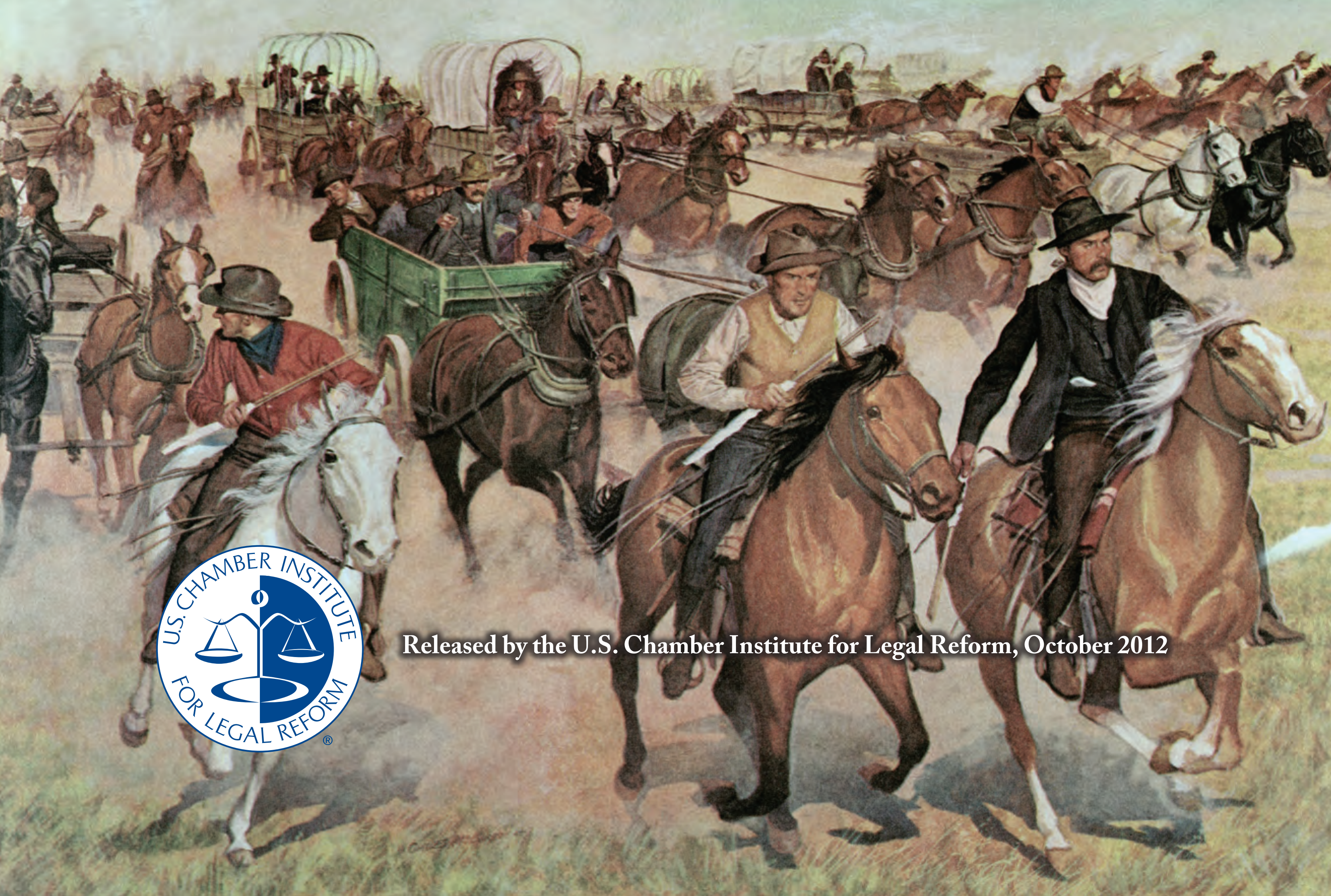
LAND RUSH!

The Latest Legal Frontier of Unclaimed Property Enforcement and Litigation



U.S. CHAMBER INSTITUTE FOR LEGAL REFORM®

Released by the U.S. Chamber Institute for Legal Reform, October 2012

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Land Rush!

The Latest Legal Frontier of Unclaimed Property Enforcement and Litigation

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The life insurance industry has long been a cornerstone of the American economy and has operated on legal terrain that, for the most part, has been stable for generations. Today, a growing number of state officials, with the help of private audit firms, are retroactively changing the rules of the insurance business as they relate to unclaimed proceeds, seeking greater transfers of funds to the states and more onerous outreach to potential beneficiaries. These changes, coupled with the aggressive enforcement approach of state officials – a "land rush" led by overlapping and competing state regulators – create questions for insurers, policyholders, beneficiaries, and state officials. This paper explores the legal tensions and business risks created by this recent approach to unclaimed property in the life insurance industry and suggests a way forward for a balanced compliance regime rooted in established law and industry best practices.

