



Escheatment 101

What issuers need to know



“

The best way to avoid surprises is to own the process.”

Melissa McCarthy, Director, Asset Reunification
& Escheatment, EQ

Of all the services a transfer agent manages for you and your shareholders, escheatment is probably the least understood – not because the concept is hard to understand, but because the tangle of state laws that govern the process make it incredibly complicated.



What is escheatment?

Escheatment, as it relates to corporate securities, is the process of identifying “lost or dormant shareholders” on behalf of a corporation and, in accordance with state laws, turning any assets they’ve abandoned over to the state listed as the shareholder’s last known residence.

The states reason that if you, the issuer, can’t locate a shareholder, or the shareholder hasn’t contacted you, then the owner is not managing their asset properly, and it should be turned over to the state to protect. As the holder, you then have a duty to deliver the abandoned assets to the state, which becomes the custodian of the property.

The shareholder is still the owner. However, if they do eventually come forward, the claims process can make it difficult to recover the shares and any cash. The shares could also be subject to market value loss if liquidated.

In addition to the property the states collect, they can also assess penalties and interest to issuers for property not delivered on time, or conduct audits to examine your records for abandoned property you haven’t reported.

Federal law vs. state laws

Both federal law, through the Securities Exchange Commission, and individual state laws have a hand in governing escheatment of securities.

01

The federal SEC law, Rule 17Ad-17 regarding lost shareholders, simply states that if the record keeper (transfer agent) receives two pieces of correspondence returned from a shareholder as undeliverable, then the agent has an obligation to "exercise reasonable care" to locate the shareholder. Over time, best practices require conducting at least two database searches in specified timeframes, sending letters and even going above and beyond with "deep search" programs. Returned mail will be a factor for escheatment in states that require returned post office (RPO) as a trigger for escheatment.

02

State escheatment laws require that if a shareholder cannot be located, or is not in contact with the transfer agent, their assets are considered abandoned and must be turned over to the state. Each state has its own criteria for establishing abandonment, their own annual reporting requirements and their own due dates.

➔ Laws and the difficulty of managing escheatment

The vagueness of the federal law and the lack of uniformity between state laws make escheatment difficult to manage. There is no uniform way to define abandonment and no single way, from state to state, to manage the process. In some cases, the timing of state laws may even interfere with carrying out the federal law to conduct searches.

54 ways to escheat

There are 54 states and jurisdictions that each have their own laws that determine the criteria for what makes property eligible for escheatment, when that property is officially considered abandoned and therefore due to the state, and when and how that property should be reported and delivered. Adding to the complexity, the states can make changes to these laws any time they want.

It is the transfer agent's role, on behalf of the issuer, to keep track of each state's reporting deadlines and requirements, analyze the data, prepare the reports and deliver the unclaimed assets to the state. Any time a state legislates a change, it impacts that state's upcoming reporting cycle and requires a quick response to avoid potential penalties.

The transfer agent needs to analyze the impact this new legislation is going to have on its processes, its clients and their shareholders.

If the change involves adding new data to the report or changing the way the data is analyzed, it may require months of programming and possibly new technology – just for that one state.

“

At EQ, we align ourselves with industry experts and associations, such as the Securities Transfer Association (STA) and the Shareholder Services Association (SSA), to ensure that we are interpreting legislative changes consistently, across the industry.”

Melissa McCarthy, Director, Asset Reunification & Escheatment, EQ

Four ways to determine abandonment

There are four abandoned property categories that abandoned property falls into that make it eligible for escheatment:

01 Returned mail – one or more instance of mail returned as undeliverable.

02 Dormancy – no contact for three years to five years (depending on state dormancy period).

03 Returned mail and dormancy.

04 Returned mail or dormancy.

Some states also look at death records as another factor, but so far only Illinois has passed this criteria as law.

“

States will often tell you what ‘isn’t’ contact, but are not at all clear or consistent as to what is. With so many forms of digital communication now available, we would appreciate clearer guidance here.”

