Unclaimed Property Law In The Spotlight

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Every state has unclaimed property laws that declare property abandoned after a certain dormancy period. The property is then turned over to the state, which tries to find the rightful owner. But in many instances no one steps forward, and the state retains beneficial use of the money. With budgets becoming increasingly stretched, state regulators have shown renewed vigor in enforcing unclaimed property laws.

Several states and their contingency fee-based auditors are increasingly targeting the life insurance industry, including small to mid-sized life insurers, through unclaimed property audits and market conduct examinations. These actions have brought to the fore the question: must life insurers affirmatively search for potentially deceased insureds or permit their regulators to do so? This article highlights some of the statutory, contractual and litigation elements of that question as respects unclaimed property law.

Historical Unclaimed Property Practices

Laws requiring abandoned or unclaimed property to be turned over or "escheated" to the state have existed since feudal times. Modern statutory unclaimed property regimes generally are based on one of three Uniform Unclaimed Property Laws, enacted in 1954, 1981 or 1995. These statutes are custodial in nature, such that the state holds the property for its rightful owner and attempts to return it to the owner. Under these laws, the state stands in the shoes of the true owner. That is, the state's rights in the unclaimed property are derivative of those of the owner, and the state can only take whatever interest the owner has in the property. Accordingly, the state can only escheat property that is due and payable by the holder to the owner.

Outside of insurance, the trigger for unclaimed property laws is generally based on loss of contact with the property owner. This makes sense because it is clear to whom such property belongs and when it is due and owning. For example, deposits in a bank account or credits on a gift card belong to the respective owners and not the bank or gift card issuer. Moreover, such monies are immediately due and payable upon demand. Thus, if the bank or gift card issuer has lost contact with the owner of those funds and the dormancy period has expired, the holder is to report those monies and escheat them to the state.

The same is not true for life insurance. Under most life insurance policies and the laws regulating them, a life insurer's obligation to pay death benefits arises only after being notified that an insured has died and receiving due proof of death. Accordingly, for life insurance proceeds, "property" is defined as the amount "due and payable" under the terms of a life insurance policy.

Life insurance proceeds due and payable are "presumed abandoned" for unclaimed property law a set number of years (typically three to five) after the obligation to pay arose. Absent such notice and due proof of death, no death benefits are due and payable and so there is nothing to escheat.

But what if the insured dies and no claim is ever made? To address that situation, a second trigger for escheatment has developed for life insurance proceeds. When the insured on a life

insurance policy attains or would have attained the “limiting age” (i.e., the age by which actuaries assume an insured has died, typically around 100 years old), state unclaimed property laws require the life insurer to escheat any death benefits associated with that policy. The life insurance industry and its regulators operated for decades with this common understanding of when life insurance proceeds become unclaimed property.

Changing Landscape in Unclaimed Property Laws

Over the past few years, however, certain contingency fee unclaimed property auditors and the states retaining them have grown dissatisfied with this approach. These entities have taken the position that life insurers must use the Social Security Administration’s Death Master File (DMF) to ascertain whether insureds are deceased and benefits are payable under life insurance policies, or to permit the states and their outside auditors to achieve the same result by themselves using the DMF and reporting the results to life insurers.

These obligations, some insurers respond, have no basis in law and are contrary to the terms of life insurance policies and statutes, which require settlement and payment of death benefits only upon receipt of a claim and due proof of death, for which an insurer may require a certified death certificate.

Some states, such as New York, Maryland and Kentucky, have enacted rules or laws requiring DMF searches. Other states have enacted no such laws, but arguably sought to achieve the same result by undertaking seriatim unclaimed property audits or market conduct examinations of life insurers on potential violations.

To this end, a task force from the National Association of Insurance Commissioners (NAIC) has announced multistate market conduct examinations of more than 40 life insurers respecting unclaimed property law and unfair claim practices and thereafter has announced settlements with 18 of those insurers. The settlements, called Global Resolution Agreements, generally require the companies to perform DMF searches on a regular basis and generate monthly reports for review.

Litigation Developments

This increase in regulatory activity has also spawned increased litigation. State regulators, as well as private litigants, have alleged that life insurance companies have breached their duties of good faith and fair dealing and have not complied with state unclaimed property laws in failing to cross-check their in-force business against the DMF. In response, some insurers have challenged certain aspects of recently enacted legislation and regulatory audits. To date, however, every court to have considered the assertion that life insurers are obliged to conduct DMF comparisons or otherwise affirmatively search for potentially deceased insureds in the absence of an express rule or statute has rejected it.

