

September 28, 2012

## A Storm Cloud on the Horizon: Unclaimed Property Auditors Targeting Middle-Tier Insurance Companies

Over the past three years, more than 25 insurance companies have become subject to market conduct exams and unclaimed property audits by more than 35 cash-hungry states. Represented by Verus Financial, LLP (Verus), state auditors and insurance regulators are asserting that insurers have engaged in improper handling of life insurance policies and annuity contracts by failing to proactively identify death claims and locate missing beneficiaries. Verus claims that insurers consult certain government databases—e.g., the Social Security Administration's Death Master File (DMF)—to terminate annuity payments when annuitants die, but do not consult these same databases to determine whether life insurance insurers or annuity contract owners have died in order to pay their beneficiaries. Verus further asserts that insurers throughout the industry have failed to timely escheat death benefits and matured policy/contract proceeds.

### The Old Is New Again

To date, regulators have focused primarily on the largest insurance companies. Indeed, the three unclaimed property settlements that regulators have reached to date have been with some of the industry's largest players. However, recent developments confirm that state officials are now targeting mid-size life insurance companies, and that Verus is no longer the only auditor involved. Two other auditors have thrown their hats into the ring: Unclaimed Property Clearinghouse (UPCH) and Kelmar. Currently, these two auditing firms are representing state auditors and not Departments of Insurance, but that may change.

While UPCH and Kelmar are following in the footsteps of Verus, additional information about UPCH and Kelmar audits will be helpful to understanding the significant impact these auditors will have on mid-size insurers.

1. Both firms have significant unclaimed property experience. UPCH, previously known as ACS, contracts with more than 40 states and has audited some of the largest companies through several industries. Kelmar has conducted audits, largely on behalf of Delaware, for more than 10 years.
2. Unclaimed property law is a highly specialized area of legal expertise. Many companies may find themselves at a distinct disadvantage when confronting an experienced auditor.
3. The touchstone of unclaimed property exams is the data. UPCH and Kelmar rely on the data developed from an insurer's records to determine that company's liability. While the data is being analyzed by the company, UPCH and Kelmar may have already determined a preliminary liability and will be unrelenting in requesting the data necessary for them to make such a preliminary assessment.
4. Audits conducted by UPCH and Kelmar sometimes span a period of 5 to 7 years, which can leave target companies with audit fatigue and may push them to settle on less than favorable terms.

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5. UPCH and Kelmar are well staffed and typically manage several dozen audits simultaneously. Over the past 5 years, Verus has concluded or begun audits of approximately 20 companies. But it is not uncommon for Kelmar to initiate 25 to 50 audits at once.
6. State unclaimed property administrators are familiar with and often rely on the methodologies and work performed by UPCH and Kelmar. As a result, it is important to develop an effective response to the audit before the auditors present their findings to the states.

## Prepare for the Inevitable: The Best Offense Is a Good Defense

There are a number of steps that insurance companies can take in order to prepare for an unclaimed property audit and potential insurance regulatory market conduct exam, even if the audit notice has not yet arrived.

### 1. Map Out Your Battle Strategy

Develop your strategy. The initial consideration for many insurers is whether and when to challenge the auditor and over what issues. Another part of the strategy may be an effort to identify and address issues that might come up in an audit by conducting a self-review under privilege of the company's book of business and engaging in remediation where appropriate.

### 2. Know Thyself: Review Unclaimed Property and Life Insurance Practices and Procedures

Unclaimed property auditors may seek to equate incomplete and/or inconsistent processes and procedures with gaps in compliance. Although most insurance companies already have unclaimed property practices and procedures in place, it makes sense to review such procedures in preparation for an unclaimed property audit, especially in light of the positions being taken by states and auditors and the fact that auditors can be expected to run company data against the DMF.

In anticipation of a market conduct exam in concert with an unclaimed property audit, companies should review their practices and procedures for processing death claims on life insurance policies and annuity contracts. Areas of recent interest to examiners include lapsed policy handling, returned mail procedures, annuity maturity dates and death benefit interest crediting on unpaid death benefits.

### 3. Identify Data Deficiencies

Imperfections in insurance administration or claim systems can generate unclaimed property issues. It is therefore important to determine where a company might have data and system deficiencies before an auditor requests that data. For example, auditors have focused on industrial life policies and group life insurance policies and annuities contracts, on the assumption that these are some of the product areas that may be challenging from a data and systems perspective for many companies.

### 4. Consider Voluntary Disclosure Agreements

A Voluntary Disclosure Agreement (VDA) is a confidential agreement under which an individual state allows a company to conduct a self-evaluative review of its unclaimed property practices

and procedures. Once the VDA is completed, the results of such review and any unclaimed property identified in the review are remitted to the state. Entering into a VDA with a state generally forecloses the state’s ability to subsequently initiate an unclaimed property audit against the company for the period and property covered by the VDA. Currently, approximately 30 states offer VDAs.

**5. Know Your Auditor**

Each unclaimed property contract auditor is unique. Audit firms may have backgrounds in particular industries or audit types and may employ proprietary methodologies that inform their approach to unclaimed insurance benefit audits. In addition, individual auditors come to unclaimed property from an array of different professional backgrounds and experiences. The ability to understand your auditor and anticipate its strategy and tactics is crucial to success during an unclaimed property audit, especially now that Kelmar and UPCH are involved.

**6. Be Cautious When Asked to Sign Agreements**

Insurers under audit will be requested by the auditor to execute documents sometimes called “Nondisclosure Agreements.” Insurers should consider these documents very carefully as they often authorize the auditor to share documents obtained during the audit with state agencies not involved in the audit.



*If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.*

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