Abandoned & Unclaimed Property Briefing

Tracking the dramatic changes in the way states enforce abandoned and unclaimed property laws

Fall/Winter 2011

Dear Clients and Alumni,

Our featured article in this issue focuses on financial institutions, however, there are applicable concepts for all industries. We also highlight some recent developments affecting unclaimed property.

We hope you enjoy reading this edition of our newsletter, and look forward to hearing from you. Your continued feedback is invaluable to us.

As the holiday season approaches, on behalf of PwC and our Abandoned and Unclaimed Property team, I would like to wish you all a happy and safe holiday season.

Regards,
Janet Gagliano
National Leader - Abandoned and Unclaimed Property

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Financial Institutions Facing Abandoned and Unclaimed Property Audits

Janet Gagliano, Partner and National Practice Leader
Kelly D'Emilia, Director, New York
Denise Dockrey, Director, Washington, D.C.
Nic Montalbano, Manager, New York

All states and the District of Columbia have escheat laws that require holders to turn over to the state unclaimed property after a specific period of time has passed if it cannot be reunited with its rightful owner. Given the significant merger and acquisition activity that occurred over the past decade in the financial institutions industry as well as the wide variety of sometimes complex financial accounts opened by customers, there may be many areas of concern for over or under reporting unclaimed property for financial institutions. In light of the current economic times, states are becoming increasingly aggressive in recognizing unclaimed property as a good source of non-tax revenue.

Accordingly, in many states legislation has recently been passed that decreases the dormancy periods and identifies new property types. Additionally, more states are contracting with third party auditors, which are compensated based on a contingency basis. All of these factors, coupled with the complex nature of the customer-based financial industry make unclaimed property tracking, reporting and remitting a significant challenge for financial institutions.

Background on Abandoned and Unclaimed Property

Abandoned and unclaimed property is property that has not been claimed by an “owner” for a specified period of time (i.e. the dormancy period). After a statutorily defined dormancy period has passed, the “holder” of the property has an obligation to file annual reports and remit the property to the appropriate state(s). All companies that are required to report and remit unclaimed property generally follow the same procedures for doing so. First, the property types that are subject to escheatment must be identified and, once identified, a process must be established to determine when a period of inactivity begins. As detailed below, there is a wide variety of account types or financial instruments that make up a bulk of the escheatable property for financial institutions. Given the vast numbers and types of accounts, determining when a specific account becomes inactive can be very challenging for financial institutions. Generally, an account is considered active when there is a deposit or withdrawal or the financial institution has received some type of communication from the account holder, such as a letter, phone call, email a request for an address change or some other direct and positive contact from the owner, which is generally known as "positive owner contact." It is also important to note that many states do not consider non-returned mail as evidence of positive owner contact.

Once an account is deemed to be inactive by a financial institution the dormancy period begins. Each state provides a specific dormancy period for each property type so understanding what property type should be reported and when can be extremely time consuming. Also, when determining which state the property should be remitted to and, therefore, which state's laws determine the dormancy period, holders must follow the priority rules established by the U.S. Supreme

Court in Texas v. New Jersey et al., 379 U.S. 674 (1965), which held that unclaimed property should be reported and remitted to the state based on the following priority rules:

i. Unclaimed property should be reported and remitted to the state of the owner's last known address, as shown on the company's books and records.
ii. If the owner's last known address cannot be determined or if the state in which the address is located doesn't have an escheat law, then the unclaimed property should be reported to the company's state of domicile; however such property is subject to later escheat if the previous state can prove that the last known address of the owner is within its borders.

After the expiration of the dormancy period, a financial institution is required to make a final attempt to contact the owner of the property before it is remitted to the appropriate state; this process is commonly referred to as "due diligence." Generally, a state requires a holder to send a first class letter to the last known address of the owner requesting a signed, written statement acknowledging the existence of the account. If a response is received then the account is reactivated. If a response isn't received then, depending on the value of the property, a state may require the holder to send a second letter via certified mail to the owner. In this instance, the returned receipt would be considered positive owner contact and the account is reactivated. If no contact is received then the account is reported and remitted to the appropriate state. Many states have threshold amounts dictating the due diligence letters that need to be sent. Additionally, a due diligence letter must include name, dates, account number and amount of liability. Many states will not accept a due diligence letter if all requirements are not met.

Identifying Escheatable property

Like many companies, financial institutions hold certain common escheatable property types, such as payroll and accounts receivable; however, unlike other single transaction based industries, financial institutions generally have a long-term, continuing relationship with their customers that may cross many segments of the organization. Depending on the type of account or financial instrument, interactions with customers can be as regular as on a daily basis or as infrequent as a few years.

