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Drafting Committee To Revise the *Uniform Unclaimed Property Act*
c/o Katie Robinson
Uniform Law Commissioners
111 N. Wabash Avenue
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Chicago, IL 60602

**Revised Uniform Unclaimed Property Act**

Dear Drafting Committee Members:

On behalf of the U.S. Chamber Institute for Legal Reform ("ILR"), I write regarding the draft amendments to the Uniform Unclaimed Property Act (the "Act") dated February 17, 2015. ILR is an affiliate of the U.S. Chamber of Commerce dedicated to making our nation's overall legal system simpler, fairer and faster for all participants. The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of over three million businesses and organizations of every size, sector and region and dedicated to promoting, protecting and defending America's free enterprise system.

ILR commends the Uniform Law Commission Drafting Committee ("Drafting Committee") on a strong start toward unclaimed property reform as reflected in the recent draft. We believe that additional reforms are needed, however, to facilitate

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responsible and fair enforcement of state unclaimed property laws while minimizing the potential for abuse that can result from contingency fee arrangements with private auditors. In April 2014, ILR published a "best practices" guide for state unclaimed property administrators that proposed three categories of reforms pertaining to the engagement of private audit firms: (i) transparency reforms, (ii) fee-arrangement reforms, and (iii) contract reforms.[1] While we are pleased that the proposed revisions to the Act incorporate some of the transparency reforms we recommended, we urge the Drafting Committee to adopt additional reforms regarding fee arrangements and private auditor contracts as set forth below.

### A. Background on the Need for Reform

State unclaimed property laws, when responsibly and fairly enforced, serve several important functions. Such laws, among other things, help reunite rightful owners with their property and ensure companies are incentivized to protect abandoned consumer property. However, in recent years, not all states have enforced unclaimed property laws fairly or within the boundaries of the law. These states are often enticed by profit-driven private auditors, rather than returning property to rightful owners. However fairly a state administers its unclaimed property laws, it is important to adhere to best practices when enforcing the law, especially when that enforcement responsibility relies heavily on outside auditors.

Although the enforcement of unclaimed property laws extend far beyond the life insurance industry, recent events surrounding audits targeting life insurance companies demonstrate the perils of contingency fee arrangements with private unclaimed property auditors. In 2009, a private audit firm began a practice of requiring life insurance companies to cross-reference their policy records against the Social Security Administration's publicly available Death Master File ("DMF") – a partial and unverified database of deaths recorded in the United States – in order to identify policyholder deaths that had not yet been reported to the insurance company and corresponding benefits that had been "abandoned." Insurance companies maintained that the private auditors' requirements had no legal basis, but the companies had scant opportunity to challenge them. The auditors failed or refused to issue formal audit findings that an insurance company could challenge in an administrative proceeding, thereby evading review of their legal positions. At the same time, unclaimed property administrators fueled significant adverse publicity for

[1] *See* http://www.instituteforlegalreform.com/uploads/sites/1/BestPractices.pdf.

the life insurance industry premised on the assumption that insurers had been legally obligated to search the DMF for potentially deceased policyholders but had failed to do so, and the number of life insurance companies facing private audits continued to grow.

The audits imposed substantial costs and burdens on companies, often requiring the hiring or redeployment of dozens of employees to meet the private auditors' demands. Faced with burdensome audits, numerous companies entered into multi-state settlements, agreeing, despite strong legal defenses, to search the DMF for escheatment purposes, to pay interest calculated from the date of death on all amounts escheated (regardless of when the company actually learned of the death and would have been in a position to process a claim or escheat funds absent DMF searching), and to pay to the states millions of dollars to cover their costs of investigation.

Recent legal developments have made clear, however, that the industry was correct: the private audit firms' demand that insurance companies cross-reference their book of business against the DMF, which resulted in substantial contingency fees for the audit firms and substantial revenues to the states, is not supported by law.[2] There have been no countervailing rulings to date by a federal or state court upholding the position taken by unclaimed property administrators and private auditors with regard to DMF searching.

