SUTHERLAND

LEGAL ALERT

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The Top 10 Ways Unclaimed Property Audits Differ From Insurance Market Conduct Exams

As more insurance companies become targets of multi-state unclaimed property audits and market conduct exams regarding their claims handling processes, insurers must understand the differences between these two legal frameworks when fashioning responses to regulators and auditors. Click here for our prior Legal Alert: "Unpaid Insurance Benefits Issues Continue to Intensify."

The inconsistency between unclaimed property law and insurance law is resulting in turmoil in the context of unclaimed property audits. Insurers know state insurance laws and how they are enforced through market conduct exams. The exams are regulated and relatively uniform in application. By contrast, unclaimed property audits are producing non-uniform application of state statutes and inconsistent enforcement efforts via third-party contingent fee auditors.

Understanding the tensions between the two frameworks will enable company officials both to prepare effective responses to regulatory inquiries and to craft proactive best practices that protect the company on a going forward basis. Following are the top 10 ways unclaimed property audits differ from market conduct exams:

10. **How do you spell relief?** Unclaimed property audits generally provide no state administrative review process, whereas state insurance market conduct exams are highly regulated, are performed in accordance with NAIC standards and are subject to administrative review. If insurers disagree with the results of a market conduct exam, they can request a hearing. But if they contest the results of an unclaimed property audit, in most states the only avenue for relief is instituting a declaratory judgment action or waiting for the state to take an enforcement action. Arguably, the state unclaimed property administrators should first address any disputed issues. However, it appears that many unclaimed property administrators have essentially delegated their authority to their retained auditors and may not give meaningful review to their auditors' conclusions. It is doubtful that state insurance commissioners would grant third-party examiners the same degree of discretion in the market conduct exam context.

9. **Confidentiality is a virtue of the loyal.** In the market conduct exam context, communications with the insurance regulator during the course of the exam generally are treated as confidential by state statute. By contrast, in the unclaimed property audit context, information provided to the states and their auditors is not treated as confidential under many unclaimed property statutes. Many state unclaimed property administrators freely exchange information among themselves about companies. Insurance companies placed under unclaimed property audit are required to enter into Nondisclosure Agreements with their auditors. These agreements give the auditors and the states the right to share information not only among themselves, but with other unrelated state agencies. As one state audit manager stated to an insurer: *"Furthermore, the Comptroller can and will discuss any unclaimed property audit to the extent statutorily provided for within the Property Code and within our open records statutes to any applicable party."*

8. **Time is money.** Most unclaimed property audits are conducted by auditors who are paid a contingency fee based on a percentage of property escheated to the states. Not surprisingly, these auditors are incentivized to discover new and innovative theories of "unclaimed" property. Contingency fees have brought to the insurance industry innovations such as "fuzzy matches" in the context of social security death matches, as well as claims that the date of death is the universal trigger of dormancy for death claims in all states. Market conduct examiners, by contrast, are paid based on time spent on the audit and are not financially incentivized to prematurely transfer to the states policy benefits owed to beneficiaries.

7. **To "heir" is human.** Unclaimed property laws allow a contingency fee to be paid for locating "owners." "Heir Finders" are permitted to obtain from owners of lost property a percentage of the value of the property, generally ranging from 10% - 30% to "locate" the property, even where the property remains with the insurance company and has not been escheated to the state. By contrast, under state insurance laws, insurers may not charge a fee for locating insureds, owners or beneficiaries if they move or are otherwise "lost" on the insurer's records.

6. **You say tomahto, I say tomato.** For many types of unclaimed property, the law assumes that the owner has abandoned the property in the absence of regular communications from the owner to the holder. By contrast, life insurance policies are long-term contracts under which there may be no need for regular contact with the owner. Insurance laws require insurers to be responsive to owner's requests and filed claims, but unclaimed property auditors are seeking to require insurers to be proactive through application of principles more appropriate to other types of property outside of the insurance context.

5. **Law and order.** In the unclaimed property context, auditors seek to place the burden on the holder (i.e., the insurance company) to disprove that claims/benefits are owing to the beneficiary or alternatively to the state. Under insurance law, the beneficiary must file a claim and prove to the insurance company that there has been a covered death that triggers payment of the claim. The beneficiary must provide the necessary documentation and information to the insurance company before a claim can be paid.

4. **Bang! You're dead!** Unclaimed property auditors have employed the Social Security Death Master File (SSDMF) to determine when someone has abandoned his/her property. The auditors compare the insurer's in-force and out-of-force policy files to the SSDMF. Any "matches" are deemed to be unclaimed property and thus potentially escheatable to the state. In contrast, under insurance law, insurers need proof that the insured has died… something more than a "match" against the SSDMF. Insurers have traditionally required a claim to be in "good order" before paying a death benefit. Such claim would include a death certificate. Under the new unclaimed property regime being urged by auditors, insurers could be forced to pay out claims to the states based upon little more than an unconfirmed and possibly erroneous match against a governmental database.

3. **For whom the bell tolls.** Under unclaimed property law, an unpaid death benefit that is due and owing must be escheated to the state within a certain period of time (typically three to five years) from the start of the dormancy period. Under state insurance law, generally there are few, if any, limits on the amount of time a beneficiary can take to file a claim, although certain claims may be barred by statutes of limitations and/or the terms of the policy. In some states, high rates of interest accrue from the date of death until the payment of the claim, providing the beneficiary with a disincentive to complete the death claim process within a short period of time.

2. **Knowledge becomes wisdom only after it has been put to practical use.** Under the unclaimed property laws in some states, the dormancy period for a death benefit begins once the insurance company has "knowledge" of the insured's death. Under some state insurance laws, "notice" of an insured's death may trigger certain unfair claims processing requirements. Under both legal regimes, it is unclear whether a "match" with the SSDMF constitutes "knowledge" or "notice" of death.

1. **It's not a sure thing until it's a sure thing.** Insurance law and policies generally provide for a "contestability period" for a claim. Where the death occurs during the contestability period, a death benefit claim may be subject to denial if the death was the result of an excluded cause or if there was a material misrepresentation in the application for the policy. The cause of death, along with other information about the insured, may be relevant to determining whether the claim should be denied. Accordingly, it is important for the insurer to obtain the death certificate. By contrast, those enforcing unclaimed property laws seek to short-circuit and/or eliminate the process of identifying and establishing any such policy defenses and thus pay lip service to states' anti-fraud statutes.

When undergoing market conduct and unclaimed property examinations, insurers must navigate two different regulatory schemes involving different philosophies and different administrative remedies, while in many cases facing the same third-party auditor. Approaches used successfully in the past to respond to typical market conduct exams may not be adequate to address the new and different challenges presented by an unclaimed property examination.

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