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Unpaid Insurance Benefits Issues Continue to Intensify

Attention to unclaimed property issues affecting life insurance companies – including issues relating to unpaid life insurance and annuity benefits – has significantly escalated in recent weeks, due to regulatory actions, media coverage, and public expressions of interest by the plaintiffs' bar. This Legal Alert discusses those developments and puts them into perspective.

Given the precarious financial condition of many states, the pace of unclaimed property audits has increased rapidly in the past several months. Over the past three years, more than 20 insurance companies have become subject to unclaimed property audits by 35 cash-hungry states. What many insurers originally viewed as routine unclaimed property audits of their business have now evolved into a challenge to alleged widespread industry practices pertaining to compliance with states' unclaimed property laws. State regulators are asserting that insurers are engaging in an alleged industry-wide practice of improperly failing to pay death benefits to the beneficiaries of life insurance policies. Insurers have also been accused of reducing cash values of these policies by collecting insurance charges from deceased policyholders. Once the policy's cash surrender values were exhausted, the insurer would purportedly cancel the policy. State officials claim that insurers consult certain government databases – e.g., the Social Security Administration's Death Master File (DMF) – to terminate annuity and claim payments when beneficiaries die, but ignore these same databases to determine if policyholders have died and beneficiaries should be paid.

A contingent fee audit firm founded by former class action plaintiff attorneys has been retained by the unclaimed property administrators of many states to conduct these audits. These state audits have gone beyond traditional unclaimed property audits in seeking information and taking positions about the insurer's procedures. (Traditional unclaimed property audits have focused more on actual property and accounting information.) Positions that the auditors are taking or suggesting include the following:

- Insurers may have a "duty" to use the Social Security Death Master File to try to identify insureds under life insurance policies who have died.
- Unless an annuity's Maturity Date is extended by contract or an owner's affirmative behavior, an annuity that remains in the accumulation phase after the Maturity Date should be treated as unclaimed property.
- Insurers should have procedures in place to carry out their alleged duties related to locating and notifying beneficiaries.

States have also addressed retained asset accounts in their audits, seeking information that appears to go far beyond the legitimate unclaimed property issues that such accounts may raise.

The unclaimed property audits have generated significant regulatory activity affecting the insurance industry. John Chiang, the California Controller, recently announced a settlement with a major life insurer and is now promising to "pursue all actions necessary – including litigation – to bring the rest of the industry into compliance."¹ Moreover, the California Department of Insurance recently issued a subpoena to a second major life insurer to testify at hearings regarding various practices relating to life insurance

¹ April 22, 2011 Press Release of California Controller, http://www.sco.ca.gov/eo_pressrel_9934.html

and annuities. The hearing may be a prelude to intensified multi-state market conduct exams for other insurers in this area.

On April 28, 2011, the Connecticut Insurance Department announced that it had launched a formal inquiry into life insurers' business practices regarding not only the timely payment of death benefits to beneficiaries, but the protocol used by insurers to locate those beneficiaries. The Commissioner stated that he was concerned that insurers allegedly use the DMF to terminate annuity, disability or other payments, but do not use the same database to check dormant life insurance policies to see if insureds have died. Describing this alleged practice as a "double standard that we will not tolerate,"² the Connecticut Department stated that it was putting insurers on notice that it "fully expects them to make every effort to locate all beneficiaries – especially in this age of rapid communication and countless databases. If, after good faith efforts, they cannot locate them, then they must comply with state laws regarding unclaimed property." *Id.*

The Florida Insurance Department has scheduled a public hearing (that Sutherland will attend) for May 19, 2011, to evaluate insurers' practices regarding use of the Social Security Administration's DMF in compliance with unclaimed property laws. Two insurers were subpoenaed to appear at the May 19 hearing in Tallahassee "to explain their company's business practices regarding these issues."³ The Florida Office of Insurance Regulation is coordinating its efforts with the Florida Attorney General's office and with Florida's chief financial officer. Florida is also chairing the National Association of Insurance Commissioners (NAIC) 10-state task force evaluating insurers' claim settlement practices and compliance with unclaimed property laws.

While some of the above positions taken by the states or their auditors do not appear to have current support in insurance law or unclaimed property law, it is possible that insurance regulators, other state officials, and/or plaintiffs' class action attorneys will seek to press such positions in administrative proceedings or in court. We have identified at least five plaintiffs' law firms that are seeking information on insurers that have received press coverage on this issue. Plaintiffs' firms often follow up on such developments by actively soliciting putative class representatives for class actions.

Insurers should be prepared to respond to these regulatory inquiries and the heightened litigation exposure from the plaintiffs' bar. The issues raised will involve the areas of unclaimed property compliance and audit, state regulation, federal securities regulation (in the context of variable products), ERISA, and complex/putative class action litigation.

² Press Release, State of Connecticut Insurance Department, Insurance Department Launches Inquiry Into Practices of Death Benefit Payments (April 28, 2011) at <http://www.ct.gov/cid/cwp/view.asp?Q-478060&A=1269>.

³ Press Release, Florida Office of Insurance Regulation, Office of Insurance Regulation to Hold Public Hearing on Life Insurance Companies' Practices (April 22, 2011) at <http://www.floir.com/pressreleases/viewmediarelease.aspx?id=3857>.



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