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I. Executive Summary

The life insurance industry has long been a cornerstone of the American economy – a source of financial security for 75 million households, as well as a major institutional investor in United States corporations.[1] Over the past several years, however, life insurance companies have been buffeted by a storm of regulatory inquiries, audits, settlements and civil litigation concerning the payment of death benefits and the "escheatment" of unclaimed insurance proceeds to various states. Unclaimed property laws require companies to transfer (or "escheat") to state treasuries any money or property deemed abandoned after a certain period of inactivity by the property's last-known owner. Such funds are then held by the state, nominally for the benefit of the absent owner, but as a practical matter as an indefinite, interest-free loan to the state.[2] New York, alone, currently holds over $11 billion in unclaimed property collected since 1942.[3] In an economic environment where cash-strapped states seek easy revenues, aggressive collection of unclaimed property is a natural focus of savvy state regulators and elected officials.

The tool that regulators and elected officials are using to increase escheatment of unclaimed life insurance proceeds is the Social Security Administration's ("SSA") publicly available Death Master File ("DMF") – a partial database of deaths recorded in the United States.[4] The focus on the DMF by state

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1 Life insurance companies hold more than $18.4 trillion worth of life insurance protection through individual policies and group certificates and, in 2010 alone, paid over $58 billion in life insurance death benefits, $70 billion in annuity payments, $16 billion in disability income insurance benefits, and $7 billion in long-term care insurance benefits. The industry is also vital to the national economy as it comprises among the largest institutional investors in U.S. corporate bonds: life insurers' holdings of corporate debt totaled over $2 trillion by end-of-year 2010.

See AMERICAN COUNCIL OF LIFE INSURERS (ACLI), Statement for the Record, House Financial Services Committee, Subcommittee on Financial Institutions and Consumer Credit, *The Impact of the Dodd-Frank Act: Understanding Heightened Regulatory Capital Requirements* at 1 (May 18, 2012); *see also* ACLI, 2011 LIFE INSURERS FACT BOOK 63 (2011), *available at* www.acli.com (follow "Industry Facts" hyperlink; then follow "Life Insurance Fact Book" hyperlink); Carl B. Wilkerson (ACLI), *Derivatives Market Reform: The Impact of Rules Implementing Title VII of the Dodd-Frank Act on Life Insurance Companies* (2012).

2 *See* DAVID PITT, CASH-STRAPPED STATES GO AFTER UNCLAIMED BENEFITS, USA TODAY, May 2, 2011 ("Technically states hold unclaimed property for the benefit of the owner, but in many cases the owner doesn't come forward. That means the state has use of the money interest-free. It's an easy source of revenue and an important one considering California faces a $15.4 billion budget deficit for the coming fiscal year.").

3 N.Y. STATE COMPTROLLER, COMPREHENSIVE ANNUAL FINANCIAL REPORT FOR FISCAL YEAR ENDED MARCH 31, 2011 (Sept. 1, 2011), *available at* http://www.osc.state.ny.us/finance/finreports/cafr11.pdf

4 The DMF is a database maintained and made publicly available by the SSA containing over 89 million records of deaths and including information such as an individual's social security number, name, date of birth, date of death, state or country of residence and ZIP code of last residence. The DMF does not purport to contain records for every deceased individual, and the SSA does not guarantee the database's veracity. U.S. Department of Commerce, Social Security Administration's Death Master File, *available at* www.ntis.gov/products/ssa-dmf.aspx.

officials began in 2009, when a private audit firm began a series of audits on behalf of state comptrollers seeking to identify unreported funds. Through these audits, state officials learned that some life insurance companies had been searching the DMF to determine whether annuitants had died to assess their contractual obligations to make life-contingent payments. Those companies, in some cases, had not been searching the DMF on the life insurance side to determine whether life insurance benefits should be paid. Although there were legitimate reasons why this "asymmetric" DMF searching made sense and was consistent with the underlying life insurance and annuity contracts, regulators and private actors seized upon the opportunity to demand that life insurers conduct similar searches with respect to life insurance benefits.

When these audits began, there were no laws on the books in any state that affirmatively required life insurance companies to search the DMF for deceased policyholders. Nevertheless, enforcement efforts have broadened significantly as unclaimed property regulators, insurance departments, and private auditors have recognized the potential of DMF searching to increase escheatment revenue – and, for private auditors, contingency fees – by identifying deaths that had not yet been reported to a life insurance company and corresponding benefits that had been "abandoned." These officials and private auditors have adopted two unprecedented positions with respect to unclaimed insurance proceeds: (*1*) life insurers must use the DMF at regular intervals and across all lines of business in order to identify potentially deceased policyholders or annuitants; and (*2*) life insurers must begin to "count down" to escheatment beginning on the date of death as reflected on the DMF as opposed to the date on which an insurance company is notified of a death or claim.[5] Despite the novelty of these positions, state officials have pushed insurers to pay examination and monitoring costs based on alleged failures to adhere to these new standards in the past.

Officials' expanding investigations and expansive readings of state unclaimed property laws are based on a combination of political pressure and aggressive and questionable legal interpretations. This paper explores the legal tensions and business risks created by this recent approach to enforcing insurers' escheatment obligations and suggests a way forward for a balanced compliance regime rooted in established law and industry best practices.

