

## Comment Letter on Proposed Rules Concerning Lost Securityholders, December 1996

November 27, 1996

Mr. Johnathan G. Katz  
Secretary  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549

**Re: Proposed Rules 17AD-17 and 17a-24**  
**File No. S7-21-96**

Dear Mr. Katz:

The Investment Company Institute<sup>1</sup> appreciates the opportunity to comment on the Commission's proposed Rule 17AD-17 and proposed Rule 17a-24 designed to address lost securityholders.<sup>2</sup> Proposed Rule 17AD-17 would require transfer agents to conduct searches in an effort to locate lost securityholders. Rule 17a-24 would allow the Commission to gather data related to lost security holders and provide information to private information distributors. Our comments, which are set forth below, generally follow the order of the Commission's Proposing Release. In addition, it should be noted that our comments focus primarily on mutual fund transfer agents.

As stated in the Commission's Proposing Release, "some transfer agents already take meaningful steps to prevent the loss of contact with securityholders and to reestablish contact after it has been lost." Indeed, we are pleased to note that most mutual funds actively seek to reestablish contact with any lost securityholders through the use of various search methodologies upon receipt of returned correspondence items. The Institute has long supported efforts on the part of mutual funds to ensure that funds, primarily through their transfer agents, maintain contact with their shareholders.

The Institute generally supports the Commission's initiative to require transfer agents to make efforts to locate lost securityholders. As discussed more fully below, however, we urge the Commission to make the proposed search requirements more flexible to be consistent with current practices in the mutual fund industry and to avoid unnecessary additional costs. Specifically, we request that the Commission permit mutual fund transfer agents to make a "lost securityholder" designation after the first piece of returned mail is remailed and returned again as undeliverable and to conduct lost shareholder database searches every six months, rather than three months after a second, separate piece of correspondence is returned. We also recommend that the Commission eliminate limitations prohibiting transfer agents from passing a reasonable cost of a search directly to a "lost shareholder."

In their efforts to ensure the accuracy of shareholder records, mutual funds make on-going efforts to assist shareholders in making timely updates by allowing address changes over the telephone, by mail, or when requests for transactions are made. Moreover, quality control procedures are employed to verify the accuracy of addresses at the time an account is established or an address is changed. Despite these efforts, the Institute recognizes that mutual funds occasionally lose contact with shareholders. While we agree that mutual fund transfer agents should take steps to prevent such a loss of contact, it is the shareholder's responsibility to make notification of an address change. Search methodologies utilized to locate shareholders who fail to notify a mutual fund of an address change are costly and time-consuming. In order to keep address records up to date, mutual fund transfer agents must employ staff to sort returned mail, update new addresses when received from the Post Office, re-mail correspondence to the new address, code shareholders as "lost" when correspondence is undeliverable, and prepare lists of lost shareholders for database searches. In addition to labor, printing, and mailing costs associated with lost shareholder searches, database information services charge for each search.

As indicated in the Proposing Release, the Commission recognizes that the proposed regulatory obligations in Rule 17AD-17 will

impose financial burdens on transfer agents. However, the Proposed Rules prohibit transfer agents from charging shareholders for their search efforts. Currently, while lost shareholder location searches are conducted without a direct charge to the account of the lost shareholder, transfer agents seek to recover these costs from their mutual fund clients. Therefore, shareholders who do not lose contact with their mutual funds share the cost burden of these efforts. We do not agree that transfer agents should be prohibited from passing the reasonable cost of a search directly to a "lost" shareholder and recommend that the Commission eliminate such limitation in proposed Rule 17AD-17.

## Current Mutual Fund Transfer Agent Practices Regarding Lost Securityholders

Methodologies employed by mutual fund transfer agents for locating lost shareholders vary slightly from the practices described in paragraph I.B. of the Proposing Release. Upon receipt of a returned "undeliverable" item, most mutual fund transfer agents immediately re-mail the returned correspondence<sup>3</sup> in a specially marked envelope. If the specially marked envelope is also returned, the shareholder is then coded as "lost" on the account records and correspondence is discontinued. Thus, most mutual fund transfer agents do not wait for a second separate piece of correspondence to be returned before making a "lost securityholder" determination, as described of correspondence to be returned before making a "lost securityholder" determination, as described in the Proposing Release. After a period of time, a search using databases such as credit bureau records may be conducted to determine if a new address is available.

