

Unclaimed Property Compliance and Its Impact on the Insurance Industry

If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

Jonathan Frank

New York
212.735.3386
jonathan.frank@skadden.com

Rachel J. Barnett

New York
212.735.3458
rachel.barnett@skadden.com

* * *

This memorandum is provided by Skadden, Arps, Slate, Meagher & Flom LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This memorandum is considered advertising under applicable state laws.

Four Times Square, New York, NY 10036
Telephone: 212.735.3000

WWW.SKADDEN.COM

Unclaimed property compliance was once an area of law that received little attention. But compliance now is being pursued aggressively, resulting in unexpected and substantial liabilities for many companies. States are expending more resources to ensure compliance and are conducting more investigations into whether companies are properly reporting unclaimed property. In particular, the life insurance industry has been under examination by state regulatory agencies for compliance with unclaimed property laws. States are retaining third-party auditing firms (on a contingency fee basis) to probe on their behalf into companies' policies and practices in handling unclaimed life insurance products, such as unclaimed life policies and annuities. States are also issuing subpoenas to insurance companies to investigate whether unclaimed property has been paid over to the states in accordance with unclaimed property laws.

Significant exposure may exist for insurance companies that have not complied with unclaimed property laws by submitting annual reports to all 50 states regarding any unclaimed property. Recently, Prudential Financial Inc., John Hancock Life Insurance Company and MetLife, Inc. announced that they have entered into multi-state settlements that have included the escheatment or payment to claimants of tens of millions of dollars of unclaimed property relating to, among other things, active and lapsed life insurance policies that have purportedly gone unclaimed. MetLife also faces a putative securities class action that was commenced in the United States District Court for the Southern District of New York relating to the company's disclosures of its unclaimed property exposure.

All companies, and especially those that have an insurance business, should take steps to be fully informed about unclaimed property compliance. Insurance companies are not the only targets for unclaimed property examinations. States such as New York have commented that they are commencing audits against companies to investigate whether the companies are compliant in reporting a variety of potential unclaimed properties. This has included, among other things, unclaimed gift certificates or discount cards and unclaimed securities (such as inactive stock accounts, unpaid stock dividends, unexchanged shares and unclaimed mutual fund shares). In addition, states are assessing interest and penalties against companies who failed to escheat property in compliance with their annual reporting mandated by unclaimed property laws.

Below are highlights of what to expect with respect to the recent audits being conducted in the insurance industry.

Every State Has Laws Governing the Escheatment of Insurance Products

Each state has specific statutory language that addresses when certain insurance products, such as life insurance policies and annuity contracts, are considered due and owing under the state's unclaimed property laws. In particular, states apply a presumption of abandonment when certain factors are satisfied. Once property is presumed abandoned under the state's statute, this triggers the so-called "dormancy period" (typically three or five years) after which such unclaimed insurance monies are required to be escheated to the states. Thus, it is important to understand each state's statutes and at what point the state considers a particular life insurance product presumed abandoned and subject to escheatment to the state.

Escheat Laws Are Not Necessarily Coextensive With Insurance Regulations

Insurance companies have argued that because they have complied with insurance regulatory laws they also are in compliance with unclaimed property laws. However, states have taken a different position. States are contending that the insurance regulatory laws and unclaimed property laws are not necessarily coextensive, that unclaimed property laws require separate and distinct obligations for insurance companies, and that unclaimed property laws must be complied with in addition to the requirements set forth in insurance regulatory laws.

States Have Rejected a Number of Defenses Asserted by Companies

A number of arguments have been put forth by insurance companies that have been rejected by the states. This is further complicated by the limited case law on these issues and the hesitancy of companies to litigate against the states. For example, insurance companies have argued that a claim for insurance proceeds under a life insurance policy does not become due and payable, and therefore cannot be subject to escheat, until the beneficiary comes forward and satisfies specific contractual conditions precedent to payment. States, however, have taken the position that insurance proceeds are unclaimed property regardless of whether conditions precedent are satisfied. Moreover, certain state statutes expressly provide that funds are deemed due and payable even though the policy or contract has not been surrendered as required.

In addition, insurance companies also have argued that a life insurance policy cannot be presumed abandoned until the company has knowledge that the insured has died. However, states are asserting that if an insurance company reviews a government database listing of the deceased (such as the Death Master File from the Social Security Administration) for its annuity business, it has direct knowledge of the death of the policy owner. States are arguing that an insurance company cannot claim that it lacks knowledge of a person's death because, while it possessed the information for its annuity business, it chose not to review the list for escheatment purposes. In addition, some states, such as New York, are sending out letters that are mandating insurance companies to use the Social Security Death Master File to locate insureds who may have died and report on the effectiveness of the search. Companies are expending substantial amounts of monies to comply with these investigations.

Understanding Unclaimed Property Liability Exposure Is Important When Exploring Mergers and Acquisitions of Insurance Companies

Unclaimed property compliance has become an important issue in the negotiations of mergers and acquisitions, as acquirers want to protect themselves from acquiring substantial liabilities from target companies that may have exposure to unclaimed property laws. Once an audit letter or subpoena is received, a company faces the risk of an intrusive audit, significant liabilities and severe interest and penalties for any noncompliance with unclaimed property laws. Thus, any company that is exploring an acquisition with an insurance company should make sure that it is fully informed and understands the risks about the target's potential unclaimed property exposure so that it can negotiate appropriate provisions in the merger agreement to protect itself against any unexpected liability.

Skadden has been working with companies in a variety of contexts to help them navigate through the complex unclaimed property laws in all 50 states. Skadden also has been involved in conducting due diligence, understanding a target company's past practices of collecting and reporting unclaimed property, and crafting resolutions in merger discussions to protect against potential unclaimed property liabilities. Because we expect that states will continue to ramp up their unclaimed property audits to increase revenues, Skadden is closely monitoring this area of law — which is, to many companies, a minefield.