First, given the questionable legal foundation of the regulatory actions at issue, state officials should

[5] With respect to this second position, regulators have insisted that the date of death reflected on the DMF should constitute the beginning of the applicable "dormancy period," *i.e.*, the period of time after which property is deemed abandoned and must be escheated to the state. If proceeds are not escheated at the close of an applicable dormancy, the escheating company is subject to high rates of interest on the "late-escheated" property, as well as to additional fines and penalties.

reassess the numerous enforcement actions and specious *qui tam* suits, and provide greater oversight of and transparency into states' arrangements with private auditors who profit from pursuing unclaimed funds. Specifically, these state officials should fully disclose contingency fee deals that remove any incentive for those officials' exercise of reasoned discretion. Additionally, states that have bound individual companies in settlement agreements should ensure the settling company realizes the appropriate protection from collateral litigation. The focus of state officials should be on developing best practices to protect consumers and provide appropriate guidance for life insurance companies going forward.

Second, there is a pressing need to replace the current regime of "regulation by settlement" with uniform national standards that will give insurers effective guidance for structuring their operations and enable them to minimize business and compliance risk going forward. States should uniformly adopt a model unclaimed property act to provide clarity and certainty for insurers rather than a patchwork of rules that vary from one state to another. Rule-making and enforcement should be approached with a recognition of the operational challenges and business costs of compliance with complex unclaimed property obligations, as well as a recognition of the profound social good that life insurance and annuities provide for the United States' economy and for millions of American households. Moreover, these uniform standards should apply prospectively to enable life insurers to adopt policy forms and premium rates accounting for these new obligations. Retroactive application undermines the insurance industry's settled expectations under the terms of their contracts and may cause significant financial challenges, negatively impacting the industry's ability to make orderly payments of claims in the future.

II. Overview of Modern Unclaimed Property Laws

Modern unclaimed property laws apply to a great variety of intangible assets and complex financial products. In most instances, the owner's right to the property is not in dispute, and the only issue is whether the owner has abandoned the property within the meaning of the relevant provision of a state's unclaimed property law. Under long-settled principles of insurance law, the proceeds of a life insurance policy are payable to a beneficiary upon "due proof of death" – typically an official death certificate – provided by that beneficiary to a life insurer.[6] In the life insurance context, therefore, the beneficiary historically did not "own" policy proceeds for purposes of escheatment unless the insured had died *and a claim had been made* on the life insurance company in satisfaction of the policy's contractual requirements. State unclaimed property laws incorporate these principles by defining abandoned property as that which goes unclaimed a specified number of years after becoming "due and payable" under a policy.

While certain states have unique statutory language and structures,[7] broadly speaking, states adhere to one of three model unclaimed property acts:

- The 1966 Model Act provides that "unclaimed funds" means "all moneys held and owing by any life insurance corporation *unclaimed* and unpaid for more than 7 years after *the moneys became due and payable* as established from the records of the corporation.... A life insurance policy *not matured by actual proof of death* of the insured is deemed to be matured and the proceeds thereof are deemed to be due and payable if such policy was in force when the insured attained the limiting age under the mortality table on which the reserve is based…."[8]

[6] *See generally* R. KEETON, BASIC TEXT ON INSURANCE LAW, 445-51 (West 1971). *See also* 29-178 APPLEMAN ON INSURANCE, § 178.01(b) (noting that an adherence to the policy terms, including the requirements of notice and proof of death, is not to be considered arbitrary practice by insurers); 13 COUCH ON INSURANCE § 49:2 (2d ed. R. Anderson 1965) (noting the purpose of such requirements is to allow the calculation of liability through investigation of the claim).

[7] *E.g.* N.Y. Abandoned Property Law § 700.

[8] Uniform Disposition of Unclaimed Property Act, § 3(b), 9A U.L.A. 89 (1966) (emphasis added). The Commissioner's Comments to the 1981 Act confirm that under the 1966 Act, where "actual proof of death has not been furnished to the insurer," proceeds of a life insurance policy "generally would not have been

- The 1981 Act provides that a life insurance policy is "matured and the proceeds payable" – thus starting the clock for the presumption of abandonment – on the occurrence of (*1*) maturation by "*actual proof of death* … according to the records of the company;" (*2*) "when the company *knows* that the insured … has died," or (*3*) when "the insured has attained, or would have attained if he were living, the limiting age under the mortality table on which the reserve is based."[9]

- 1995 Model Act provides that dormancy begins after an "*obligation to pay arose* or, in the case of a policy … payable upon proof of death, … after the insured has attained, or would have attained if living, the limiting age under the mortality table on which the reserve is based."[10]

None of these model acts requires an insurer to undertake an affirmative search for potentially deceased policyholders or beneficiaries. Instead, absent a claim for benefits under a policy or – under the 1981 Act – "knowledge" of a death, the proceeds escheat when the insured person reaches the limiting age under the applicable mortality table, which is typically around 99-years as established by state law.[11] Compliance with the unclaimed property laws based on these models has long been overseen by state treasurers and comptrollers through routine audits, and life insurance companies' claims practices are regulated by state insurance departments. Until very recently, there had been no suggestion that a failure to search the DMF to determine whether an insured person had died ran afoul of any law or regulation.

reportable" until the insured reached mortality limiting age. 1981 Uniform Unclaimed Property Act §7. Commissioner's Comment.

