Recent Developments in Unclaimed Property/Escheat Law

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I. Introduction

In recent years, various state enforcement agencies have initiated investigations of the life insurance industry concerning claims settlement practices and compliance with state unclaimed property laws. These investigations are on-going and have resulted in several multi-state settlement agreements with nationally recognized insurers.

This article discusses recent developments surrounding the states' efforts to recover unclaimed insurance funds, use of the U.S. Social Security Administration's "Death Master File," possible best practices, ERISA preemption issues that affect the states' recovery of unclaimed insurance funds under state abandoned property laws, and how those ERISA issues may relate to insurers' positions regarding use of Retained Asset Accounts. Finally, this article discusses other potential litigation risks facing life insurers concerning non-compliance with state unclaimed property laws.

II. Overview of Unclaimed Property Laws

Unclaimed property refers to intangible personal property that has been unclaimed by the rightful owner after a specified period of time. Unclaimed property laws are based on the concepts of "escheat" and "bona vacantia" under English common law. Escheat only applied to land and involved the reversion of land ownership to the feudal lord when the immediate tenant died without heirs. Black's Law Dictionary (9th Ed. 2009). "Bona vacantia," meaning "vacant goods," was the term for ownerless property subject to claim by the Crown. *Id.* The Crown's entitlement to "bona vacantia" was premised on the proposition that possession by the Crown was more equitable than that of a stranger, and that it removed the potential for conflicting claims by interested parties.

In 1954, the National Conference of Commissioners on Uniform State Laws ("NCCUSL") approved the Uniform Disposition of Unclaimed Property Act (the 1954 Act). The 1954 Act was amended in 1966 and then wholly revised in 1981 to become the Uniform Unclaimed Property Act ("UUPA"), which was then revised in 1995. All fifty (50) states, the District of Columbia, the Commonwealth of Puerto Rico, Guam, and the U.S. Virgin Islands have unclaimed property laws that in various forms are based on a version of the UUPA.

There are several key terms in unclaimed property laws. The "holder" of property is a person obligated to hold for the account of, or deliver or pay to, the owner of property subject to unclaimed property laws. *See 1995 Uniform Unclaimed Property Act*, §1(6). The "owner" of the property is a person who has a legal or equitable interest in property or the person's legal representative. *See 1995 Uniform Unclaimed Property Act* §1(11). The term includes a depositor in the case of a deposit, a beneficiary in the case of a trust other than a deposit in trust, and a creditor, claimant, or payee in the case of other property. *Id.* A "dormancy period," also known as an "abandonment period," refers to a specified time period during which an owner takes no action regarding his or her property. *See 1995 Uniform Unclaimed Property Act* §2 . Property is presumed abandoned if the dormancy or abandonment period is met. *Id.* The dormancy or abandonment period differs depending on the nature of the intangible property and varies from state to state.

Under the UUPA, before turning over abandoned property to the state, the holder of the property must conduct due diligence and attempt to return the property by contacting the owner, using the owner's name and last known address. *See New Jersey Retail Merchants Ass'n v. Sidamon-Eristoff,* 2012 WL19385 (C.A. 3d Cir., January 5, 2012). If the holder is unable to return the property to the owner, unclaimed property laws require

the holder to deliver the property to the state and provide the state with the name and last known address of the owner. *Id*. Upon delivery to the state, the holder is no longer liable to the property owner. *Id*. The state holds the unclaimed property for the benefit of the owner and attempts to reunite the owner with the property. *Id.* If the property owner does not come forward to claim it, the state keeps the abandoned property. *Id.*

III. Investigation of the Life Insurance Industry

State regulators have asserted that life insurers use the U.S. Social Security Administration's Death Master File (the "DMF") to stop payments on annuity products, but fail to use the DMF to identify deceased policy holders in order to timely pay life insurance benefits. The DMF contains over 89 million records of reported deaths. *See* http://www.ntis.gov/products/ssa-dmf.aspx. The DMF includes the following information on each decedent, if the data are available to the SSA: social security number, name, date of birth, date of death, state or country of residence (prior to February 1988), ZIP code of last residence, and ZIP code of lump sum payment. *Id.* The SSA does not have a death record for all persons; therefore, SSA does not guarantee the veracity of the file. *Id*. The absence of a particular person is not proof this person is alive. *Id*.

State regulators also doubt that life insurers compare the DMF against life insurance policies or against annuities in "accumulation" on a consistent basis. Consequently, state regulators, individually, collectively, and in conjunction with the National Association of Insurance Commissioners ("NAIC"), initiated investigations seeking to determine whether these or similar industry practices violate insurer claims and trade practices acts and whether life insurers are complying with fiduciary duties to report and remit unclaimed death benefits, matured annuity contracts, and retained asset accounts ("RAAs") to states as required by their unclaimed property laws. RAAs are demand accounts established by insurers as a settlement option for death benefits, instead of paying a lump sum benefit).

