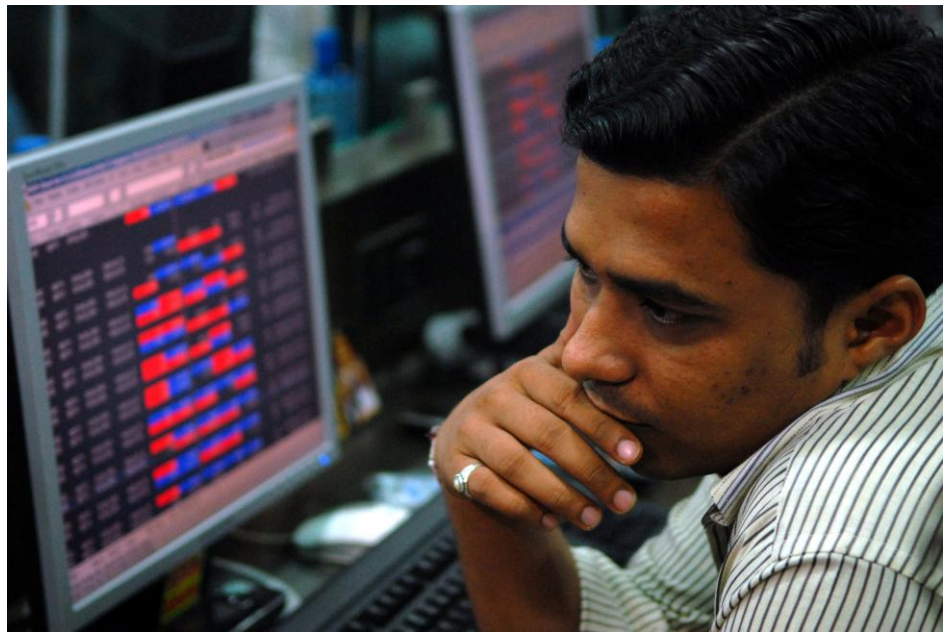


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Equity audits:

- As part of the audit information request for security-related audits, companies are being asked to provide copies of all unclaimed property reports filed on their behalf by the transfer agent and the supporting documentation.

The insurance industry:

- It appears that the audit and regulatory activity surrounding the insurance industry from 2011 will roll over to 2012 as other states start to focus on the issue and the third party auditor expands its list of companies under audit on the states' behalf.

Deal-of-the-day:

- The type of deal structure and how that deal is set up can trigger different unclaimed property issues. Is the deal a gift card, electronic certificate, or a voucher?

Abandoned and unclaimed property: A growing area of concern for many companies and industries

In recent years, unclaimed property audits have demanded more attention from companies than ever before. The increase in third party auditors, aggressive audit positions, shrinking dormancy periods, and the possibility of public scrutiny over internal controls are just a few of the reasons why these audits are moving up on the list of priorities for companies dealing with these issues.

As we move through the next year, it will be interesting to see where these unclaimed property issues will go and whether state legislatures will continue to amend their laws to keep the revenues flowing in at a faster pace. This article focuses on three unclaimed property areas that have developed and grown over the past year: debt and equity audits, scrutiny over the insurance industry, and the developing market for deal-of-the-day type of promotions.

Debt and equity-related property — Increase in state-initiated audits

Over the past year, unclaimed property audits focusing on debt and equity related property types have been at an all time high. The state of Delaware, through its third party contract auditors, increased their focus and attention on this area where, historically, this specific type of unclaimed property was not analyzed or the mere mention of a transfer agent obviated any additional information from being requested or collected.

Types of property covered in an equity audit

Equity-related property (i.e., stocks and dividends) and debt-related property (i.e., debentures and bonds) are now areas of high visibility for state unclaimed property audits. Generally, the audits conducted by third party auditors are split into two different audits, with the first audit geared to general ledger related property (i.e., payroll, accounts payable, and accounts receivable) and the second and concurrent audit geared to equity and debt related property (i.e., stocks, dividends, debentures and bonds). Currently, many holders that are struggling to meet the demands of the general ledger related audits, with numerous record requests dating back to 1981, are now being required to also provide similar information for equity audits.

Being proactive to make audits run smoother

In the past, when equity- and debt-related property was questioned, a holder would notify the auditor that this responsibility was held by their transfer agent, who was responsible for escheatment and reporting on their behalf to the states, assuming that is what the contract stipulated. Providing additional assurances, the Security and Exchange Commission (SEC Rule 17Ad-17) requires transfer agents to use reasonable care in locating missing shareholders and establishing minimum search requirements.

However, many companies take a passive approach to this process and solely rely on their transfer agents and just assume that the reporting is actually happening. As part of the audit information request for security-related audits, companies are being asked to provide copies of all unclaimed property reports filed on their behalf by the transfer agent and the supporting documentation. For example, information requested may relate to common stock, preferred stock, records from recent mergers, acquisitions, redemptions, unpaid dividend checks, unpaid debenture bonds, employee stock purchase plans, dividend reinvestment plans, restricted stock, and corporate trust relationships. Also, to make matters even more challenging, if the audit is being conducted on behalf of Delaware, this information is requested back to 1981, which is Delaware's reach-back period. Companies should take a proactive approach to this issue to ensure that their contracts with transfer agents clearly address the responsibility for

escheatment and to require that proper accounting records are both maintained and provided to the company as evidence that the escheatment is taking place.