Additional procedures that may also be employed by mutual funds to locate lost securityholders are:

- Utilizing Post Office return mail special procedures to obtain forwarding addresses.
- Conducting reviews of account records for recent address changes and researching related accounts for different addresses.
- Attempting to contact shareholders by telephone and using telephone directory assistance for the same area and contiguous areas if necessary.
- Contacting the broker on the account, if any, for recent contact by the shareholder.

## Definition of Lost Securityholder

The Commission proposes that a "lost securityholder" be defined as "when two items of correspondence, such as distribution payments, that were sent by first class mail at least three months apart, have been returned as undeliverable." The Institute recommends that the Commission modify the requirement that two separate pieces of correspondence be returned before a shareholder meets the definition of a "lost securityholder." Instead, transfer agents should be permitted to make the "lost securityholder" determination after the first piece of returned correspondence is re-mailed and returned again as undeliverable. This change would allow transfer agents to make the "lost securityholder" determination earlier than proposed and in conformity with current practice.

Such an earlier "lost securityholder" determination will, in many instances, permit an earlier commencement of search efforts. For example, mutual fund shareholders who own funds that pay dividends only annually or semi-annually with no other activity may only receive one or two mailings per year. Thus, waiting for a second mailing to these shareholders to be returned as undeliverable to designate them as "lost" under the proposal, would delay the ability to initiate search efforts.

## Transfer Agent Search Requirements

Rule 17AD-17 proposes that every recordkeeping transfer agent conduct a search for lost securityholders within three months of the securityholder being classified as lost. The Rule proposes that the initial search be based on either name or taxpayer identification number. If the lost securityholder is not found, the transfer agent must conduct a second search between one year and eighteen months after the initial search.

We believe the proposed rules are overly burdensome in that they require transfer agents to track each individual shareholder's returned mailings and determine a separate time period within which to begin a search. This will require transfer agents to build and maintain elaborate lost shareholder tracking systems currently not in existence. The Institute urges the Commission to consider permitting transfer agents to make a database search every six months for shareholder who were determined to be "lost securityholders" in the preceding six months.

Mutual fund transfer agents typically conduct database searches of lost mutual fund shareholders collectively, for a group of lost shareholders, not on an individual basis. For example, a mutual fund transfer agent, on a semi-annual basis would provide a

database service with a list of shareholders that were designated as "lost" during the preceding six months. Thus, some of the accounts may have been coded as "lost" almost six months prior and other accounts may have been coded only several weeks before. Permitting transfer agents to conduct database searches every six months would allow them to collect names over a period of time and benefit from reduced rates that database search firms offer for a "bulk" search. Incorporating this flexibility into a final rule would also avoid disrupting current industry practice and would, in many instances, achieve the same or better results in terms of when searches would be conducted.

With regard to a required second database search, we are not aware of any empirical evidence of the success rate of a second search of informational databases. Most mutual fund transfer agents only conduct one database search as part of their search methodology. We believe the costs of a second search would far outweigh any benefits and that transfer agents should be allowed the option to determine whether or not a second search would be appropriate. Therefore, we strongly oppose the requirement that transfer agents conduct a second search of information databases.

## Cost Impact De Minimis Exemption

As discussed previously, mutual funds and their transfer agents are currently active in efforts to locate any lost shareholders. These efforts are costly in terms of personnel, printing, mailing, and database search charges. Also, as noted above, in order to meet the proposed requirements as drafted, transfer agents would have to build tracking mechanisms, currently not in existence, which are costly to develop, implement, and maintain. Moreover, under the proposed requirement of two separate mailings and two database searches, transfer agents would require additional personnel and associated staff expenditures in order to record returned correspondence and conduct additional database searches, transfer agents would require additional personnel and associated staff expenditures in order to record returned correspondence and conduct additional database searches. We urge the Commission to consider adopting more flexible rules in keeping with current practice, so as not to overly burden transfer agents with the cost of locating shareholders, particularly in light of the fact that the costs are borne by all the shareholders of a mutual fund.

In response to the Commission's request for comment, we agree that the requirement to search for a lost securityholder only apply where the transfer agent is holding assets over a de minimis amount. We propose an amount of \$100 per shareholder account as a threshold for search requirements to avoid a situation where the transfer agent would be required to expend funds in excess of the value of the account.

## Periodic Assessment of Effectiveness and Appropriateness of Search Procedures

The Proposing Release requested comments on whether the rule should include a requirement that "transfer agents periodically assess the effectiveness and appropriateness of the search procedures and technology they employ and/or a requirement that transfer agents' search procedures meet a performance-based standard based on success in locating lost securityholders." We do not believe transfer agents should be required to conduct an assessment of the procedures and technology they employ. Transfer agents should be making such evaluations in annual assessments of their operations and procedures and should not need a specific requirement with respect to lost shareholder location efforts. We are unable to determine how the Commission would monitor compliance with such a rule. Additionally, any performance-based standards would be difficult to monitor and evaluate as the success rate of locating a shareholder is primarily dependent on whether or not shareholders update their address in a timely manner.