Many larger financial institutions are segregated into two financial houses: the investment banking side and the commercial banking side. As unique as these separate business units are, they also have different property types that might be subject to escheatment.

On the investment banking side of a financial institution, the following property types might be present:

Bond Interest
Bond Principal, Matured and Called
Stock Dividends
Fiduciary Checks
Liquidating Dividends

Unidentified Overage
Redemption Values
Bond Interest over Receipt
Dividend Reinvestment Plans
Mutual Funds Shares
Unexchanged Shares or Predecessors Companies
Cash Dividends
Stock over Receipts (Dividends and Other Memos)
Warrants
Unapplied Receipts (Dividends, Interest or Underlying Debentures or Bonds Process from Sales)
Other Distributions Resulting from Ownership of Interest or Debt Obligation
Credit Balances in Trading and Trusts Brokers Investment Forms etc.
Funds for Liquidation/Redemption of Unsurrendered Stocks or Bonds
Cash over Receipts (Dividends and Others)

While the commercial banking side of the financial institution may have the following property types:

Demands Deposits
Club Accounts
Retirement Accounts
Matured Certificates of Deposit
Consumer Credit Balances
Unidentified Deposit Remittances and Suspense Accounts
Credit Balances Arsing from Loans (Including Liquidation Mortgages)
Savings Accounts
Security Deposits
Time Deposits
Collateral Deposits
Credit Balances
Consumer Loans

With over 30 property types that are unique to financial institutions, it is clear that simply identifying the various property types presents a significant challenge to a financial institution. However, even before each property type might be subject to escheatment financial institutions must be aware of escheat laws to ensure their policies and procedures are compliant. For example, if a financial institution has determined that an account has become inactive it will either start to impose an inactivity charge or stop paying interest. Generally, savings and checking accounts are presumed abandoned when there has been no positive customer contact for three years. The Uniform Disposition of Unclaimed Property Act and its supporting administrative rules, which are adopted by many states, provide several requirements that must be met before an inactivity charge may be imposed or interest payments may be stopped on subsequently escheatable property. For example, the contract with the customer must clearly and prominently define the terms that will allow for the imposition of the inactivity fee or ceasing of interest payment. Often, financial institutions inconsistently apply the inactivity charges or stopping the payment of interest, which may lead some states to assert that incorrectly charged inactivity fees or withheld interest payments are also escheatable property.

IRAs, Koeghs and educational accounts also present unique escheat issues for financial institutions due to their specified dates for mandatory payouts. Due to the mandatory payout age of 70 1/2 for IRAs and Koeghs, if a state has a three year dormancy period for such accounts, then a financial institution should remit an inactive account to the state only if there has been no positive owner contact and the presumed owner is 73 1/2. Similarly, many educational accounts are subject to a mandatory payout 30 days after the beneficiary's 30th birthday and a three year dormancy period, so financial institutions should report these accounts to appropriate states if there has been no positive contact with the presumed owner once they turn 33.

However, as noted above, the identification of property types is only the first step in the process of reporting and remitting unclaimed property. Financial institutions are required to track their accounts, identify those that are inactive and properly report and annually remit the property to the appropriate state.

Reporting challenges for financial institutions

There are a number of factors that make reporting and remitting unclaimed property more challenging for financial institutions than it is for other industries. Some of these difficulties are the result of the traditional, decentralized operational model for financial institutions, the complex property types and even the recent significant merger and acquisition activity that has reshaped the industry over the past decade.

Decentralized reporting may lead to omissions or overpayments

Many financial institutions operate in a decentralized manner. Separate business units, such as the investment or commercial banking operations, or even branch locations, may maintain separate business ledgers and operate according to their own policies and procedures for a variety of business functions, including reporting and remitting unclaimed property. There may be a different person or group within each unit or branch that is responsible for reporting unclaimed property, so there is no clear communication channel within the entire organization to establish a unified process or enable proper account tracking. What might be considered the responsibility of the tax group in one unit may be the responsibility of the legal department in another. As a result, gaps may exist in coverage of reporting unclaimed property or misreporting from duplicate records may occur. In a decentralized organization it is typical for property to be reported that may not actually be due. One business unit or branch may not be knowledgeable to what information might be available from another unit or branch. Consequently, the ability to research items properly or net common owners is not performed.

Related Account Activity: As discussed above, one of the steps in complying with unclaimed property requirements is identifying the accounts that are inactive. Oftentimes, a financial institution's customer may have more than one account with the same institution and, when viewed in isolation, one account may be inactive while a related account may have significant activity. Related accounts may include loans, safe deposit boxes, savings or checking accounts, time certificates and IRAs or other retirement accounts. Many states, however, provide that if a customer has a related account with a positive owner contact then that activity should be used to determine the aging on all of the customer's accounts. If a financial institution is operating its unclaimed property reporting process in a decentralized manner, then the apparent inactive account may be incorrectly escheated to the state. Conversely, during an audit an account may be improperly identified as escheatable to the state if the financial institution is unable to provide documentation that two accounts are related.