9 Uniform Unclaimed Property Act, § 7(c)(1), 8C U.L.A. 202 (1981) (emphasis added).

10 Uniform Unclaimed Property Act, § 2(a)(8) (1995) (emphasis added).

11 *See, e.g., Conn. Mut. Life Ins. Co. v. Moore*, 333 U.S. 541, 543 (1948).

III. State Officials' New Emphasis on the Death Master File

A. Demand for Unprecedented Uses of the DMF

Although state officials – stoked by private audit firms – have leveraged for their advantage certain life insurers' use of the DMF to stop annuity payments but not to initiate payments under life insurance policies (so-called "asymmetric" matching), such use of the DMF is rooted in legitimate business concerns particular to annuities that do not equally impact life insurance business operations. The survivors of a deceased annuitant have no financial incentive to report the death of an annuitant to the company making life-contingent payments on an annuity contract; while some survivors report deaths promptly, others simply continue to collect payments to which they are not entitled, recoupment of which is a difficult and sensitive task. Life insurance beneficiaries, on the other hand, have a natural incentive to report the death of the insured to the life insurance company in order to claim benefits under the terms of the policy. As a result, underreporting of deaths is a more significant concern on the annuities side.

Both unclaimed property officials (generally state comptrollers, treasurers, or departments of commerce) and insurance regulators have leveraged this focus on asymmetric matching to justify opening undeveloped territory of escheatment, by demanding two unprecedented uses of the DMF.[12] *First*, these officials have insisted that life insurers proactively search the DMF in order to locate potentially deceased policyholders. *Second*, officials have adopted the position that a person's date of death, as listed on the DMF, should trigger the dormancy period that leads to escheatment, rather than the date on which a claim for proceeds is submitted to the insurer or, in the absence of a claim, the date on which a policy attains its limiting age. This altered timing has serious implications for the amount of interest

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[12] These positions are reflected in the terms of several multi-state settlement agreements entered into between major life insurance companies and state unclaimed property and insurance regulators over the course of the past few years. Each of these agreements requires the companies to escheat allegedly "late" payments using the insured's date of death, rather than the policy's becoming "due and payable" on the basis of a contractually required claim, as the trigger for dormancy under state unclaimed property laws. *See* MetLife, Inc. Regulatory Settlement Agreement § 2(c) ("For the sole purpose of this Agreement, the Company…shall implement policies and procedures establishing a DMF listing as *prima facie* proof of death and requiring the Company to initiate its death claims process and conduct a Thorough Search for Beneficiaries in accordance with [this Agreement].").

accrued on purportedly "late" escheatments and has featured prominently in regulators' arguments that funds have been wrongfully withheld from the state. If, for example, the DMF indicates an insured died in 2005, officials from a state with a three-year dormancy period would now take the position that unclaimed proceeds were subject to escheatment in 2008, whether or not the life insurance company was aware of the policyholder's death, much less whether or not the company had received "due proof of death" as required by most abandoned property laws. The acceleration of escheatment by means of audits and settlements also creates collateral risk for insurers that are required to escheat unclaimed proceeds prematurely and therefore may lack the protection of indemnification provisions of existing abandoned property laws.

B. *The Limits of Officials' Claims Based on Allegations of Asymmetric Matching*

The novel positions held by officials with respect to the uses and implications of a DMF match are problematic under existing law. *First*, until 2011, no state law required that life insurance companies undertake proactive searches of the DMF. Undeterred by this fact, some regulators have nevertheless threatened to pursue actions based on the loose standards of unfair claims settlement statutes. But this kind of retroactive application of newly created requirements is fundamentally unfair, not to mention untimely under applicable statutes of limitations.

Second, there is no basis for regulators' arguments that the date of death reflected on the DMF is tied to any trigger for the beginning of dormancy under any of the three Model Acts. The DMF's date of death corresponds neither to the date that benefits became "due and payable," nor the policy's limiting age, nor the date on which an insurer obtained "knowledge" of death.[13] Thus, no state's dormancy period is measured by reference to that date.

Third, there is no legal or factual basis for asserting that mere access to the DMF triggers an escheatment obligation. Under the 1966 and 1995 Model Acts, dormancy for life insurance proceeds starts to run when those proceeds become due and payable, or upon the provision by a beneficiary of proof of death, which entitles a beneficiary to his or her claim under the policy's terms. Although the 1981 Act includes "knowledge" of death as one trigger for the dormancy period, there is still no basis for an assertion that mere theoretical access to the DMF constitutes "knowledge" of the contents of that database or how those death records might intersect with millions of policy records held by an insurance company. For

[13] No state insurance code requires life insurance to be payable without satisfaction of policy conditions, such as receipt of due proof of death.

those companies that considered a DMF listing as sufficient to stop annuity payments pending an annuitant's provision of evidence of survival, a regulator would have a colorable argument that the knowledge standard of the 1981 Model Act had been satisfied with regard to a life insurance policy held by the same annuitant, but an insurer would have colorable defenses as well.