The efforts of state insurance regulators to apply the states' unclaimed property laws to life insurance benefits creates difficulties for life insurers, in part because the terms of the unclaimed property laws are ambiguous in material respects, and do not always neatly square with the insurer's contractual obligations. For example, Florida's unclaimed property law requires that:

> (1) All funds held or owing under any life or endowment insurance policy or annuity contract which has matured or terminated are presumed unclaimed if unclaimed for more than five (5) years after the funds became due and payable. as established from the records of the insurance company holding or owing the funds, but property described in paragraph (3)(b) is presumed unclaimed if such property is not claimed for more than 2 years. The amount presumed unclaimed shall include any amount due and payable under s. 627.4615.
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> (2) If a person other than the insured or annuitant is entitled to the funds and no address of the person is known to the company or it is not definite and certain from the records of the company who is entitled to the funds, it is presumed that the last known address of the person entitled to the funds is the same as the last known address of the insured or annuitant according to the records of the company.
>
> (3) For purposes of this chapter, a life or endowment insurance policy or annuity contract not matured by actual proof of the death of the insured or annuitant according to the records of the company is deemed matured and the proceeds due and payable if:
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> (a) The company knows that the insured or annuitant has died; or
>
> (b)1. The insured has attained, or would have attained if he or she were living, the limiting age under the mortality table on which the reserve is based;

2. The policy was in force at the time the insured attained, or would have attained, the limiting age specified in subparagraph 1.; and

3. Neither the insured nor any other person appearing to have an interest in the policy within the preceding 2 years, according to the records of the company, has assigned, readjusted, or paid premiums on the policy; subjected the policy to a loan; corresponded in writing with the company concerning the policy; or otherwise indicated an interest as evidenced by a memorandum or other record on file prepared by an employee of the company.

(4) For purposes of this chapter, the application of an automatic premium loan provision or other nonforfeiture provision contained in an insurance policy does not prevent the policy from being matured or terminated under subsection (1) if the insured has died or the insured or the beneficiaries of the policy otherwise have become entitled to the proceeds thereof before the depletion of the cash surrender value of a policy by the application of those provisions.

(5) If the laws of this state or the terms of the life insurance policy require the company to give notice to the insured or owner that an automatic premium loan provision or other nonforfeiture provision has been exercised and the notice, given to an insured or owner whose last known address according to the records of the company is in this state, is undeliverable, the company shall make a reasonable search to ascertain the policyholder's correct address to which the notice must be mailed.

(6) Notwithstanding any other provision of law, if the company learns of the death of the insured or annuitant and the beneficiary has not communicated with the insurer within 4 months after the death, the company shall take reasonable steps to pay the proceeds to the beneficiary.

(7) Commencing 2 years after July 1, 1987, every change of beneficiary form issued by an insurance company under any life or endowment insurance policy or annuity contract to an insured or owner who is a resident of this state must request the following information:

(a) The name of each beneficiary, or if a class of beneficiaries is named, the name of each current beneficiary in the class.

(b) The address of each beneficiary.

(c) The relationship of each beneficiary to the insured.

§717.107, Fla. Stat. (2011). What constitutes a "reasonable search," what constitutes "knowledge" of an insured or annuitant death, and whether (and how) the law's requirement of "reasonable search" affects actual "knowledge" of death under the state's unclaimed property law are all unclear. Moreover, most state unclaimed property laws have differing criteria for their triggering dormancy periods and differing due diligence standards.

Below is a brief summary of state regulatory investigations the life industry:

A. California and Florida

In July of 2008, the California Office of the Comptroller (the "COOC") began audits of the life insurance industry to determine whether the industry was complying with California's unclaimed property laws. *See In the Matter of Metropolitan Life Insurance Company's Practices and Procedures Relating to the Use of Death Master File Data and Related Information,* Case No. IH-2011-00002, Transcript of Proceedings (May 23, 2010) at 9-10. The COOC was concerned that insurance companies were holding the proceeds of life insurance for years after the insured died. The COOC was also concerned that the life insurance industry was ignoring information that it had access to, information which would identify deceased clients and would enable insurers to pay those benefits to either the insured's beneficiaries or to the state of California so that the State of

California could return those benefits to the beneficiaries. *Id.* Thirty-four states ultimately participated in the COOC's investigation of at least two dozen life insurers.

In April 2011, the Florida Office of Insurance Regulation announced a multi-agency and multi-million dollar settlement with John Hancock wherein John Hancock agreed to revise its business practices related to unclaimed property for life insurance products, and to revise its use of the Social Security Administration Death Master File ("DMF"). *See* http://www.floir.com/PressReleases/viewmediarelease.aspx?ID=3885.

In May 2011, the California Insurance Department and the Florida Office of Insurance Regulation held public hearings to evaluate industry practices that involve claim settlement practices, use of the DMF, and compliance with unclaimed property laws. The Florida Office of Insurance Regulation subpoenaed Metropolitan Life Insurance Company ("Met Life") and Nationwide Life Insurance Company to testify at the Florida hearing. In California, Met Life was the target of the COOC and the California Insurance Commissioner investigatory hearing.

