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Unclaimed Property Issues in the Insurance Industry: Be Prepared for Changes

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The recordkeeping and reporting of unclaimed property, such as unclaimed policy benefits and premium refunds, can present insurance companies with significant risk and compliance costs.

Large life insurance companies have been subject to close scrutiny and aggressive state unclaimed property audits for a number of years. More recently, however, health insurance and property and casualty (P&C) carriers have begun encountering similar audit experiences.

Some insurance industry and general business organizations have responded to these developments by urging state legislatures to adopt limits and safeguards that provide insurers with some relief from the significant administrative and financial burdens these audits can cause. Insurers in all lines of business are advised to stay up to date on legislative proposals, current litigation, and evolving unclaimed property audit practices that could affect their businesses.

How We Got Here: Basic Unclaimed Property Concepts

To appreciate the significance of current unclaimed property trends, it can be helpful to review how statutory obligations for unclaimed or abandoned property originated. Under common law, whenever property is abandoned, that property ownership transfers or “escheats” to the state. The state, in turn, uses the abandoned property for public good. This principle applies not only to abandoned tangible and real property but also to intangible property such as uncashed checks, refunds, credit balances, abandoned shares of stock, unclaimed dividends, and various types of insurance payments, including unclaimed policy benefits.

In the United States, individual states act as custodians of such abandoned or unclaimed property, stepping into the shoes of the owner. The theoretical rationale is that the permanence of the states as compared to insurance companies leaves property owners in a better position to be reunited with their property. As such, businesses are required to identify and report unclaimed property and to turn it over to the appropriate jurisdiction. In most cases, the jurisdiction is determined by the last known address of the owner of the property. If that address cannot be determined, the property escheats to the state in which the business is domiciled (incorporated). As a result, insurance companies often find themselves subject to the unclaimed property laws of many different U.S. jurisdictions.

The laws vary from state to state, but generally speaking, intangible property must meet three criteria to be considered unclaimed property:

1. The property meets the legal definition of unclaimed property in the jurisdiction. Certain types of property do not fall within the states' purview, and some states offer exemptions for some property types, such as business-to-business or "de minimis" transactions.
2. The appropriate dormancy period has elapsed. This period varies depending on the type of property in question. For example, many states consider uncashed payroll checks to be unclaimed property after one year, while the dormancy period for other types of property often is three to five years.
3. There has been no owner-generated contact during the dormancy period.

If property meets these three conditions, the company that holds the property (the holder) must report it to the state.

Audits and Estimates: Revenue Generators for States

Some states have come to rely on unclaimed property funds as a steady source of revenue. In Delaware, for example, unclaimed property collections in fiscal year 2016 amounted to $528 million – 13 percent of the state's entire operating budget.[1] And any unclaimed property proceeds go directly into the state's general fund.

Because so many companies are incorporated in the state, Delaware is something of a bellwether for unclaimed property actions. But other states have come to regard unclaimed property as a significant revenue generator and have begun to work aggressively to make sure companies report and remit all such property.

In most states, unclaimed property administrators engage private firms to conduct audits in exchange for a contingency fee based on the total amount of funds collected. Because these companies' fees are directly related to the funds they collect, insurers and industry groups have objected to particularly aggressive audit practices.

This situation is further complicated because, unlike tax obligations, many states do not have a defined statute of limitations for reporting unclaimed property. As a result, audits can span several decades' worth of transactions. Because most companies do not retain records for such long periods of time, auditors will choose a more recent sampling period for which records do exist and will then estimate obligations for prior years.

The combination of contingency fee audit contracts and aggressive estimation techniques has led to large assessments, especially in the past few years when auditors began targeting life insurance companies. Inevitably, it also has led to court challenges and efforts to rein in audits through legislation.

In late 2016, the Uniform Law Commission (ULC) finalized a draft of the *Revised Uniform Unclaimed Property Ac*t (RUUPA). This revision is a significant step, as the model law had not been updated since 1995, before many of the most aggressive audit and estimation practices were adopted.

Within two months of the final RUUPA draft, the state of Delaware passed legislation that adopts some – but not all – of the RUUPA language. Utah and Tennessee also have passed new RUUPA-inspired laws, and legislatures in a number of other states are working on similar bills. Although statutory changes are based on the RUUPA language, variations exist from state to state, and departures from the RUUPA model are, in some cases, significant.

At the same time, case law governing unclaimed property is evolving. Among the various recent or pending cases, one particularly important decision came in 2016: *Temple-Inland v. Cook*.[2] In ruling for the plaintiff, the U.S. District Court for the District of Delaware declared that Delaware's approach to auditing and the state's method of estimating an unclaimed property liability violated the company's due process rights. The court stated that Delaware had "engaged in a game of 'gotcha' that shocks the conscience." The case was settled less than two months later when the state and Temple-Inland reached a voluntary settlement agreement.

Issues for Life Insurance Companies

Of the various types of insurance businesses, life insurers have been under the most intense unclaimed property audit scrutiny. After some of the nation's largest insurers agreed to large settlements in several high-profile situations, other auditors began copying the pattern and expanding audits to smaller insurers.

One of the most contentious issues is the question of what steps an insurer must take to determine if a policyholder is deceased. Beginning in 2009, some states began requiring insurers to cross-reference their policies against the Social Security Administration's Death Master File (DMF) on a recurring basis, rather than waiting for beneficiaries to file a claim or otherwise provide notice of death. The objective was to proactively identify more potential instances of unclaimed benefits.