Fundamentally, the premise that access to the DMF is the equivalent of "knowledge" is wholly untenable, and even an actual match against a listing in that database cannot necessarily be equated with knowledge of death. Although in theory an insurance company could determine the date of death of some insureds simply by conducting detailed searches of the DMF using personal data within the insurance company's files, the reality is far more complex and uncertain. The parameters of search criteria required to arrive at a maximally accurate search are more art than science – and the subject of dispute among regulators, insurers, and private search firms. The efficiency and accuracy of these searches depend upon complicated matching criteria accounting for issues such as the use of nicknames (*e.g.*, "Jim" and "James"), common typographical errors (*e.g.*, the transposition of numbers in a date of birth), or other misspellings or mistakes (*e.g.*, the "Anglicization" of certain names, such as a substitution of "McDonald" for "MacDonald"). Indeed, the SSA itself disclaims any guaranty of the accuracy of the DMF with respect to any of these, or other, potential mistakes or omissions.[14] Moreover, a match against the DMF is only the beginning for a company seeking to determine whether proceeds should be paid to a beneficiary or escheated. Companies must verify through labor-intensive manual searches that the person listed on the DMF is, in fact, the same individual policyholder reflected in company records, determine whether a policy was in force at the time of that person's death, determine whether a claim has already been paid on that policy, and determine whether the policy includes a joint-survivorship provision and, if so, whether that joint-survivor is living, to name a few of the many operational complexities of performing a DMF search.

C. *The Costs and Confusion of Expanding Demands for Escheatment*

Despite the legal tensions, an affirmative requirement to perform DMF matching on a regular basis appears to be here to stay. The costs and burdens for life insurers working to comply with this new expectation

[14] As a result of concerns over the use of the DMF by identity thieves, four million death records were expunged from the DMF in 2011. In 2010, 2.8 million deaths were disclosed in the DMF, but as a result of the exclusion of state death records, Social Security officials expect that one million fewer entries will be disclosed via the DMF each year. KEVIN SACK, RESEARCHERS WRING HANDS AS U.S. CLAMPS DOWN ON DEATH RECORD ACCESS, N.Y. TIMES, Oct. 8, 2012.

are significant. Insurance companies are frequently comprised of formerly independent entities that have been merged through the acquisition of multiple companies, sometimes over decades. Such companies, therefore, often have data spread across several different platforms of various quality and reflecting different information for individuals. Collecting information sufficient to confirm that a person is or is not listed on the DMF is an enormous burden. Insurance companies must expend large sums on software and IT platforms capable of performing detailed searches, and must sort through various platforms and documents (often manually) in order to determine whether a policy was in-force on the date of death reflected on the DMF or whether the policy has previously been paid out. The time and effort involved in conducting DMF searches is taxing for even the largest insurance companies; for smaller companies, a requirement that such matches be performed would be daunting.

Without regard to these costs, the inquiries that began with allegations of "asymmetric" matching have spiraled out to ever-expanding investigations into insurance companies' general unclaimed property practices. As more officials outside of state unclaimed property departments have focused on these issues, multiple agencies *within the same state* have initiated overlapping and uncoordinated investigations into unclaimed life insurance proceeds, resulting in compounded confusion and increased burdens on insurers.

IV. Challenges of the Current Environment

In the current regulatory environment, it is no longer clear what is required and what will be sufficient, on a going-forward basis, to minimize companies' business and legal risks. Regulators' demands have not taken account of the operational complexity and costs of compliance with the newly shifted burdens of affirmative and early outreach to policyholders and beneficiaries. Meanwhile, premature payment of life insurance benefits to the wrong beneficiary or premature escheatment to the states may spawn collateral litigation by aggrieved stakeholders or shareholders.

A. Stalled Attempts at Reforming Legislation

Some legislation has been proposed that would begin to rationalize the outreach and escheatment processes going forward, but regulators and legislators are far from consensus regarding the correct approach to clarifying existing law and promulgating new standards of conduct. The National Conference of Insurance Legislators ("NCOIL"), for example, has published a resolution in support of a model law dealing with unclaimed property.[15] The NCOIL model law would require that insurance companies conduct matching of in-force life insurance policies, annuity contracts, and retained asset accounts against the DMF, or an equally comprehensive database, on a quarterly basis. The matching criteria are left unspecified, but NCOIL would require that the matching rules that are applied be "reasonably designed to identify potential matches."[16] Upon a successful match, the NCOIL model law would give insurers ninety days to conduct outreach to potential beneficiaries before notifying state unclaimed property regulators of the existence of abandoned property and escheating per applicable state law.[17]

NCOIL's approach, however, has not been widely adopted. To date, only four states have passed bills or adopted regulations embodying the basic provisions laid out in the NCOIL model law.

