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February 2, 2017

The Honorable Cecile Bledsoe, cecile.bledsoe@senate.ar.gov
The Honorable Joyce Elliot, joyce.elliot@senate.ar.gov
The Honorable Stephanie Flowers, stephanie.flowers@senate.ar.gov
The Honorable Jeremy Hutchinson, jeremy.hutchinson@senate.ar.gov
The Honorable Jason Rapert, jason.rapert@senate.ar.gov
The Honorable David Sanders, davidjamessanders@gmail.com
The Honorable Greg Standridge, greg.standridge@senate.ar.gov
The Honorable Larry Teague, larry.teague@senate.ar.gov

Re: HB1142 – An Act to Amend the Law concerning the Payment of a Security Presumed to be Abandoned Property

Dear Senators:

The Securities Transfer Association ("STA") and Shareholder Services Association ("SSA") write to express our grave concerns regarding certain provisions of HB1142, which mandates that holders liquidate securities prior to escheatment. For the reasons discussed herein, this requirement is unconstitutional, will cause Arkansas residents to lose assets, unintentionally creates negative tax consequences, and runs afoul of case law and federal regulations. Further, since record keepers do not have the legal authority to sell shares, compliance with the proposed bill may not even be possible.

Founded in 1911, the STA represents more than 100 transfer agents who are responsible for the record keeping for more than 15,000 issuers of securities[1], representing the investments of over 100,000,000 registered shareholders. The SSA was founded in 1946 with a mission of facilitating its members' compliance with complex state and federal regulatory matters relating to securities. The SSA counts hundreds of public companies as its members and is proud to support its members' service to their shareholders while achieving regulatory compliance. Combined, the STA and SSA's members are directly or indirectly responsible for the record keeping and maintenance of the securities investments of one third of the United

[1] These issuers include all of the largest public companies in Arkansas.

States population. For many of these shareholders, these investments in securities represent their life savings.

The STA's and SSA's members are directly or indirectly responsible for compliance with escheat laws nationwide and have an interest in seeing that the escheat laws are administered so as not to create risk of loss for these shareholders. We are writing to request that you reject HB1142, which will undoubtedly cause significant loss for citizens of Arkansas, with a particularly adverse impact on seniors. HB1142 will negatively impact compliance with federal securities regulations designed to protect the very shareholders whose assets will be seized under HB1142. The bill runs afoul of the due process concerns recently raised by the Supreme Court of the United States in *Taylor v. Yee* in that it does not allow shareholders to receive notice that the state is about to take their property. Further, HB1142 is at odds with the Revised Uniform Unclaimed Property Act ("RUUPA") passed by the Uniform Law Commission ("ULC") in July of 2016. As you may be aware, Arkansas' ULC Commissioners voted to enact the RUUPA. Surprisingly, HB1142 eviscerates the important safeguards for shareholders contained in the RUUPA, which is likely to be introduced to the Arkansas legislature shortly.

Background of 17 C.F.R. §240.17Ad-17

The Securities and Exchange Commission ("the Commission") enacted Rule 17Ad-17 in 1997 in order to protect investors whose securities were at risk of escheatment.[2] The regulation requires transfer agents to track shareholders who appear to be "lost."[3] These are defined as shareholders for whom the postal service has returned mail.[4] In 2013, pursuant to Dodd-Frank, Congress expanded the regulation to apply to "unresponsive payees."[5] These are shareholders who are not lost, but have failed to cash a securities-related payment. Under federal law, transfer agents must search for better addresses for lost shareholders and obtain updated account information so that their accounts will not be subject to escheat. For unresponsive payees, transfer agents must send certain communications at specified intervals in an attempt to have the shareholders negotiate their payments. Congress and the Commission have unequivocally mandated extraordinary outreach to shareholders so that their investments will only be escheated if they have truly abandoned their shares. With the language proposed in HB1142, these important protections will be thwarted. The impact of the state's frustration of the federal law will be discussed more fully below.

Due Process Violations

In many recent and current cases, federal courts have held that the states' unclaimed property programs violate the United States Constitution, particularly when, as in HB1142, no

[2] Transfer Agents' Obligation to Search for Lost Securityholders, 17 C.F.R. § 240.17Ad-17 (1997).
[3] *Id.*
[4] *Id.*
[5] Lost Securityholders and Unresponsive Payees, 17 C.F.R. § 240.17Ad-17 (2013).

meaningful notice is provided to owners prior to the taking. The Ninth Circuit prohibited California's Unclaimed Property Division from accepting any unclaimed funds for a year while its notification and liquidation provisions were rectified.[6] In *Temple-Inland v. Cook*, the Third Circuit recently noted that the manner in which Delaware utilized its unclaimed property program as a revenue generator "shocked the conscience."[7] The court also held that even if the state indemnifies a holder for property that has been escheated, "indemnification is not . . . adequate protection."[8] In February of 2016, the Supreme Court of the United States recognized that "States appear to be doing less and less to meet their constitutional obligation to provide adequate notice before escheating private property."[9] The Court continued that "cash-strapped States" may have an interest in shoring up state budgets with property that is "truly abandoned."[10] However, the Court held, "To do that, the States must employ notification procedures designed to provide the pre-escheat notice the Constitution requires."[11] As currently written, HB1142 provides absolutely no state notice prior to the taking of the property. As such HB1142 cannot withstand constitutional scrutiny.