The Florida and California hearings sought to determine whether insurance companies:

- Had information indicating that customers are deceased with active policies or accounts, but failed to act upon that information, except when it is in their best interest to do so.
- Failed to pay death benefits or "escheat" unclaimed death benefits in situations where the insurance company had information that individuals had died with in-force policies or accounts, but beneficiaries had not filed claims because they are not aware of the policies.
- Had adequate controls to monitor when RAAs had been dormant for years, so they could locate the account holder or "escheat" the proceeds if the owner could not be found. RAAs are demand accounts established by insurers as a settlement option for death benefits, instead of paying a lump sum benefit.
- Failed to pay out annuity contracts after their maturity date or report and remit unclaimed benefits to the states in cases where the owners could not be located.

See http://www.floir.com/siteDocuments/Miller_Testimony05192011.pdf; http://www.insurance.ca.gov/upload/CAInvestigatoryHearing.pdf

On January 2, 2012, the Florida Office of Insurance Regulation, along with the Florida Department of Financial Services and the Florida Attorney General, announced a multi-state and multi-million dollar settlement agreement with Prudential Insurance Company of America and its affiliates ("Prudential"). *See* http://www.floir.com/PressReleases/viewmediarelease.aspx?ID=4007. For several years, Prudential used the DMF to make life insurance payments when it had found that an annuity holder had died or when it had a precise match to name, social security number, and date of birth. *Id.* However, under the agreement, Prudential agreed to build a system to match inexact data, to search for beneficiaries if they find an inexact DMF match, and to conduct DMF matching exercises more often. *Id.* The lead investigatory states were California, Florida, Illinois, Pennsylvania, New Hampshire, New Jersey, and North Dakota, and these states have all signed the agreement. *Id.* The agreement became effective on February 15, 2011. *See* http://insurance.ca.gov/0400-news/0100-press-releases/2012/release05-12.cfm.

B. Connecticut

Shortly after the April 2011 announcement regarding the John Hancock settlement, the Connecticut Department of Insurance commenced an investigation of the life insurance industry regarding timely payments of death benefits to beneficiaries and the protocol used to locate those beneficiaries *See* http://www.ct.gov/cid/cwp/view.asp?a=1269&Q=478060.

C. New York

On July 5, 2011, the New York State Insurance Department, now the Department of Financial Services (the "Department"), issued a letter pursuant to Section 308 of the New York Insurance Law ("308 letter") advising all authorized life insurers and fraternal benefit societies ("life insurers") that a cross-check of all life insurance policies, annuity contracts, and retained asset accounts on their administration data files, including group policies for which a life insurer maintains detailed insured records, should be performed with the latest updated version of the DMF, or another database or service that is at least as comprehensive as the DMF, to identify any death benefit payments that may be due under life insurance policies, annuity contracts, or retained asset accounts as a result of the death of an insured or contract or account holder. *See* http://www.dfs.ny.gov/insurance/life/308_letter_07052011.pdf. The period to be covered by the SSA Master File cross check extends back to policies in-force beginning January 1, 1986. *See* http://www.dfs.ny.gov/insurance/life/filing_guidance_08082011.pdf. Life insurers are required to report the results of their initial policy cross-check with the DMF to the Superintendent of Insurance by October 31, 2011 (the "First Stage Request") and to update the First Stage Request by detailing actions the insurer has taken to investigate the matches to determine if death benefits are due and procedures implemented to locate beneficiary, and payments made where appropriate (the Second Stage Request. *See* http://www.dfs.ny.gov/insurance/life/308_letter_07052011.pdf. Second Stage Requests are to be filed with the Superintendent of Insurance on the last day of each month from and including November 2011 through March 31, 2012. http://www.dfs.ny.gov/insurance/life/filing_guidance_08082011.pdf.

A parallel probe of the issue is being conducted by the New York Attorney General's Office. In August, 2011, it subpoenaed the records of the nation's nine largest insurers. *See* http://www.lifehealthpro.com/2011/10/24/new-york-issues-unclaimed-property-report-guidelines. The subpoena was issued pursuant to New York Executive Law §63(12), General Business Law §352, Finance Law §§187 *et seq.*, and N.Y.C.R.R. tit. 13 §400.2, Abandoned Property Law 700 *et seq.*, and CPLR Article 23, and states that it was issued in furtherance of "an investigation and inquiry undertaken in the public interest."

The subpoena broadly seeks documentation and information, including:

- Documents and communications concerning the insurers' policies and procedures for determining when to cease making payment of benefits on any type of insurance product where such benefits may be affected by the death of a measuring life;
- Documents and communications concerning the insurers' policies and procedures for locating, notifying, or otherwise contacting the policyholders, insureds, or beneficiaries of matured life insurance policies;
- Documents and communications concerning the insurers' access to, purchasing of, or licensing of any death records database.

D. National Association of Insurance Commissioners

In May 2011, state insurance regulators, working through the National Association of Insurance Commissioners (the "NAIC"), formed a special task force to help coordinate regulatory investigations involving life and annuity claim settlement practices (the "NAIC Task Force"). *See* http://www.naic.org/Releases/2011_docs/regulators_review_life_payment_practices.htm. Members of the task force include California, Florida (chair), Illinois, Iowa, Louisiana, New Hampshire, New Jersey, North Dakota, Pennsylvania and West Virginia. *Id.* The NAIC Task Force is developing a plan to handle on-going investigations as well as engaging in additional multi-state market conduct investigations covering most of the insurance industry. *Transcript of In Re Public Hearing Metropolitan Life Insurance Company, Florida Office of Insurance Regulation* (May 19, 2011) at 7.