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[15] NCOIL, Proposed Model Unclaimed Life Insurance Benefits Act (Nov. 17, 2011), *available at* http://www.uprrinc.com/wp-content/uploads/2011/11/Proposed-NCOIL-Unclaimed-Life-Insurance-Benefits-Act-11-17-11-passed-11-21-11.pdf.

[16] *Id.* at § 4(A).

[17] *Id.* at § 4(A)(1).

Maryland has enacted a statute requiring a semi-annual DMF match; New York has issued an emergency regulation requiring quarterly DMF matching; Kentucky has adopted a law also requiring quarterly matching; and Alabama now requires a DMF match every three years.[18] As is apparent from even a cursory summary of their key provisions, these laws provide scant guidance with respect to key operational details of DMF matching, including the applicable matching criteria or uniform frequencies of searches.

Complicating matters further, the National Association of Insurance Commissioners ("NAIC") has criticized the very fact that NCOIL promulgated a model law in any form, stating that the NAIC understood that the NCOIL's model law attempted "to clarify state laws to require the use of the Social Security Death Master File," but is concerned that "insurance companies will likely use the NCOIL model as a reason the state should not complete regulatory and unclaimed property audits."[19] In other words, the NAIC has objected to any possible inference that *current* law does not require the steps insisted on by state regulators through their recent inquiries and examinations. The desire to avoid such an admission has become a reason offered by regulators to avoid clarifying the industry's obligations prospectively.

B. Settlements Fill a Legislative Vacuum

This current environment encourages regulatory disarray. The new regulatory positions requiring frequent and unprecedented usage of the DMF for outreach and escheatment may be motivated by valid public policy concerns, but they are not reflected in any existing law. Rather, regulators have relied solely on their own assertions and achieved reform without providing guidance. Insurance companies have been the recipients of subpoenas or other inquiries regarding beneficiary outreach and escheatment issued by at least ten state insurance departments. At the same time, single-state market conduct examinations have been initiated in at least nine states, and a series of retrospective and prospective multi-state settlements have been negotiated with an array of regulators from thirty-three jurisdictions across the country.[20]

Regulators and auditors show little sign of slowing their investigations or deviating from this settlement-

[18] 2012 Maryland Laws Ch. 171; N.Y. Comp. Codes R. & Regs. Tit. 11, § 226.0 (2012); 2012 Ky. Acts Ch. 58; Ala. Code 1975 § 27-15-53 (2012). A bill is currently pending in the New York General Assembly that would also require quarterly matching against the DMF. A9845B-2011, 235th Gen. Assemb. (N.Y. 2011). A similar bill introduced in Tennessee would also have required quarterly matching against the DMF, but that legislation died in committee. H.B. 2283, 107th Gen. Assemb. (Tenn. 2012).

[19] *See* Arthur D. Postal, *NAIC and NCOIL Disagree Over Unclaimed Property*, LIFEHEALTHPRO (Nov. 22, 2011).

[20] Bergstrom et al., *ALIC Annual Meeting: Navigating Through Uncertainty: Life Insurance Regulation and Unclaimed Property Audits*, May 22, 2012, *available at* www.alic.cc/Attachments/Bergstrom-Powerpoint.pdf.

based approach to unclaimed property regulation. More subpoenas are expected for other companies; more private auditors are likely to lobby state regulators for a chance to conduct company- or product-specific audits; certain states (New York and Minnesota) continue to pursue their own unclaimed property audits outside of the framework of a global, multi-state settlement; and various state officials are threatening their own "reverse false claims act" lawsuits that would impose punitive fines on companies for alleged failures to comply with unclaimed property laws extending many years into the past. For example, the Treasurer of West Virginia (acting through a private law firm) recently filed a number of lawsuits against various insurance companies seeking life insurance proceeds allegedly withheld from that state, despite the plain language of his state's unclaimed property law requiring the escheatment only upon proof of death or the attainment of a policy's limiting age.[21] Each of these actions continues to impose a significant cost on businesses that have had every reason to believe they were in compliance with the law as it is written and as (formerly) interpreted by state regulators.

The costs and burdens to insurance companies in facing these disparate and shifting standards are significant. Undertaking to respond to multiple requests for examinations concerning overlapping issues is both inefficient and expensive for any company subject to such a series of inquiries. Redundant document productions, repeated record retrievals and analyses and the establishment of non-uniform operational procedures are inherent by-products of this uncoordinated, piecemeal enforcement approach.

C. *Stymied by Settlements*

To date, only five companies have been pressed to enter into multi-state settlements; even among these five companies, the obligations encompassed by their agreements diverge. Areas of contrast between these settlements include: insurers' new obligations with respect to certain industrial life insurance policies; whether companies must undertake matching obligations even for those policies for which the company is not the record keeper with respect to individual insureds' data (*e.g.*, for certain group life policies); whether certain low-dollar policies are excluded from reporting and escheatment requirements; and the frequency and thoroughness of the matching requirements with respect to the DMF. The details of outreach to beneficiaries, the inclusion or exclusion of ERISA-covered policies and contracts, the permissibility of requiring a valid death certificate prior to escheating and state regulators' prospective interpretation of dormancy triggers each remain unsettled for the industry at large.