The experience of the life insurance industry is a cautionary tale about the risks of inadequately supervised private audit firms operating on a contingency fee basis. The enforcement of unclaimed property should strike a balance between the interests of returning property to rightful owners and the fair application of the law. To obtain

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[2] *See, e.g., Total Asset Recovery Servs. v. MetLife, Inc.*, Case No. 2010-CA-3719 (Fl. Cir. Ct. Aug. 20, 2013) (holding that Florida's unclaimed property law does not require DMF searches), *aff'd*, Case no. 1D13-4420 (Fla. App., 1 Dist., Sept. 19, 2014) Sept. 19, 2014; *Thrivent Financial for Lutherans v. State of Florida, Dep't of Financial Services*, Case No. 1D13-5299 (Fl. App., 1 Dist., Aug. 5, 2014) (same); *State of West Virginia ex rel. John Purdue v. Nationwide* (Dec. 27, 2013) (dismissing lawsuits brought by West Virginia Treasurer against 69 life insurance companies on the ground that the West Virginia unclaimed property law does not require DMF searches); *Feingold v. John Hancock Life Ins. Co. (USA)*, Civ. Action No. 13-10185-JLT, 2013 WL 4495126, at *2 (D. Mass. Aug. 19, 2013) (insurance laws of Massachusetts and Illinois do not require insurer to search out potentially deceased policyholders), *aff'd*, 753 F.3d 55 (1st Cir. May 27, 2014); *Andrews v. Nationwide Mut. Ins. Co.*, No. 97891, 2012 WL 5289946, at *5 (Ohio Ct. App. Oct. 25, 2012) (insurance company under no legal duty to search the DMF to determine whether policyholders had died).

this balance, the Drafting Committee should prohibit contingency fee auditors and require state unclaimed property administrators to follow transparency and contracting best practices when engaging private auditors. The recommendations below provide sensible safeguards to maintain the credibility and integrity of the enforcement of a state's unclaimed property law.

## B. Recommended Revisions to the Act

### 1. Contingency Fee Prohibition

*The Drafting Committee should prohibit the use of contingency fee arrangements between states and private auditors in contracts to conduct unclaimed property audits.*

While the draft revisions to the Act contain a 10 percent cap on contingency fee arrangements between private auditors and state unclaimed property administrators, the draft should go further by incorporating a flat prohibition on contingency fees. As the Reporter Comments note, "[c]ontingent fee auditors are paid very large amounts of money and have a substantial economic incentive to adopt aggressive examination techniques." Simply capping the fees at 10 percent does little to significantly alter the private-profit motives of private auditors that the Reporter Comments note. In fact, many state contracts for private auditing services include contingency fee amounts similar to 10 percent, and it is in these states we have witnessed some of the most egregious private auditor practices. Accordingly, by including a similar fee structure and amount in the revised Act, the incentive problem recognized by the Drafting Committee and the holder community is not addressed.

Therefore, the Drafting Committee should prohibit the use of contingency fee arrangements between states and private auditors. Several states have already enacted statutes barring or restricting the use of contingency fee auditors in recognition of the problematic incentive structure of such arrangements,[3] and several other states have recently considered banning such arrangements.[4] Requiring administrators to

[3] In recognition of this problematic incentive structure Illinois, Virginia, and North Carolina have enacted statutes that limit or bar the state's unclaimed property administrators from relying on contingency fee auditors to collect unclaimed property. *See* 765 ILCS 1025/24.5 (banning the use of contingency fee auditors for in-state businesses); Va. Code Ann. 55-210.24(D) (banning the use of contingency fee auditors for in-state businesses); N.C.G.S. § 116B-8 (banning the use of contingency fee auditors except with regard to the life insurance industry).

[4] Oklahoma H.B. 1741 (2015); Delaware S.B. 215 (2014); Michigan H.B.5524 (2012); Michigan H.B. 5525 (2012); Michigan H.B. 5526 (2012).

compensate private auditors on an hourly basis or other alternative fee structure that better correlates fee payments with the actual value of the work completed will eliminate the risk of overly aggressive enforcement that exceeds the boundaries of the law. These alternative fee structures will also help ensure that private audit firms prioritize accuracy and operate under the highest ethical standards, befitting their role as representatives of the state. Any resource challenges associated with alternative fee arrangements can be mitigated by implementing a robust voluntary disclosure program or structuring contract payments to be due after the auditor remits unclaimed property to the state.