IV. Proposed Legislation

A. National Conference of Insurance Legislators Model Unclaimed Life Insurance Benefits Act

The National Conference of Insurance Legislators ("NCOIL) is an organization of state legislators whose main area of public policy interest is insurance legislation and regulation. Most legislators active in NCOIL either chair or are members of the committees responsible for insurance legislation in their respective state houses across the country. *See* http://www.ncoil.org/ncoilinfo/about.html.

On November 21, 2011, the NCOIL Executive Committee approved a Model Unclaimed Life Insurance Benefits Act (the "NCOIL Model Act").

The NCOIL Model Act requires a quarterly comparison of an insurer's in-force life insurance policies and RAAs against a Death Master File, which may be the DMF or another database that is at least as comprehensive as the DMF. *National Conference of Insurance Legislators, Model Unclaimed Life Insurance Benefits Act*, §4.A (2011). The comparison must be reasonably designed to identify matches of its insureds. *Id.* For potential matches based upon a Death Master File Match, the insurer has ninety (90) days to complete a documented good faith effort to confirm the death of the insured or RAA holder against other available records or information and to determine if benefits are due in accordance with the applicable policy or contract. *Id.* at §4.A.1. Policies or certificates of life insurance that provide a death benefit under an ERISA employee benefit plan or under any Federal employee benefit plan are excluded under the Model Law. *Id*. at §3.C. Furthermore, annuities that are used to fund an employment-based retirement plan or program where the insurer is not committed by the terms of the annuity contract to pay death benefits to the specific beneficiaries of plan participants are excluded. *Id.* at §3.D.

If benefits are due under the policy or contract, the insurer must conduct a good faith effort to locate policy or contract beneficiaries and provide appropriate claims forms or instructions to the beneficiary or beneficiaries needed to make a claim, including information about the need to provide a death certificate, if applicable under the policy or contract. *Id.* at §4.A.1.b.(i), (ii). Regarding group life insurance, insurers are only required to confirm the possible death of an insured when the insurers provide full-record keeping services to the group policyholder. *Id*. at §4.A.2.

Insurers may not charge insureds, account holders, or beneficiaries any fees or costs associated with a search or verification conducted under the NCOIL Model Act. *Id*. at §4.B. Insurers must pay accrued interest to the beneficiary or beneficiaries. However, if the beneficiary or beneficiaries are not located, the insurer "escheats" the property to the state agency responsible for unclaimed property enforcement. *Id.* at §4.C.

Insurers must provide notice to the appropriate insurance department upon expiration of the applicable dormancy period, that the policy beneficiary or RAA holder has not submitted a claim with the insurer, that the insurer has performed a DFM comparison, and performed a documentable good faith effort to locate the beneficiary or RAA holder. *Id.* at §4.D.1. Once the notice is provided, the insurer must immediately turn over the unclaimed life insurance policy benefits or unclaimed RAA benefits with any accrued interest to the applicable state unclaimed property agency. *Id.* at §4.D.2.

The NCOIL Model Act must be adopted by the states through legislative action. The States of Alabama, Kentucky, and Tennessee each have bills pending before their respective legislatures seeking to adopt the NCOIL Model Act. *See* 2012 AL H.B. 126; 2012 KY H.B. 135; 2012 TN H.B. 2283. It should be noted that The NCOIL Model Act has met with some resistance from the NAIC, which contends that the NCOIL Model Act will not work for handling existing claims due to the pending state investigations. *See* http://www.lifehealthpro.com/2011/11/22/naic-and-ncoil-disagree-over-unclaimed-property. Moreover, the industry has

expressed some concern that the NCOIL Model Act does not provide life insurers with clear and uniform guidelines and may further confuse the situation. *Id.* Thus, whether the NCOIL Model Act will be uniformly adopted by the states remains an open question.

V. Best Practices—Do They Exist?

In light of the on-going investigations and the lack of uniformity concerning unclaimed property statutes, no specific best practices have been developed by the life insurance industry. However, there are some actions life insurers should consider taking until such time as best practices are developed.