The RUUPA's Securities Provisions

In July of 2016, the ULC Commissioners from Arkansas voted along with 48 other states to endorse the RUUPA. Some of the most significant provisions of the RUUPA relate to the escheatment of securities. Specifically, in recognition of SEC Rule 17Ad-17, RUUPA §208 requires that securities accounts be lost before they can be subject to escheatment.[12] RUUPA §702 prevents the liquidation of securities for at least three (3) years after the state receives the property.[13] Further, if shareholders claim their property from the state within six years of its escheatment and the shares have been sold, the state is required to make the shareholder whole.[14] The latter two provisions were inserted specifically to protect shareholders and in recognition of the constitutional challenges described above. The language of HB1142 completely contradicts the valuable protections of the RUUPA. Please note that the National Association of Unclaimed Property Administrators served as an advisor to the ULC in drafting the RUUPA and agreed to these protections, particularly since the goal of any unclaimed property program is to protect property for rightful owners. No state wants its unclaimed property program shut down as California's was in the wake of its failure to provide notification to residents prior to liquidation.

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[6] *Taylor v. Chiang*, No. CIV. S-01-2407 WBS GGH, 2007 WL 1628050 (E.D. Cal. June 1, 2007).
[7] *Temple-Inland, Inc. v. Cook et al.*, No. 14-654-GMS, at *18 (D. Del. June 28, 2016).
[8] *Id* at *32.
[9] *Taylor v. Yee*, at *2, 577 U.S. ___ (2016).
[10] *Id*.
[11] *Id*. at *2-3.
[12] Rev. Unif. Disposition of Unclaimed Prop. Act § 208 (2016).
[13] *Id.* at § 702.
[14] *Id.* at § 703.

Concerns

"The purpose of enacting [unclaimed property] laws is to provide for the safekeeping of abandoned property and then reunite the abandoned property with its owner."[15] Securities are not the same as cash. Rather, they represent the shareholder's ownership interest in the company. This includes the right to participate in management decisions via proxy voting; the right to company profits via receipt of dividends; and the right to appreciate company value via increases in the price of the security. By forcing the sale of securities prior to escheatment, HB1142 terminates all of these property interests. Therefore, instead of protecting owners and reuniting them with their property, it deprives owners of their property rights, thus violating the very intent of the statute that HB1142 seeks to amend.

As the Supreme Court noted in *Taylor v. Yee*, cash-strapped states may have an interest in utilizing property that is "truly abandoned." However, the property that HB1142 seeks to designate as "abandoned" does not meet this requirement. Holders would be forced to liquidate underlying shares if the owner fails to cash even a single dividend check. The use of an inactivity standard disproportionately affects seniors, who occasionally are not able to conduct their banking, but nevertheless have not abandoned their shares and expect to be able to use the investment, either in retirement or to pass along to their heirs. Such an approach also does not accommodate for the SEC Rule 17Ad-17 protections, resulting in the liquidation of shares of owners who are not lost. Equally troubling is that the forced sales will create a taxable event for these folks, and the capital gains cannot be reversed. As a practical matter, many holders of securities do not have the ability to execute liquidation orders themselves and they do not have the legal authority to instruct third parties to sell. Further, it is not clear if brokers will be able to accept liquidation instructions from any party other than the owner (i.e., from the state, which is not yet the custodian of the securities).

The purported basis for requiring the liquidation is because "security management costs and fees are costly."[16] California similarly attempted to defend its due process violations by noting that budgetary constraints did not allow the state to provide adequate notice. The Ninth Circuit rejected this defense and prevented the state from accepting any property until it amended its statute and practices and provided notice to owners that was sufficient to satisfy due process. If the state is interested in reducing its costs, this can be achieved in a manner that does not destroy the hard-earned savings of Arkansas residents. We would be pleased to discuss with you some ideas that would allow for the reporting of securities property to Arkansas, without the need for Arkansas to incur management and custody fees.

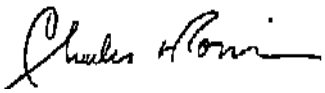
Conclusion

For all of the reasons discussed herein, we sincerely request that you consider adopting the RUUPA, rather than HB1142. The RUUPA was the result of a comprehensive, two-year

[15] *N.J. Retail Merchs. Ass'n v. Sidamon-Eristoff*, 669 F.3d 374 (3d Cir. 2012)
[16] HB1142 §5.

deliberative process with all interested parties, incorporating provisions to protect consumers, while allowing the states to implement their unclaimed property programs without fear of constitutional challenges. We welcome the opportunity to discuss our concerns with you. Thank you in advance for your consideration of this important issue.

Sincerely,



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