Melissa McCarthy, Director, Asset Reunification & Escheatment, EQ

What is (and isn’t) contact?

Among states that use dormancy or “no contact” as proof of abandonment, there isn’t a uniform definition of contact.

States are demanding proof, not only that contact was made, but that it was shareholder initiated. So a proxy mailing that was not returned does not count as “contact.” An email that did not bounce back is not “contact.” An automated dividend reinvestment is not “contact.”

Instead, shareholder-initiated contact has been loosely interpreted as any contact that requires authentication, such as logging in to an online account with a user name and password, or calling in to a self-service phone line with appropriate identification. Endorsing and cashing a check, or voting by proxy are also considered authenticated shareholder-initiated contact. Even more troublesome, the same type of contact may be considered “authenticated” in one instance but not in another.

Melissa McCarthy, Director, Asset Reunification & Escheatment at EQ, explains, “States will often tell you what ‘isn’t’ contact, but are not at all clear or consistent as to what is. For example, we see that many states will accept online contact as owner-initiated contact when analyzing information during an audit, but most states do not have specific language on online contact when it comes to examining accounts for annual reporting. With so many forms of digital communication now available, we would appreciate clearer guidance here.”

Ultimately, to prevent escheatment, the issuer is expected to have adequate records that prove authenticated contact, despite this lack of a uniform definition.



About those audits

In addition to requiring annual escheatment reports, states can also conduct escheatment audits at any time, and require no specific reason to do so.

States commonly share information with each other regarding a company's filing practices or something in the news that raises a red flag. They can either audit a company on their own, or come together and hire a third-party auditor. These audits are not always limited to shareholder assets. They may also include items such as vendor payments or an issuer's general ledger.

If you do come under audit, the important thing to know is that the burden of proof is on the issuer, regardless of who is handling your escheatment services. You'll be expected to manage the process, prove that due diligence was done to find lost shareholders and show valid evidence of shareholder-initiated contact. While your transfer agent will support you in this process, it is vitally important that you are aware of the stakes and are making business decisions now that keep you out of audit later.

Liability – who has the burden of proof?

If you have returned mail or can't show valid proof of contact with a shareholder, their account must be turned over to the state. If the state doesn't get their abandoned property in time, they will penalize you, not your transfer agent.

Your record keeper is there to help you, but it's important for issuers to take an active role in understanding the process, and to make the business decisions needed to prevent things from escheating in the first place.

“

A lot of times when a company gets audited, they assume 'They're not auditing me, they're auditing my record keeper.' But the reality is, no matter who is performing the services, the liability lies with the issuer.”

Melissa McCarthy, Director, Asset Reunification & Escheatment, EQ

What issuers should be doing

01

Put internal processes in place, such as annual reviews, to ensure that your transfer agent is regularly filing reports and has the data and resources they need.

02

Make sure your vendor keeps copies of these reports so that, if you are audited, you have records of consistent filings for review.

03

Have a general working knowledge of the process, so you're not blindsided by things you weren't expecting.

04

Utilize your transfer agent to make contact with your shareholders. If the only thing you're actually mailing is a proxy, think about other ways to reach out to them on an annual basis.

05

Proactively manage your shareholder base to prevent things from escheating. Conduct the necessary research to identify deceased shareholders, for example, or shareholders with multiple addresses where they might be reached.

06

Be aware of what's going on in the industry. Get involved with the Shareholder Services Association (SSA) where legislative changes are discussed and interpreted.

“

If there's one thing I recommend that issuers do, it's to be proactive. At the end of the day, it's your company and they're your shareholders. Anything that negatively impacts them, negatively impacts you. The best way to avoid surprises is to own the process.”

Melissa McCarthy, Director, Asset Reunification
& Escheatment, EQ



Visit EQ today at equiniti.com



© 2021 Equiniti Trust Company