A. General "Best Practices"

These practices would apply to all businesses and entities that are holders of unclaimed property and are suggested by the National Association of Unclaimed Property Administrators ("NAUPA"):

- Develop and utilize computer systems that track the date of last contact with account owners.
- Establish retention policies and retain documents concerning contact with account owners.
- Develop and establish procedures concerning address changes for account owners and updating systems to reflect address changes.
- Monitor stale dated checks.
- Identify what part of the organization will assume responsibility for monitoring changes in unclaimed property laws and develop internal procedures to communicate such changes within the organization.
- Conduct internal audits of unclaimed property processes and procedures.
- Identify unclaimed company assets held by third parties.
- Form an Unclaimed Property Committee within the organization that would include representatives from the legal, finance, internal audit, finance and information management systems departments to assist with compliance.
- Procure technical assistance and consider hiring an outside consultant experienced in unclaimed property issues. State regulators are routinely engaging outside auditors to conduct unclaimed property audits on behalf of the state. Therefore, companies should consider having equivalent resources.
- Determine the number of jurisdictions in which the company must file reports and the company's filing status in those jurisdictions.
- Establish procedures regarding due diligence to contact and find owners, including documentation of due diligence efforts.
- Establish procedures to ensure that any database used to locate owners is regularly updated.
- Consider use of multiple databases to locate owners.
- Consider use of Voluntary Disclosure programs.

B. Business Practices Based on Regulatory Investigations to Date and/or NCOIL Model Act

- Increased frequency of Death Master File searches. As previously discussed, the NCOIL Model Act requires quarterly searches of the Death Master File, which may be the DMF or another

database that is at least as comprehensive as the DMF. The state settlement agreements referenced above require *both* an *annual* search of the complete DMF and *monthly* searches using the DMF monthly update.

- Use multiple sources for Death Master File searches. Both the NCOIL and the state investigations refer to use of the DMF for the searches. However, effective November 1, 2011, the Social Security Administration will no longer disclose protected state records of deaths, which are records the Social Security Administration acquires from the states. *See* www.insure.com/articles/ifeinsurance/ssa-limits-death-records.html. Therefore, the DMF will decline in size, which may be substantial; 4.2 million records in the DMF will be excised from the public files and only made available to federal agencies. *Id.* Furthermore, of the 2.8 million deaths annually reported to the DMF, only 1 million will be available to the public. *Id.* Therefore, life insurers should consider using other databases to supplement DMF searches.
- Develop methodology for minimum match standards to include both exact Social Security Number matches and non-Social Security Number matches. Non-Social Security Number matches should include matches to names and date of births where insurer records do not contain Social Security Number information or where Social Security Number information is incomplete.
- Use the same methodology for minimum match standards for life insurance policies, annuity contracts, and RAAs and ensure that the frequency with which such methodology is applied consistently across these products/categories.
- Establish policies, procedures or methodologies to be used to locate a beneficiary. The NCOIL Model Act is silent on this issue; however, the above-referenced state settlement agreement requires such efforts to locate beneficiaries to include:
    - Use of best efforts to identify the beneficiary and determine addresses based on the insurer's records;
    - Making at least three (3) attempts to contact the beneficiary in writing at the addresses contained in the insurer's records;
    - If such writing to a beneficiary is returned undeliverable, within thirty (30) days attempt to locate the beneficiary using online search or locator tools.
    - If no response is received to the writings sent to a beneficiary or the writings are returned undeliverable, attempt contact with the beneficiary three (3) times at the most current telephone number contained in the insurer's records or obtained through the use of an online search or locator tool.
    - If no response is received to any written or telephonic contacts, attempt to contact the beneficiary at the most current email address, if any.
    - Document all attempts to contact the beneficiary.

VI. ERISA Preemption

The cases that have considered whether ERISA preempts state unclaimed property laws in relation to unclaimed benefits payable under an ERISA plan are mixed in their results. *Aetna Life Ins. Co. v. Borges*, 869 F.2d 142 (2d Cir. 1989) ("*Borges*") held that ERISA does not preempt Connecticut's unclaimed property law (which the court loosely characterized as an "escheat law") as it applies to uncollected employee benefits, which are held in reserve by an insurance company in an insured plan. The Second Circuit reasoned that the

effects of the Connecticut law on plan administration were insubstantial and incidental, and therefore did not "relate to" an ERISA plan, within the meaning of ERISA's general preemption provision, 29 U.S.C. §1144(a). Instead, the Second Circuit viewed the state law as a statute of general application that affected the insurer in its capacity as a holder of abandoned property, but did not affect the structure, administration, or types of benefits provided under the ERISA plan. *Accord, Attorney General v. Blue Cross and Blue Shield of Michigan,* 168 Mich. App. 372, 424 N.W. 54 (1988). ("*Blue Cross*").

In contrast, the Seventh Circuit held that Illinois' unclaimed property law, as applied to a self-funded ERISA plan, is preempted by 29 U.S.C. §1144(a). *Commonwealth Edison Co. v. Vega*, 174 F.3d 870 (7th Cir. 1999) ("*Vega*"). Acknowledging *Borges* and *Blue Cross*, *Vega* nevertheless concluded that the effect of the Illinois law was to take a portion of the self-funded plan's assets, put them in the state treasury, and place the state essentially in the position of a plan administrator with respect to those assets. *Vega* found this, and the plan's loss of the interest on the funds, sufficient reason to conclude the Illinois law preempted by ERISA as it applied to the plan in that case. *Vega* noted that unclaimed property laws, like the Illinois law, are "pertinently different" from escheat laws, which vest immediate title in the state. Thus, if a state law was a true an escheat law, it would immediately vest title to the unclaimed benefits in the state, meaning those benefits no longer would belong to the plan beneficiary. However, as *Vega* noted, unclaimed property laws such as Illinois' do not vest ownership of unclaimed benefits in the state. Instead, the Illinois law, as applied in that case, placed the state, rather than the plan administrator, in possession of funds which constituted plan assets under the plan's terms until distributed to beneficiaries. This, *Vega* concluded, "is precisely what ERISA bars." *Vega,* at 875. *See generally, Herman v. Lincoln Nat. Life Ins. Co.,* 2012 WL 386586 (D. Maryland, Feb. 7, 2012) (discussing claim preemption under §502 of ERISA, tangentially discussing unclaimed property statute).