[21] *See*, *e.g.*, Complaint, *State* ex rel. *Perdue v. Prudential Ins. Co. of Am.*, C.A. No. 12-C-290 (Cir. Ct. – Putnam Cnty. Sept. 20, 2012).

Disparate enforcement actions create confusion and a potentially unlevel playing field amongst life insurers, and industry-wide guidance is unlikely to result from a series of one-company settlements. *First*, the different terms of the various agreements create unintended competitive disparities between insurers who are not approached with enforcement proceedings, and even among the insurers executing those agreements. For example, differing matching criteria imposed on different insurers may result in substantial competitive advantages for companies that strike more attractive settlements with less burdensome matching requirements, or that avoid a settlement altogether.

Second, the settlements provide no roadmap for the future operations of life insurance companies. The advantage of a rules-based regulatory regime is the industry's confidence that rules and laws are fixed: industry participants can undertake compliance and project implementation costs years into the future. By contrast, regulation-by-settlement raises the possibility that regulators' views as to the application of law may shift from one subpoena to the next, making a settled plan for compliance impossible. Moreover, the settlements reached to date cannot provide an indication of regulators' long-term plans insofar as those settlements incorporate sunset provisions and provisions that guarantee that the settlement will be amended in the event that future agreements are materially more favorable to other companies. Those mechanisms deprive individual settlements of value as guidance to other companies as to the behavior to which regulators will expect the industry to conform in the months and years ahead. This lack of clarity is especially burdensome on smaller companies that lack the resources to fund multiple rounds of reinvention for their compliance and operations teams.

Third, and most basic, this approach to regulation leaves the content of state law unsettled, especially with respect to the events that validly trigger the running of an unclaimed property statute's dormancy period. As noted, officials' insistence on the mandatory use of the DMF, and on the significance of a date of death as reflected on the DMF, often conflicts with settled standards and laws within the insurance industry, for example by up-ending the long-standing requirement that proceeds of a life insurance policy are payable to a beneficiary upon "due proof of death" provided by that beneficiary to a life insurer.[22] Further, an insistence on using the DMF's date of death as the basis for the beginning of dormancy results in early escheatment for which insurers may not be protected under state unclaimed property laws' indemnification provisions. Not only do these changes apply more onerous standards than would state law as written, but by applying novel interpretations of dormancy triggers and escheatment

[22] *See supra* note 6 and accompanying text.

obligations, settlements are fundamentally altering the obligations and responsibilities under *existing* contracts between insurers and their policyholders.[23] Insurers' obligations are being transformed in unprecedented ways that, even if constitutional, substantially alter the costs of offering coverage and administering claim settlements.

D. Opportunistic Audit Firms

These seismic shifts in insurers' obligations have predictably opened the door for private companies – chief among them Verus Financial and, more recently, Total Asset Recovery Services, Inc. – seeking to profit from "recovering" allegedly late escheatment payments.[24] Their theory of recovery is based on the very reforms already required by regulators' newly developed approaches to the application of unclaimed property laws, rather than the actual provisions of those laws or existing regulations. These private parties have arrived in two forms: bounty-seeking audit firms and private *qui tam* relators.

With respect to private audit firms, it is inappropriate for officials to allow private firms to direct the course of public policy to the exclusion of a reasoned application of law by disinterested public officials. But this is precisely what state unclaimed property regulators have allowed. The profitability of these audit firms depends on their recouping a percentage of funds that would otherwise benefit the public treasury. It also depends on their mining massive amounts of data to uncover relatively small, discrete amounts of unclaimed proceeds. These audits, therefore, quickly balloon into unwieldy and largely unfruitful expeditions. By outsourcing the expense of the audit, however, regulators dispel of both the need to assess the costs of unmoored explorations into insurers' past escheatment practices and any incentive to consider whether those practices actually conflict with existing law.

Meanwhile, those audit firms that are either too slow or unorganized to jump on the market conduct exam bandwagon simply file suit in state court seeking the same return of allegedly late payments, purportedly on behalf of the state. Ironically, certain of these

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23 Certain state officials have argued on the basis of *Connecticut Mutual Life Insurance Co. v. Moore*, 333 U.S. 541 (1948), that contractual defenses to payment of benefits under a policy – for example, lack of a perfected claim or due proof of death – are no impediment to a state's right to demand escheatment. *Connecticut Mutual* was an action for declaratory judgment brought by a group of out-of-state insurance companies seeking to block enforcement of New York's abandoned property law against them. While the Supreme Court upheld that particular law against challenges brought under the Contracts and Due Process Clauses of the Constitution, nothing in the decision requires an insurer proactively to search for deceased policyholders or beneficiaries or to escheat based on mere access to the DMF, absent notification of a claim under a policy. Notably, *Connecticut Mutual* was decided in 1948, long before the existence of either the DMF or technology capable of affirmatively searching for deceased policyholders, and was decided without the benefit of any factual record, *see id.* at 556 (Jackson, J., dissenting). No court has spoken on that case's import with respect to the current drive for unclaimed property or the changes to insurers' settled obligations imposed through these recent efforts.

