

August 8, 2013

## Ready or Not: Lost Securityholders, Uncashed Checks and Dormant Accounts

In the dog days of August, it would be tempting to put aside challenges created by new Securities and Exchange Commission (SEC) rules. But we all know that would be a mistake. Instead, attention needs to be paid now to new rules requiring searches for lost securityholders and persons holding uncashed checks, and – if that weren't enough – to state audits of dormant broker-dealer accounts. So take the dog to the pool and get back to your office. In less than six months' time, broker-dealers with customer accounts will be required to search for lost securityholders, and paying agents – a group that can include companies not otherwise regulated by the SEC – will need to track and trace uncashed checks.

### Lost Securityholders – SEC Rule 17Ad-17

As of January 23, 2014, any broker-dealer that has customer security accounts that include accounts of lost securityholders must “exercise reasonable care to ascertain the correct addresses of such securityholders.” This reasonable care standard is different from the legal requirement imposed on broker-dealers by another SEC rule, Rule 17a-3(17), which requires broker-dealers to follow up with customers after they receive notice of the customer's change of address. The new rule, codified in Securities Exchange Act Rule 17Ad-17, requires that broker-dealers conduct two database searches using at least one “information database service,” defined as an automated database service that contains addresses from the entire United States geographic area and the names of at least 50% of the U.S. adult population; is indexed by taxpayer identification number or name; and is updated at least four times a year; or a search service that produces comparable results.

Beginning in January, broker-dealers will be required to conduct the database searches if an item of correspondence is sent to a securityholder at an address contained in the customer security account records of the broker-dealer, and that item of correspondence is returned as undeliverable (unless the item of correspondence is re-sent successfully within one month of being returned as undeliverable, or the broker-dealer receives information regarding the securityholder's new address).

Introducing firms should be careful not to assume that their clearing firms will comply with the rule on their behalf. Although the SEC intimated when it adopted the rule that it expected the compliance burden to fall mainly on clearing firms, to date there is no indication that clearing firms alone will shoulder the rule's regulatory obligations. Introducing firms should also pay attention to the cost of the searches; under the rule, searches must be conducted without charge to the lost securityholder, which means a broker-dealer (whether the introducing or the clearing firm) will need to absorb the cost.

### Uncashed Checks Require Searches, Too

At the same time the SEC adopted the lost securityholder rule for broker-dealers, it also adopted a new rule that will apply to broker-dealers and a much larger universe of entities, known as “paying agents.” A paying agent includes any issuer, transfer agent, broker, dealer, investment adviser, indenture trustee, custodian, or “any other person that accepts payments from the issuer of a security and distributes the payments to the holders of the security.” Paying agents will be required to send at least one written notice to any securityholder to whom the paying agent has sent a check, and the check is not negotiated

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before the earlier of the paying agent's sending the next regularly scheduled check, or the elapsing of six months (or 180 days) after sending the not-yet-negotiated check.

The paying agent rule becomes effective on January 23, 2104, the same date as the lost securityholders rule. Like the lost securityholders rule, entities needing to comply with the paying agent rule will have to implement robust "track and trace" systems in order to comply with the rule.

### Impact – Who's Ready?

At the very least, the new rules will impact more than a thousand entities in the U.S. Once an entity determines that it is covered by the lost securityholder rule and/or the paying agent rule, it must – before January – adopt new written policies and procedures spelling out how it intends to comply with the rule(s), and most importantly, it must design the operational functionality to track all items of correspondence returned as undeliverable and to track and trace all uncashed checks.

### The State Angle

Searching for lost securityholders and tracking uncashed checks are SEC-imposed requirements. They are close cousins, however, to state unclaimed property laws. All 50 states have laws that require "holders" of other's property, such as broker-dealers and paying agents, to escheat the property to the state if the "holder" loses contact with the securityholder for a prescribed period of time. In a time of strained state budgets, state treasurers are increasingly hiring aggressive third-party contingent fee auditors to pursue the collection of unclaimed property from all types of entities – and broker-dealers, paying agents and their holding companies are on the list. Any company subject to state unclaimed property laws will likely want to coordinate the compliance programs it adopts for the SEC rules, with programs designed to satisfy state unclaimed property audits and escheatment laws. All of this will take a lot of planning, which is why August shouldn't be wasted.



*If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.*

[Susan S. Krawczyk](mailto:susan.krawczyk@sutherland.com)  
[Holly H. Smith](mailto:holly.smith@sutherland.com)  
[Mary Jane Wilson-Bilik](mailto:mj.wilson-bilik@sutherland.com)

202.383.0197  
202.383.0245  
202.383.0660

[susan.krawczyk@sutherland.com](mailto:susan.krawczyk@sutherland.com)  
[holly.smith@sutherland.com](mailto:holly.smith@sutherland.com)  
[mj.wilson-bilik@sutherland.com](mailto:mj.wilson-bilik@sutherland.com)