Escheatment Process



1 Type of contact considered to be valid varies by state

2 Length of dormancy period varies by state

3 Mailings may not be required if the value of the property is below a certain amount, which varies by state

4 Some states also require a mailing to lost shareholders, in addition to database searches

5 "Lost" states require that the shareholder be lost for the property to be escheated. "Non-lost" states escheat property based on inactivity on the account alone.