Private Litigation Against Insurers

In one such case, Andrews, private plaintiffs filed class action complaints alleging that their insurers breached their duty of good faith and fair dealing by failing to use the DMF in

identifying possible deaths of policyholders. Andrews v. Nationwide Mutual Insurance Co., No. 979891, (Ohio Ct. App. Oct 25, 2012). The court rejected the argument, noting that the life insurance contracts "expressly require[d] 'receipt' of 'proof of death.'" Use of the terms "receiving" and "receipt" "demonstrate[d] [the life insurers's] passive role" in establishing proof of death, the court found.

The court expressly refused to "import additional unspoken duties and obligations" into the contracts. Likewise, in Total Asset Recovery Servs. LLC v. MetLife Inc., No. 2010-CA-3719 (Fla. Cir. Ct. Aug. 20, 2013) (appeal pending), a court held that Florida "has not adopted a law requiring [insurers] to consult the Death Master File" or "to engage in elaborate data mining of external databases ... in connection with payment or escheatment of life insurance benefits."

More recently, in Feingold v. John Hancock Life Ins. Co., No. 13-2151 (1st Cir. May 27, 2014), the First Circuit upheld the dismissal of a beneficiary's claim that a life insurer had an affirmative duty to search the DMF. In reaching this decision, the circuit court held that language in the policy requiring submission of a proof-of-death form before paying a claim was consistent with state law. Id. at *13. The court also rejected the argument that the plaintiff could bootstrap common law claims against the insurer based solely on its signing of a Global Resolution Agreement. Id. at *9.

Litigation Involving Regulators

In West Va. ex rel. Perdue v. Nationwide Life Ins. Co., No. 12-C-287 (W. Va. Cir. Ct. Dec. 27, 2013), a West Virginia court considered several lawsuits filed by the West Virginia State Treasurer against life insurers for failure to turn over unclaimed life insurance proceeds to his office. The allegations were that each insurer's statutory duty of good faith and fair dealing required it to conduct annual examinations of life insurance policyholders to determine if they are deceased or three years past the limiting age.

The West Virginia Treasurer alleged that such information is readily available by searching the DMF or other third party databases. The court began its analysis with West Virginia's Unclaimed Property Act (UPA). That law, it found, defines "property" as respects life insurance proceeds as "an amount due and payable under the terms of an annuity or insurance policy, including policies providing life insurance." Id. at 5. Only property "presumed abandoned" must be turned over or reported to the administrator, the court noted.

As respects life insurance proceeds, property is "presumed abandoned" under West Virginia unclaimed property law "three years after the obligation to pay arose or, in the case of a policy or annuity payable upon proof of death, three years after the insured has attained, or would have attained if living, the limiting age under the mortality table on which the reserve is based." Id. at 5-6.

Turning next to the insurance laws, the court noted that the West Virginia Insurance Code requires life insurance policies delivered or issued in the state to include language conditioning an insurer's liability upon the presentation of a claim, which in turn required a claimant to provide an insurer with notice giving rise to liability under a policy.

Id. at *6.

Reading the UPA and the Insurance Code in conjunction, the court found that “receipt of due proof of death” required to be in each of the subject policies was the trigger giving rise to an “obligation to pay” under the UPA. Absent statutorily required receipt of due proof of death, the court found, there were no life insurance proceeds “due and payable” and hence no “property.” Thus, the court found, the “State Treasurer’s argument that the UPA applies to life insurance proceeds before those proceeds meet the definition of ‘property’ and before they are ‘presumed abandoned’” must fail. Id. at *7.

Furthermore, the court found, the argument that the UPA imposes an affirmative duty to search the DMF is inconsistent with the UPA’s limiting age trigger, which expressly provides a mechanism for unclaimed life insurance proceeds to be remitted in the event the insurer never receives due proof of death from a claimant. Id. at *8. Under the UPA, the “only two statutory triggers for the unclaimed property dormancy period are receipt of due proof of death and the limiting age.” Id.

Based upon the “clear and unambiguous” language of the UPA and the Insurance Code, the court found that defendants “have no obligation to surrender the life insurance proceeds under the UPA until the obligation to pay arises — either upon receipt of due proof of death or once the insured reaches the statutorily imposed limiting age” and dismissed the case. Id. at *9.

Other lawsuits challenging regulator actions respecting life insurer unclaimed property audits or market conduct examinations are pending in California and Illinois.[1] Decisions in these cases should shed further light on the important question of what obligation, if any, do life insurers have to affirmatively search for deceased policyholders in the absence of an express rule or statute.

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[1] E.g., Chiang v. American National Ins. Co., Case No. 34-2013-00144517 (Sup. Ct. Cal. Oct. 9, 2013); Chiang v. Kemper Corp. et al., Case No. 34-2013-00148154 (Sup. Ct. Cal. Oct. 16, 2013); United Ins. Co. of America et al. v. Boron et al., Case No. 13-20383 (Ill. Cir. Ct., Sept. 4, 2013).

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