In *Manufacturers Life Ins. Co. v. East Bay Restaurant & Tavern Retirement Plan*, 57 F. Supp. 2d 921 (N. D. Cal. 1999) ("*Manu-Life*"), the court considered whether California's unclaimed property law was ERISA-preempted as applied to unclaimed annuity benefits under an insured ERISA plan. The group annuity contract between the plan and the insurer provided that the plan was entitled to request a premium refund from the insurer as to any annuitant not located after a certain time, and the insurer was under an obligation to return funds to the plan. Finding those facts more analogous to *Vega* than to *Borges*, the court relied on *Vega*'s analysis and found that ERISA preempted the California law on the facts of the case, reasoning as follows:

> Regardless of whether the unpaid benefits can properly be understood as a "plan asset," the annuity contract is itself a plan asset and its value derives directly from the refund provision's guarantee that unclaimed benefits will be returned to benefit all plan participants pending location of those missing. The present plan is, therefore, in a position analogous to that of the plan in [*Vega*], not the plan in [*Borges*]. This is not a simple instance where the state is attempting to step into the shoes of beneficiaries pending their location. Instead, California seeks to insert itself between the ERISA plan and an asset of the plan, the annuity contract.
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> Application of California's UPL here . . . would be a direct usurpation of the plan's position vis à vis a plan asset, the annuity contract. California is attempting not merely to govern the payout of plan benefits, but to manage plan assets.

Id. at 924. The court further noted that section 1515, Cal. Civ. Proc. Code, the portion of California's unclaimed property law specifically addressing escheat of "funds held or owing by a life insurance corporation under any life or endowment insurance policy or annuity contract," was not "saved" from ERISA preemption under 29 USC §1144(b)(2)(A), despite its express reference to insurance. The court held that section 1515 merely particularized "a rule of general application applicable to all holders of property and thus did not carve

out distinctive treatment for life insurance carriers; . . . . attempt to transfer or spread a policy holder's risk [or] dictate the terms of the relationship between the insurer and the insured." It therefore was not exempt from ERISA preemption as a law regulating insurance. *See also, Kentucky Assoc. of Health Plans, Inc., v. Miller*, 123 S. Ct. 1471 (2003) (to be saved from preemption under ERISA as a "law . . . . which regulates insurance" the state law must be "specifically directed toward entities engaged in insurance" and "must substantially affect" risk pooling.").

Under the predominant trend in current precedent, it thus appears likely that ERISA will be held to preempt a state's unclaimed property law when the state law interferes with plan assets or the administration of plan assets. However, whether the state law will be held to interfere depends on the specifics of the plan's terms, or, in the case of insured plans, on the specifics of plan terms and the plan's contracts with the insurer.

Whether ERISA preempts unclaimed property laws as applied to benefits distributable by means of an RAA is likely to be similarly influenced by the specifics of plan terms and plan-insurer contracts. Assume, for instance, a self-funded plan document, or the contract between an insured plan and its insurer, contains these provisions: (a) benefits will be funded by means of an RAA (b) RAA benefits will be distributed as and when the beneficiary presents demand drafts against the RAA; and, (c) the balance remaining in an RAA after five years of account inactivity is deemed unclaimed and reverts to the plan. Assume that the state's unclaimed property law says benefits are "payable or distributable" when the beneficiary may demand payment in full on a lump-sum basis, and are deemed unclaimed under state law two years after that date. The state demands escheat three years after a dormant RAA was first established. In that circumstance, *Vega* and *Manu-Life* suggest that ERISA would preempt, since the state law would insert the state "between the ERISA plan and an asset of the plan" and is not merely a situation "where the state is attempting to step into the shoes of beneficiaries pending their location." *Manu-Life, supra.*

Assume, alternatively, that plan documents, or the contract between an insured plan and its insurer, says benefits will be funded by means of an RAA and will be deemed unclaimed as stated in the first example, but after five years of account inactivity, the remaining RAA balance will be deemed unclaimed and delivered as unclaimed property to the state, rather than reverting to the plan. Assume, as above, that the state's unclaimed property law says benefits are "payable or distributable" when the beneficiary may demand payment on a lump-sum basis, and are deemed unclaimed under state law two years after that date. The beneficiary makes a withdrawal in year one of the RAA, but makes no further withdrawals in years two and three. At the end of year three, the state demands escheat. Would ERISA preempt state law escheatment on these facts?