24 Unclaimed property audits initially focused on the larger life insurance companies, but recently have been expanded to target middle-tier companies; these audits are being led by new private firms such as ACS Unclaimed Property Clearing House (UPCH) and Kelmar.

suits have been filed on behalf of states that have *already* settled their unclaimed property disputes with the defendant companies.[25]

[25] *See, e.g.*, Complaint, *State* ex rel. *Total Asset Recovery Services LLC v. MetLife, Inc.*, et al., Case No. 2011-L-001225 (Ill. Cir. Ct. – Cook Cnty. Jan. 24, 2011) (seeking the return of unclaimed life insurance proceeds already addressed in Illinois' acceptance of the defendants' multi-state settlements). This suit was recently dismissed upon the parties' stipulation. Agreed Order of Dismissal, *Total Asset Recovery Servs.*, Case No. 2011-L-001225 (Ill. Cir. Ct. – Cook Cnty. Sept. 6, 2012).

V. Recommendations for More Balanced Unclaimed Property Collection

The current regulatory approach means that insurers' compliance with existing statutes and regulations may nevertheless attract negative attention from those regulators and the private firms that profit from unbounded audits. Officials' lack of fidelity to the very laws they enforce is both unfair and expensive for life insurers and taxpayers alike. This state of affairs must end.

First, state officials should immediately act to impose greater oversight of the arrangements between private firms and state treasurers and comptrollers. Oversight should include greater attention to the legal theories under which private audit firms are operating. Where those firms are seeking to uncover funds based on a theory that extends beyond funds that are legally required to be escheated, officials should either insist on an audit rooted in actual legal requirements or cut ties with those auditors. Officials should also provide full public disclosure of contingency fee arrangements with those auditors, as such arrangements eat into funds rightfully owed to missing property owners or taxpayers and remove any incentive for officials' exercise of reasoned discretion as to the conduct of the audit.[26] State Attorneys General should also proactively move to dismiss existing *qui tam* actions that lack merit.

Second, and most crucial for the future, must be the adoption by state legislators of uniform rules and standards for determining when property is to be deemed "abandoned," and for defining the circumstances under which an insurer is obligated to undertake affirmative outreach for policyholders or beneficiaries. Only a uniform model law will give insurers the appropriate guidance for structuring their operations and enable them to minimize their risks and expenses going forward. Any model law must

[26] Relatedly, Verus Financial has recently applied for, and received partial approval of, a patent for its DMF-matching-criteria methods and associated computer software. The patent would lend an air of authority to such matching logic – which is necessarily imperfect and properly subject to cost-benefit analysis by insurers and state officials. This development aggravates the conflict of interest posed by Verus's initiation of these audits and support for state-legislated matching criteria. If a single auditor can command licensing fees for use of its methods and software, that auditor stands to benefit by pressing for ever-wider application of its matching logic, without regard to the costs or utility of its patent-protected criteria.

take into consideration the fact that not all insurance companies are the same and that the imposition of new requirements when imposed on a retroactive basis could have significant adverse financial consequences, especially for smaller companies. Thus, states should act quickly to adopt a uniform model unclaimed property act that provides clarity and certainty for businesses, and should do so while taking account of the operational complexity and business costs of compliance with a reformed unclaimed property escheatment regime. The NCOIL model law is a starting point, and those areas left unsettled by the NCOIL model – for example, matching rules to be applied by insurers when searching the DMF or equivalent databases – should be clarified in a uniform fashion by state insurance and unclaimed property regulators, working in cooperation with the operational and technical personnel at insurance companies of all sizes.

Finally, for those states that have entered into settlement agreements with life insurance companies regarding past escheatment practices or future outreach procedures, signatory officials should take a public and proactive role in ensuring that the release and immunity provisions of those agreements are respected. *Qui tam* plaintiffs and private auditors continue to seek further gains from investigations of life insurers that have already created both look-back and prospective procedures for complying with the demands of state unclaimed property and insurance regulators, but without the active support of their official counterparties those companies are deprived of their rights under those agreements.

VI. Conclusion

The combination of complicated financial products and an acute need for revenues has led states to push into new a frontier of increasingly aggressive – and disturbingly uncodified – interpretations of unclaimed property law. Long-established readings of unclaimed property laws, endorsed by years of cooperation with state regulators, have given way to an environment of unpredictable enforcement, driven in part by private companies seeking to benefit at the expense of the public fisc. This approach subjects life insurers to expensive, redundant, and unforeseeable examinations by state officials. By adopting model laws, state legislatures can take an important step toward rationalizing the rush for escheatment of unclaimed life insurance proceeds, and by exercising renewed discretion over those laws, state regulators can discourage unmeritorious investigations and lawsuits founded on flimsy legal bases.

Life insurance companies have, to date, borne the brunt of regulators' aggression, but other industries and financial products are equally likely targets of the new piecemeal enforcement regime. We hope this examination of the experience of the life insurance industry can help open a dialogue on the issues and provide officials with suggestions for a more productive way forward.

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