Insurance industry groups pointed out that at the time, no law required insurers to take such actions, particularly since the DMF is a partial and unverified database that often generates false positives – incorrect declarations of death that later must be reversed due to typographical errors or other clerical issues. This contention was reinforced by a 2013 Government Accountability Office report that found the Social Security Administration "does not independently verify all reports before including them in its death records."[3]

Furthermore, insurers require certain steps to perfect a claim, such as receiving a verified death certificate and verifying the appropriate beneficial parties.

Conversely, states and private auditors have maintained that insurers routinely relied on DMF data to suspend annuity payments to deceased customers. So, they contend, why shouldn't the same source be acceptable evidence of death for life insurance claims?

In 2015, the National Conference of Insurance Legislators (NCOIL) updated its *Model Unclaimed Life Insurance Benefits Act* in an attempt to standardize these requirements. More than 20 states now have adopted variations of the model act, requiring insurers to conduct semiannual DMF searches. Many states also require insurers to conduct "fuzzy matching" to capture misspellings, transposed letters or numbers, and other variables that could lead to a positive match being overlooked.

While this trend is leading to some clarity, many questions remain, including how to manage varying requirements from state to state and how to handle false positives. For many insurers, the larger question is how to address the significant resource requirements that are needed to handle the intensive manual data reviews that often are required for fuzzy matching of DMF data and related claims processing.

Issues for Health Insurance Companies

For many years, unclaimed property audits were less frequent in the health insurance sector. Since early 2016, however, a noticeable increase in audit activity has taken place. Insurers and plans, both large and small, are beginning to be audited by some of the same contract audit firms that swept through the life insurance industry using the DMF file and other questionable theories for determining what might be considered unclaimed property.

In the case of health insurance, it seems that unclaimed property audits might be aimed beyond simply identifying unreported, uncashed checks. Contract auditors appear to be interested in exploring the claims adjudication process to identify sources of unclaimed amounts, such as miscalculated patient responsibility amounts, errors in crediting patient payments against deductibles, and errors resulting from provider and payer settlements. In so doing, state administrators and private audit firms are attempting to expand the definition of unclaimed property to include transactions that arise from the ordinary conduct of business – a potentially significant expansion.

Health insurers face other unique concerns, including how to maintain the privacy of protected health information (PHI) given the massive amount of information these auditors request. Unresolved questions also exist about the commingling of patient data, insurers' responsibility for tracking patients, and the inevitable concerns over possible negative stereotypes and public relations problems as insurers seek to maintain responsible and practical processes for managing claims. Health insurers are advised to follow unclaimed property developments closely, be prepared for audits, and consider whether proactive state voluntary disclosure agreements might be advantageous.

Issues for P&C Insurance Companies

The property and casualty (P&C) insurance industry has seen a relatively moderate amount of unclaimed property audit activity so far, but considering how states and contract auditor firms have been expanding their scope to include health insurance companies and smaller life insurers, presumably P&C companies will see increased audit scrutiny.

Challenges unique to P&C insurers include the need to distinguish between “offers to settle” and “fixed and certain payments.” A best practice is to record such payments as distinct or in separate accounts altogether. It also is important to adequately document how offers ultimately are settled, so that they are not misinterpreted as pending or unresolved. Unidentified payments and suspense accounts are areas auditors generally scrutinize as well.

P&C insurers should retain clear documentation for all transactions, especially when legacy systems are involved as the relevant data can be difficult to maintain for often protracted periods. This step can help establish a clear audit trail to show how claims were resolved, why checks were voided, and how amounts in suspense or unidentified payments were correctly resolved.

Like health insurers, P&C companies should analyze risks and take steps to address audit exposure proactively. It also is wise to investigate whether it is advisable to submit either catch-up filings or state voluntary disclosure agreements prior to receiving an audit notice. With the rise in costly natural disasters and loss events (for instance, hurricanes Katrina, Sandy, Ike, and Rita), and the resulting spike in claims now reaching or passing unclaimed property dormancy periods, P&C companies should prepare in advance for fee-hungry contingent fee auditors.

The Bigger Picture

In addition to exploring steps to counter certain arguments unclaimed property auditors might make, insurers of all types should understand that auditors might be looking further upstream in the chain of transactions to identify possible breakdowns in documentation that could result in putative unclaimed property. Auditors no longer are content with identifying uncashed checks or unapplied credit balances. Instead, they are looking for anomalies that occur earlier, such as during the adjudication process. Unfortunately, this scope creep often is welcomed by state unclaimed property administrators for the extra revenue it can generate.

Despite attempts to standardize and clarify various state laws, certain state governments likely will continue filling their coffers with unclaimed property proceeds. Additionally, contingency fee audits and aggressive estimation practices will continue to be a concern for insurers of all types.

Learn More

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[2] *Temple-Inland, Inc. v. Thomas Cook*, No. 1:14-cv-00654-GMS (D. Del. 6/28/16), http://www.ded.uscourts.gov/opinions/temple-inland-inc-v-thomas-cook-his-capacity-secretary-finance-state-delaware

[3] "Unclaimed Property: Best Practices for State Administrators and the Use of Private Audit Firms," U.S. Chamber of Commerce Institute for Legal Reform, April 15, 2014, http://www.instituteforlegalreform.com/research/unclaimed-property---best-practices-for-state-administrators-and-the-use-of-private-audit-firms

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