The cases provide no direct answer. However, *Vega*, and *Manu-Life*, among other cases, suggest that preemption may be a possibility on these facts. Though they emphasize non-interference with plan assets in their reasoning, both *Vega* and *Manu-Life* evince a more general concern about whether application of state law would usurp the architecture of plan administration set forth in the plan documents. Viewed in light of that general concern, a state law that requires benefit payments and forfeitures on a schedule which is at odds with plan documents quite arguably warrants preemption. *Cf. also, Egelhoff v. Egelhoff ex rel. Breiner*, 532 U.S. 141, 147, 121 S. Ct. 1322, 1327, 149 L. Ed. 2d 264 (2001) (state law that binds ERISA plan administrators to a particular choice of rules for determining beneficiary status "implicates an area of core ERISA concern" and "runs counter to ERISA's commands that a plan shall 'specify the basis on which payments are made to and from the plan. . . .'").

Several recent decisions have addressed the question of whether life insurers can be held to have violated ERISA fiduciary duties when they pay group life benefits under insured ERISA plans by creating RAAs, rather than paying death benefits in a lump sum. *Mogel v. UNUM Life Ins. Co. Of America*, 547 F.3d 23 (1st Cir. 2008) ("*Mogel*"); *Faber v. Metropolitan Life Ins. Co.*, 648 F.3d 98 (2d Cir. 2011) ("*Faber*"); *Merrimon v. Unum*

Life Ins. Co. of America, 2012 WL 406968 (D. Me., Feb. 3, 2012) ("*Merrimon*"); *Edmonson v. Lincoln Nat. Life Ins. Co*., 2012 WL 368367 (E.D. Pa., Feb. 3, 2012) ("*Edmonson*"). Though not directly on point for preemption analysis, these cases might influence future preemption decisions in relation to RAAs. They are therefore summarized briefly here.

In *Mogel*, the insurer's group life policies provided that "[u]nless otherwise elected, payment for loss of life will be made in one lump sum," but the insurer routinely set up RAAs to distribute life insurance benefits to ERISA plan beneficiaries. The plaintiffs alleged that, by investing unpaid RAA balances for its own benefit, the insurer violated its fiduciary duties under 29 U.S.C. §1104(a)(1) ("a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries") and under 29 U.S.C. §1106(b)(1) (prohibiting a fiduciary from dealing "with the assets of the plan in his own interest.").

The First Circuit noted that "[u]ntil a beneficiary draws a check on the [RAA], the funds represented by that check are retained by [the insurer] and [the insurer] had the use of the funds for its own benefit." *Id*. at 26. By analogy to the *Vega* decision above, the First Circuit therefore concluded that "sums due [as death benefits under RAAs] remain plan assets subject to the insurer's fiduciary obligations until actual payment." *Id.* at 26. Based on that reasoning, the court found that the insurer was acting as an ERISA fiduciary in creating the RAAs, and therefore may have breached ERISA fiduciary duties under ERISA by retaining and investing the RAA death benefits for its use until drawn down as beneficiaries wrote checks on the RAAs.

Moreover, noting that 29 U.S.C. §1002(21)(A) classifies one as a fiduciary if he or she has "any discretionary authority or discretionary responsibility in the administration of [an ERISA] plan," the *Mogel* court held alternatively that the insurer's "disposition to the beneficiaries of benefits [by means of RAAs] falls comfortably within the scope of ERISA's definition of fiduciary duties with respect to plan administration." *Id*. at 27.

In *Faber,* the Second Circuit reached a contrary result. The summary plan descriptions in *Faber* provided that death benefits of $7,500 or more would be provided by means of RAAs, unless the beneficiary opted affirmatively for a different mode of payment. *Faber* held that unpaid balances in RAAs did not constitute plan assets under those facts, because the plan documents did not give the ERISA plan a beneficial ownership interest in the RAA balances. It came to that result based on "ordinary notions of property rights" embraced by the U.S. Department of Labor ('DOL"), and advocated by DOL in an invited amicus brief letter in that case. *Faber* thus concluded that the insurer had no ongoing fiduciary duty governed by ERISA after the RAAs were established. Instead, the insurer's obligation thereafter "to honor the account holder's 'checks' and pay interest at a guaranteed rate . . . . constituted a straightforward creditor-debtor relationship governed by the [RAAs] and state law, not ERISA." *Id.* at 105-106. The court held, accordingly, that the insurer had no ERISA fiduciary duty in regard to investment of RAA balances, and therefore could not have breached such a duty, on the facts alleged in that case.

Merrimon disagreed with *Mogel*'s holding that unpaid balances in RAAs constitute plan assets, and aligned with *Faber*'s view that unpaid balances in RAAs are not plan assets. *Merrimon,* at *7 -*8. Nevertheless, the *Merrimon* court aligned itself with *Mogel* in holding that, an insurer has an ongoing ERISA fiduciary duty with regard to how it administers RAAs. *Merrimon* holds that an insurer may liable for breach of ERISA fiduciary duties in administering benefits through RAAs even though the plan makes RAAs the default settlement option and requires beneficiaries to affirmatively request a different mode of payment. According to *Merrimon,* if an insurer "retain[s] any discretion in its provision of RAAs," it has an ERISA-based fiduciary obligation to manage the RAAs to optimize the beneficiaries' earnings, not to optimize its own earnings, and it breaches that duty if it offers interest on RAAs at rates at the bottom of what is available in the market. *Merrimon,* at *8 -*9, *15.