## Definition of Information Database

The proposed definition of "Information Database" in the Proposed Release generally describes databases currently employed by transfer agents. However, adoption of specific criteria in the proposed definition may be too constraining. In the future, advanced technologies may lead to the development of database resources that further assist transfer agents in their searches but that do not meet the proposed definition. The Institute believes the rule should be sufficiently broad so as to allow transfer agents to employ these yet to be developed resources.

## Collection of Lost Securityholder Data

Proposed Rule 17a-24 would require recordkeepers to file information on lost securityholders with the Commission on an annual basis. It is proposed that this information would become available to private entities which could establish databases available to the public and charge a fee to persons who may inquire as to whether they have been reported lost. Alternatively, it has been suggested that the Commission maintain such a database. We strongly oppose the creation of a national database of lost securityholders, regardless of whether it would be maintained by a private entity or the Commission.

We oppose any effort to build a database of lost securityholders, their names, and social security numbers which would be made available to the public. Proposed Rule 17a-24 raises a number of security risk and shareholder privacy concerns. Providing information such as a social security number would compromise the privacy of the shareholders. If made available in an easily accessible location, mutual funds and their shareholders could potentially be at financial risk for fraudulent schemes that could be perpetrated using the information. We do not believe such a database will assist shareholders and may potentially cause financial harm.

We also believe that the information provided on a database such as the one proposed would require updates to reflect "found" shareholders. Such a database would be subject to errors and inaccuracies if information were not reported timely to reflect changes. We believe that transfer agents should be responsible for maintaining their own records of lost shareholders and should protect the privacy and security of their shareholders.

## Definition of Recordkeepers

The filing requirements under Proposed Rule 17a-24 would apply to any entity defined by that rule as a "recordkeeper," which currently includes, among other entities, "a registered broker or dealer." The Institute strongly urges the Commission to explicitly exclude mutual fund underwriters from the definition of "recordkeeper." While, such underwriters are registered broker-dealers, they do not maintain shareholder accounts and would therefore not be in a position to be subject to the rule.

The Commission has requested comment as to whether any entities not within the scope of the proposed definition of recordkeepers, such as investment advisers, should be included. The Institute believes the inclusion of investment advisers is unnecessary because they typically do not have lost securityholders. The only investment advisers that even conceivably could have lost securityholders are those with custody of client securities, which constitute a very small percentage of investment advisers. Moreover, advisers with custody of client assets are not likely to lose track of their clients because such advisers typically have a limited number of clients with whom they normally maintain reasonably frequent communication. In the event the commission includes investment advisers within the scope of the definition of "recordkeeper," we recommend that it apply only to investment advisers with custody of client securities of funds and therefore subject to the custody rule, Rule 206(4)-2, under the Investment Adviser Act of 1940. We also strongly urge the Commission not to adopt a "negative" reporting requirement applicable to all investment advisers.

\* \* \*

The Institute appreciates the opportunity to comment on the proposed rules designed to address lost securityholders. However, we are concerned that the proposal would introduce unnecessary procedural complexity and impose significant new burdens on mutual funds and their transfer agents. Moreover, we believe current mutual fund transfer agent practices and procedures with respect to lost securityholders are generally appropriate and effective. Therefore, we respectfully request a meeting with the Commission staff to discuss the proposed rules and current mutual fund practices in this area before any further action is taken by the Commission. Please contact me at 202/326-5845 or Justine Phoenix at 202/326-5850 regarding our request for a meeting or if you have any questions or require additional information as to any of the foregoing.

Sincerely,

Donald J. Boteler  
Vice President - Operations and Training

### ENDNOTES

<sup>1</sup> The Investment Company Institute is the national association of the American investment company industry. Its membership includes 6,078 open-end investment companies ("mutual funds"), 440 closed-end investment companies, and 10 sponsors of unit investment trusts. Its mutual fund members have assets of about \$3.266 trillion, accounting for approximately 95% of total industry assets, and have over 38 million individual shareholders.

<sup>2</sup> Securities Exchange Act Release No. 34-37595, dated August 22, 1996 (the "Proposing Release").

<sup>3</sup> Correspondence includes, but is not limited to, items such as account statements, distributions, semi-annual and annual reports.