Tracking of Customer Accounts: An account may also be improperly reported to a state when the financial institution has not established a process for tracking customer accounts. Merger and acquisition activity often results in the convergence of different computer systems that may not accurately capture account information. Issues involving prior account activity, emails and out-dated messages or notes may be eliminated during the conversion. Human error may also come into play as hand-made changes to account information, such as address changes may also affect the accurate tracking of customer account information

Filing to the wrong state: As customer accounts or check payments move through the financial institution and the various areas, it is common for name and address information to no longer be attached to the balance prior to remittance. As such, the property is remitted to the state of incorporation instead of the state of last known address.

Mergers activity and prior liability of the acquired entity: In recent years mergers and acquisitions have been on the increase in the financial and banking industry. Depending on the type of acquisition, the acquiring company may be responsible for all historical outstanding unclaimed property from the acquired company. Due to decentralization, the acquired property from older accounts may not be incorporated into the escheat process and remains as a liability. Other issues that may arise from an acquisition are whether the state of incorporation of the organization has changed and if all the shareholders properly exchanged their shares. Since there is effectively no statute of limitations for non-filers, financial institutions may succeed to significant liabilities plus interest and penalties from acquired entities if the escheat issues are not addressed during the acquisition and integration process.

The Current Audit and Compliance Environment

As noted above, the difficult budget issues that many of the states are facing are causing them to look for additional sources of revenue. One non-tax revenue source is the enforcement of the unclaimed property laws through audit. To answer the call for assistance in completing these audits and to pull in additional revenue to the states, many third-party audit firms are stepping into the state's shoes and conducting the unclaimed property audits on their behalf. Over the last decade the number of audits completed by third-party firms has risen dramatically and the states' audit positions are becoming much more aggressive than they have in the past. Moreover, many of the third-party auditors enter into contingency fee compensation arrangements with the states which may result in higher revenue that the state receives from the audit and higher compensation fees paid to the third-party auditor.

Financial institutions have not been immune to the flurry of third-party audits. As outlined above, the banking industry has unique issues and varying reporting requirements under unclaimed property statues. The decentralized nature of the organizations, the recent merger and acquisition activity as well as the types of property held by financial institutions all make the unclaimed property compliance process a complex undertaking. When completing an audit, states use statistical sampling to determine prior years' liabilities and are requiring company executives to attest to how far back records are available.

Reviewing the compliance function in a financial organization and highlighting areas for improvement starts with identifying who will own the process. Whether it is the tax department, legal or a department reporting directly to the corporate secretary, one group should develop policies and procedures and manage the reporting process across all business units. The significant financial impact that can result from an aggressive audit coupled with the states' movement towards requiring company executives to attest to the availability of records may be enough to convince the company's leadership that unclaimed property is an issue that should be addressed proactively.

Whether a financial institution has strong internal controls for completing its compliance or it is just beginning to develop them, careful consideration should be given to whether the compliance function should be performed in-house or outsourced. In decentralized organizations, outsourcing may be an efficient way to establish universal compliance policies and procedures. For organizations that have a centralized compliance process, outsourcing may provide a more economical means to complete the annual reporting requirement and property tracking, allowing internal resources to focus on other areas. Finally, whether a company decides to utilize internal personnel or to outsource the compliance function, an effort should be made to organize the documentation that supports the identification of accounts as inactive and the annual reports that are submitted for future audits.

MULTISTATE DEVELOPMENTS

While not fully inclusive of all developments in state AUP, the following provides highlights of some notable items.

California

2011 CA S 713 signed by the Governor July 26, 2011

The Life Insurance Proceeds Disclosure Act of 2011 requires insurers to provide written disclosures to life insurance beneficiaries, as specified, at the time a claim is made and before a retained asset account, as defined, is selected or established as the benefit payment. The bill requires an insurer that settles life insurance benefits through a retained asset account to provide the beneficiary with a supplemental contract that clearly discloses the rights of the beneficiary and the obligations of the insurer under the supplemental contract. The bill also requires, if the life insurance benefits are placed in a retained asset account, the insurer to send the beneficiary at least one statement per quarter, and a statement for any month in which there has been any account activity other than the crediting of interest. The bill provides that an insurer that fails to conform to the requirements is subject to provisions of existing law that provide for the imposition of a civil penalty against any person who engages in any unfair method of competition or any unfair or deceptive act or practice in the business of insurance, as provided.

