

Pay Attention to Your Orphans

December 16, 2025

What should a broker-dealer do when a customer's contact information no longer works? The law imposes responsibilities on broker-dealers in such situations. We expect the Securities and Exchange Commission (SEC), the Financial Industry Regulatory Authority (FINRA), and State securities regulators to have heightened interest and increased scrutiny over "orphaned" accounts, which are those where the designated representative relationship has ended or the client has become unresponsive. Recent SEC and FINRA actions and regulatory priorities focus on retail accounts, underscoring that firms must actively supervise these accounts, make diligent efforts to locate the customer, maintain escalation protocols, avoid charging fees for services not provided, and, if contact remains unsuccessful, transfer the abandoned property to the state. Failure to follow the rules governing orphaned accounts can expose a broker-dealer to significant sanctions.

SEC Requirements

Rule 17Ad-17 under the Securities Exchange Act of 1934 (Exchange Act) requires brokers and dealers, as well as transfer agents, to exercise reasonable care to locate "lost securityholders" and to conduct specific database searches when correspondence is returned as undeliverable and no updated address is obtained. This is critical for orphaned or unresponsive accounts. Once mail is returned undeliverable and the firm has no accurate address, the "lost securityholder" framework applies, triggering specific outreach obligations before it escalates to state unclaimed property processes. Regulators have asserted that such loss of contact could be harmful to securityholders because they no longer receive corporate communications or the interest and dividend payments to which they may be entitled. Additionally, their securities and any related interest and dividend payments are often placed at risk of being deemed abandoned under the operation of state escheatment laws. This loss of contact has various causes, but it most frequently results from: (1) failure of a securityholder to notify the transfer agent or broker-dealer of his/her correct address, especially after relocating to a new address; or (2) failure of the estate of a deceased securityholder to notify the transfer agent or broker-dealer of the death of the securityholder and the name and address of the trustee for the estate.

Failure to follow the specific requirements of Rule 17Ad-17 can expose a broker-dealer or transfer agent to significant sanctions. For example, in an SEC enforcement action, the SEC alleged that a transfer agent failed to follow the requirements of Rule 17Ad-17, resulting in tens of millions of dollars being wrongly escheated to the states, thereby causing the impacted customers to incur significant costs to recover their property. See *SEC v. The Bank of New York, C.A.*No. 06 CV 3121 (LS) (S.D.N.Y., April 24, 2006).

See also *In re DST Asset Managers Solutions, Inc. Admin. Pro. 3-21565* (August 17, 2023), where the transfer agent failed to take reasonable steps to locate 78 securityholders regarding their lost securityholder status and the securities were escheated to the states.

FINRA Expectations

Although FINRA does not have a rule akin to SEC Rule 17Ad-17, several FINRA rules touch on a broker-dealer's obligation to be attentive to contact with its customers.

- **FINRA Rule 11721** provides that "[a]ny member who discovers securities in its possession to which it is not entitled is required to make reasonable attempts to ascertain and to promptly notify the true owner of such securities and to take affirmative steps to correct the situation."
- **FINRA Rule 4512** requires firms to maintain core customer account information and, for non-institutional accounts, to make reasonable efforts to obtain a trusted contact person who may be contacted about the customer's account. These requirements are particularly salient where a broker-dealer loses direct contact with the customer or where health or capacity concerns may impair the client's ability to respond to outreach.
- **FINRA Rule 2150** warns against the improper use of a customer's securities or funds.
- **FINRA Rule 2090** is the regulator's "Know Your Customer" rule.
- **FINRA Rule 3110** requires a firm to establish and maintain a reasonably designed supervisory system.

A FINRA-litigated enforcement action illustrates the dangers of a broker-dealer improperly designating customer accounts as abandoned. In the appellate decision, FINRA's National Adjudicatory Council found that, among other violations. Alpine wrongfully treated $54 million in customer securities as "abandoned" without regard to whether, in the last three years, a deposit or withdrawal had been made on an account, a customer had contacted the firm or otherwise expressed an interest in an account, or there was any trading activity in an account, and without customer authorization seized the assets by moving them to firm accounts. See *FINRA Department of Enforcement v. Alpine Securities Corporation, Complaint No. 2019061232601, Decision March 25, 2025*.

State Escheatment

Every state and territory has laws governing escheatment. These laws vary, with a useful summary provided by the North American Securities Administrators Association (NASAA):

> Escheatment is a process whereby the government takes ownership of property, including financial assets, that has been deemed abandoned by the property's rightful owner. Escheatment of financial accounts typically occurs after a period of account-related dormancy (or "inactivity") and after attempts to identify and contact the account owners have failed. The dormancy period is determined by the type of property (e.g., payroll checks, insurance payouts, bank accounts, CDs, Health Savings Accounts as opposed to securities), and can vary from as little as one year to as long as 15 years. There is no uniform standard in the United States regarding the length of time required for an account to be escheatable. The definition of inactivity also varies by jurisdiction. Some jurisdictions require that an article of mail be returned to the broker or other custodian as undeliverable. Other jurisdictions deem an account escheatable if the owner has not contacted a broker or other custodian for a specified period of time.
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> Financial institutions are required to attempt to contact account owners before escheating property to the state. What qualifies as an "attempt" can be as varied as the definition of "inactivity." For example, some state authorities take out advertisements in newspapers to provide notice of escheatable property, notwithstanding that the owners of the property may not reside in the vicinity. If there is no valid address associated with an account, it can be escheated to the state of incorporation of the financial institution with custody of the account. (Some firms have taken advantage of this by offering to find unclaimed property for states in exchange for keeping a portion of any property escheated – effectively collecting a bounty for their work.)

Escheatment laws require a broker-dealer to make a correct determination that an account has been abandoned. Failing to transfer abandoned property to the state can expose the broker-dealer to sanctions by the state. Incorrectly designating property as abandoned and transferring it to the state can also expose the broker-dealer to liability to the customer.

Practical Takeaways and Controls

Firms should review their procedures and ensure they consider the proper handling of "orphaned accounts" in light of federal, FINRA and state rules. For example, firms could consider:

- Create lost securityholder reports for bounced email and undeliverable correspondence, with automated two-stage database searches and records that track search timing, outcomes, and restored contact. Maintain written procedures and document evidence.

- Engage payment services that monitor and flag debits, credits, overall account activity or unnegotiated checks and record compliance. Ensure these processes coexist with state due diligence and dormancy timelines.
- Maintain clear procedures for registered representative departures. Include timely client notifications, documented servicing re-assignments, and supervisory reviews confirming that services continue, or, if not, that fees are halted.
- Evaluate carefully unilateral liquidations, negative consent sales processes, or internal "abandoned" transfers to firm accounts to close customer accounts. If escheatment is necessary, follow state law carefully, and ensure communications to customers accurately reflect the status of assets and any transfers to state custody.
- Calibrate supervisory testing to identify accounts with prolonged inactivity, undeliverable mail, repeated unnegotiated distributions, or post-departure "house" assignments, and to verify outreach, documentation, and appropriate fee treatment.
- Embed trusted contact person collection and periodic refresh into new account onboarding and scheduled updates. Use trusted contact person outreach to validate client contact details, capacity and authorized agents when contact lapses or exploitation is suspected.

Taken together, the existing SEC framework for lost securityholders and unresponsive payees, FINRA's trusted contact person and elder-protection regime, and state escheatment requirements, impose clear expectations: broker-dealers must either maintain active, documentable servicing and contact with customers, or take legally prescribed steps to restore contact or remit property. In sum, pay attention to your orphans.

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