Edmonson aligned itself with *Faber*'s reasoning and result, concluding that an insurer of an ERISA plan does not have ongoing ERISA fiduciary obligations when it holds and invests the funds backing RAAs. Like *Faber*, *Edmonson* holds that RAA balances are not plan assets. The plan documents in *Edmonson* were silent about payment modalities, and thus allowed the insurer discretion to choose RAAs as the benefit distribution method. Nonetheless, *Edmonson* concluded that establishment of the RAAs immediately shifted practical control over the entire benefit amount to the beneficiaries, leaving the insurer with only administrative and ministerial duties, not with the sort of discretion required to find a fiduciary responsibility remaining in the insurer.

Although the foregoing ERISA fiduciary duty cases are not directly on point, their analytical approaches have some potential to influence future decisions about whether, in the context of RAAs, ERISA preempts state unclaimed property laws. In a jurisdiction following *Mogel* in the fiduciary duty context (RAA balances "remain plan assets subject to the insurer's fiduciary obligations until actual payment"), the courts might be more inclined to find preemption under *Vega*'s preemption analysis (interference with plan assets prohibited). *Vega*'s analysis may be seen as a better logical convergence with *Mogel*. In a jurisdiction following *Faber* (RAAs are "creditor-debtor relationship[s] governed by . . . . state law, not ERISA"), the courts might be less inclined to find preemption. *Borges*' analysis (unclaimed property laws do not affect the administration of ERISA benefits) may be seen as a better logical convergence with *Faber*.

VII. Other Litigation Risks Concerning Non-Compliance with State Unclaimed Property Laws

At least 18 states have enacted False Claims Acts in recent years. They often impose liability for a wider range of acts than does the federal False Claims Act.

False Claims Act (FCA) theories of suit are attractive to entrepreneurial plaintiffs. Besides authorizing suit by the government itself, many state FCAs encourage private "relators" (qui tam plaintiffs) to sue on the government's behalf, as the federal FCA does, and handsomely reward a successful private plaintiff with a substantial share of the recovery or settlement. Proof of specific intent to defraud typically is not required to establish FCA liability. Instead, liability attaches for "knowingly" presenting a false statement to obtain money from the government. "Knowingly" is typically defined as acting merely with "deliberate ignorance" of the truth or falsity of information or with "reckless disregard" of the truth or falsity of information. Knowledge of falsity by relatively low-level employees or agents may be sufficient to impose FCA liability on an organization. Statutes of limitations for FCA claims are typically long – seven to ten years.

"Reverse false claim" liability under state acts is often much broader than under the federal act. A "reverse false claim" clause typically imposes liability for knowingly making or using (or causing to be made) a false record or statement to conceal, avoid, or decrease an obligation to pay or transmit money to a government entity. This sort of clause may attach liability to alleged failures to comply with state unclaimed property laws. A case in point is *Harris v. Old Republic Title Co.*, 23 Cal.Rptr.3d 529 (Cal. 1 Dist. 2005). ORTC is a California title insurer. After closings, some customers failed to instruct ORTC to disburse all the funds on deposit. Sometimes a party to whom ORTC disbursed funds at the close of escrow failed to cash the check. According to the relator in this California false claims act suit against ORTC, California claimed the right to such "unclaimed" funds under California's unclaimed property laws. ORTC swept such dormant funds from escrow accounts into its general fund. It did not report or remit the unclaimed funds to the state for several years. ORTC was held liable for treble the amount of interest the state would have earned on the funds if they had been timely reported and remitted, plus fines, attorney's fees, and costs.

Additionally, the possibility of filed, but sealed and therefore undisclosed, relator FCA cases poses threats associated with parallel investigations by insurance regulators. These threats suggest that counsel should be alert to the potentiality of FCA liability when communicating with insurance regulators, such as when negotiating a settlement of insurance regulatory complaints. For instance, an unqualified recitation of fact in a consent order negotiated with the state insurance regulator, or in correspondence or discussions with the regulator, may become a party admission in a qui tam FCA suit that the insurer may not know of, if the suit remains under seal while such regulatory negotiations are taking place.

Counsel should also be alert to concerns about whether the insurance regulator has the authority to settle false claims act liability in a regulatory consent order. For instance, the Florida False Claims Act provides that only the Florida Department of Legal Affairs, which is not the Florida insurance regulator, may settle claims under the Florida False Claims Act, and that settlement of such claims requires court review and approval.

VIII. Conclusion

The nascent efforts of state insurance regulators to incorporate the terms of state unclaimed property laws into the sphere of insurance regulation present ongoing concerns for the insurance industry, and life insurance carriers in particular. The manner in which unclaimed property laws and insurance regulation will or should be meshed is newly evolving, and budding efforts at doing so present significant uncertainties and risks that require attention and careful management.