### 2. Transparency Best Practices

*The Drafting Committee should require unclaimed property administrators to:*

a. *Make a written determination prior to engaging a private auditor that such engagement is both cost-effective and in the public interest.*

b. *Post such determination on the unclaimed property administrator's website.*

c. *Subject contracts for private audit services to an open, competitive bidding process.*

d. *Post contracts on the unclaimed property administrator's website for public inspection throughout the duration of the contract.*

While we are pleased to see that the existing draft revisions to the Act incorporate some of these transparency reforms, such as the competitive bidding and written determination requirements, the draft should include full transparency. Under the draft language, the required written determinations regarding whether or not it is appropriate for the state to hire a private auditor fail to include a determination that privately contracting for the services is in the public interest. When a private party is enforcing laws on behalf of the state, a determination that this arrangement is in the public interest should be made. Additionally, while the draft includes a provision requiring the state to provide businesses under audit with the relevant private auditor contract, it does not include a provision that would make the contract easily available to the public. The public should be able to easily access these contracts through the state unclaimed property administrators' website rather than being forced to comply with state Freedom of Information Act hurdles.

Accordingly, we urge the Drafting Committee to incorporate additional and more stringent transparency requirements such as those listed previously. Such transparency will ensure that unclaimed property administrators retain the highest

quality private audit firms that deliver the best value to the state and are in the best interest of the public. In addition, public posting of the contracts will ensure that unclaimed property administrators and private audit firms are accountable to the public for fee arrangements impacting public funds and ward off any inclination for private auditors to engage in "pay-to-play" activity to receive a state unclaimed property contract award.

### 3. Contract Best Practices

*The Drafting Committee should require unclaimed property administrators to:*

a. *Require private auditors acting on behalf of the state to act with the highest ethical standards befitting representatives of the state, to conduct all audits within the boundaries of applicable unclaimed property law, and to refrain from pursuing abusive, unreasonable or cumbersome audit procedures.*

b. *Provide that the unclaimed property administrator shall at all times retain complete control over the course and manner of any audit conducted by a private auditor and shall not delegate to private auditors substantive decision-making authority regarding the types of property to be pursued, the legal theories underlying audit practices, or the initiation, resolution, or termination of an audit.*

c. *Require private auditors acting on behalf of the state to issue formal audit findings at the conclusion of an audit when requested by the holder of unclaimed property.*

d. *Provide that any holder of unclaimed property subject to audit by a private audit firm may contact the unclaimed property administrator's staff directly on any matter pertaining to the scope of, legal justification for, or resolution of the audit.*

ILR commends the Drafting Committee on including a provision requiring Administrators and private auditors to present audited businesses with final audit findings at an audit's conclusion. However, contracting reforms such as making clear private auditors must act with the highest ethical standards and that unclaimed property holders under audit have the right to contact Administrators directly should also be fundamental provisions in a private auditor contract. These contracting reforms guarantee an appropriate degree of oversight and accountability for private audit firms and help ensure that all audits are conducted within the boundaries of the law — safeguards necessary to ensure the integrity of the private unclaimed property audit industry. Certified public accountants are overseen and regulated by the government-created Public Company Accounting Oversight Board and associations like the American Institute of Certified Public Accountants. However, there is no

equivalent corollary monitoring private auditors hired by states to conduct unclaimed property audits. Therefore, the Drafting Committee should include these additional reforms in the next revision of the Act to ensure unclaimed property audits conducted by private parties on behalf of the state include appropriate safeguards.

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On behalf of ILR, I thank you for your consideration of these proposals and for your continued leadership on the pressing issue of unclaimed property reform.

Sincerely,

Harold Kim
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U.S. Chamber Institute for Legal Reform