* Note that the bill states it is only operative if SB 599 of the 2011-12 Regular Session is enacted and becomes effective.

2011 CA S 495 signed by the Governor September 23, 2011

- Makes clarifying and technical changes to the requirement that the contents of a safe deposit box, or the proceeds of their sale, held in the state by a business association escheat to the state if unclaimed by the owner for more than 3 years.
- Clarifies escheat rules for certain funds in retirement accounts and plans and when they become due and payable
- Exempts tangible or intangible property from escheating to the state if the fiduciary and owner of the property have taken certain actions regarding the property,
- Requires the person holding the property to report to the Controller only the property subject to escheat,
- Requires that property that has no apparent commercial value to be retained for a period of not less than 7 years from the date the property is delivered.

2011 CA S 599 signed by the Governor October 2, 2011

Requires that all life insurance benefits be paid in the form of a lump-sum payment to the beneficiary or by another settlement option that is clearly described in the claim form. If the beneficiary does not choose one of the available settlement options, a retained-asset account is authorized to be the default option only if the claim form provides a prominent disclosure, as prescribed, that in the absence of a choice by the beneficiary, payment of policy benefits are made through establishment of a retained-asset account on the beneficiary's behalf. Any life insurance benefits settlement an insurer offers or recommends, other than for a lump-sum payment, are required to conform to specified conditions.

* Note that the bill states it is only operative if SB 713 of the 2011-12 Regular Session is enacted and becomes effective.

Connecticut

2011 CT H 6351 signed by the Governor July 13, 2011

Clarifies requirements for general-use prepaid cards regarding expiration dates and required disclosures. Effective October 1, 2011, a holder of a general-use prepaid card may not impose on the property a dormancy charge or fee, abandoned property charge or fee, unclaimed property charge or fee, escheat charge or fee, inactivity charge or fee, or any similar charge, fee or penalty for inactivity with respect to the property.

Illinois

2011 IL H 1560 signed by the Governor August 8, 2011

Provides that unclaimed wages, payroll, and salary in any form, held or owing by a bank or financial institution is presumed abandoned after one year. The prior law required the property be held five years before presumed abandonment.

2011 IL H 159 signed by the Governor August 12, 2011

Amends currency exchange law to state that any remaining funds after the conclusion of a receivership of an abandoned currency exchange are considered unclaimed property and must be remitted to the State.

New York

2011 NY S.16 signed by the Governor on March 31, 2011
Note: The Spring/Summer AUP newsletter incorrectly reported that certain property types' deemed abandonment period decreased from 5 to 3 years.

Nevada

2011 NV A 219 signed by the Governor June 16, 2011

Provides that seventy-five percent of all reported unredeemed and expired wagering instruments be remitted to the Commissioner on a quarterly basis.

Rhode Island

2011 RI S 725 signed by the Governor July 12, 2011

Amends requirements for public notice of unclaimed property.

2011 RI H 5755 and S 727 signed by the Governor July 12, 2011

The tax administrator may dispose of any "de minimis" unclaimed property with a value of less than $50 that has been in the possession of the administrator for more than ten years.

2011 RI S 45 signed by the Governor July 13, 2011

Established requirements for the complete and proper disclosure, transparency, and accountability relating to any method of payment for life insurance death benefits and require that beneficiaries are fully informed in bold and in layman's language of their options. Specifically addressed are retained asset accounts and the reporting requirements of unclaimed property.

Texas

2011 TX S 130 signed by the Governor June 28, 2011 and 2011 TX H 232, signed by the Governor June 29, 2011

Clarifies provisions of Senate Bill 1, enacted July 19, 2011, by providing clear examples of what types of records or documentation, appropriate to a tax or fee, may be used to verify certain claims. Also clarifies that a utility deposit is presumed abandoned on the latest of:

1) the first anniversary of the date a refund check for the utility deposit was payable to the owner of the deposit;
2) the first anniversary of the date the utility last received documented communication from the owner of the utility deposit; or
3) the first anniversary of the date the utility issued a refund check for the deposit payable to the owner of the deposit if, according to the knowledge and records of the utility or payor of the check, during that period, a claim to the check has not been asserted or an act of ownership by the payee has not been exercised.

And, decreased the period for which money orders are presumed abandoned from seven years to the periods as follows:

1) the third anniversary of the date the money order was issued;
2) the third anniversary of the date on which the issuer of the money order last received from the owner of the money order communication concerning the money order, or
3) the third anniversary of the date of the last writing, on file with the issuer, that indicates the owner's interest in the money order.

For more information, please do not hesitate to contact:

Janet Gagliano, Partner, in Atlanta, (678) 419-1068
janet.c.gagliano@us.pwc.com