If these areas are not addressed in a proactive fashion, significant unclaimed property liabilities can be assessed on audit, along with assessment of penalties and interest. Also, in the post Sarbanes-Oxley era it is critical, for regulatory reasons, that companies maintain accurate records. There are many actions a company may take to address these issues before an audit is started. Companies should consider implementing corporate policies and procedures that address compliance with unclaimed property laws, which should be rolled out by a representative of senior management and should be implemented throughout the organization. Companies should develop and implement detailed policies and procedures for identifying, tracking, reporting, and record retention requirements for all unclaimed property laws. Careful planning and taking proactive measures both with transfer agents and within a company is necessary to effectively comply with these extensive and complicated unclaimed property equity audits.

Insurance industry and abandoned and unclaimed property (AUP)

Unclaimed property and insurance companies is not a new topic. Historically, insurance companies have been scrutinized, along with many other financial institutions, for compliance with abandoned and unclaimed property laws. Due to their business nature of holding individuals' claims to property in the form of policy benefit payments, many large insurance companies have extensive filing histories related to this area. Although unclaimed property laws in their current form have been on the books of the states since the 1950s or 1960s, compliance with laws was not a focus of companies or states until the 1980s. The financial institutions, including insurers, were among the first industries to be reviewed by the states for filing compliance. Through these audits, the majority of the large financial institutions refined their compliance processes.

Today, states are taking a look at some of these corporations with fresh eyes, specifically focusing on accounting practices, products offered, and consumer outreach efforts performed in the insurance industry. To fully understand the nuances of an insurance company audit, it is important to factor in the type of insurance products offered and the mainline business of the company.

Audit triggers for property and casualty insurance companies

In today's environment, property and casualty (P&C) insurance companies would generally be selected for audit by a state or third party for a number of reasons. If a company has an inconsistent filing history, either when that company's annual filings are compared from year to year, or in comparison with a competitor's filing for the same year, this can draw the focus of an auditor. As with many types of state tax, large mergers and acquisitions may also trigger a state to commence an audit of a company. However, unlike other companies, most insurance companies generally have a filing history and more refined policies and procedures surrounding the reporting of unclaimed property, which include a process of contacting owners prior to escheatment. Consequently, a state audit has to dig a little deeper to uncover any liabilities that may be unreported or underreported.

One major area of focus in an audit of a P&C insurance company surrounds the concept of full claim settlement. In pursuing these types of claims, a state auditor may select a number of outstanding or voided checks and require documentation supporting the assertion that the claim check is properly classified as outstanding, or more likely, why the check was ultimately voided. The issue becomes a burden of proof. The company under audit is required to provide proof that the underlying liability, represented by an endorsed check for the original amount was settled in full. This is a straightforward exercise if the check was

voided and subsequently reissued for the same amount to the same payee within a reasonable amount of time, and the reissued check was cashed. In this situation, the company under audit would only need to provide the copy of the reissued check, showing both the front and back with evidence that the check cleared the bank. However, if the check was subsequently reissued to a different payee (a policy holder versus a body shop, for example) or in a different amount (estimated repair value changes or an initial settlement offer is rejected), then the documentation becomes more difficult. The company would not only need to show that the reissued check cleared the bank, but would also need to show documentation that would tie the initial voided check to the subsequent reissued check. In many cases, the only place where this documentation can be found is in the notes to the claim and, given the age of the checks likely being tested in an unclaimed property audit, there is a higher likelihood of incomplete or nondescriptive notes that would not be sufficient to fully clear the potential liability during an audit. This area, along with complications related to the accounts receivable side of the business, including documentation of unidentified remittances, reconciling balances related to agency billings, and potential premium overpayments, can lead to drawn out audits that can take more than three years to close.

The new focus on life insurance companies

Over the past year, audits, along with a lot of media press, have focused on specific practices believed to be held by some companies in the life insurance industry. During 2011, buzz was generated when John Hancock settled with the state of California for underreported funds related to the company's life insurance benefits. Due to this settlement, public opinion appeared to develop that large life insurers were taking extra precautions to determine if an annuitant had passed away by performing a matching process against open annuities; however, these same insurers were not communicating these death matches to the departments or business units that may also hold a life insurance policy for the same owner. The perceived result was that the company was being proactive to determine a date of death so that it may stop making payouts on annuity type products while relying on the beneficiary to provide notice of death before benefits would be paid out under a life insurance policy. Hypothetically, this could lead to a company knowing of a policy holder's death, but taking no steps to pay out money owed, and using the knowledge solely to stop making annuity payments to the same person.

A third-party audit firm, which has represented upwards of 30 states during one audit, has taken center stage in this area. This audit firm is focused on the areas of Group and Individual Annuity Products, Group and Individual Life Products, and Retained Asset Accounts. The process that the audit firm appears

to use for an audit is fairly straightforward. First, the audit firm reviews the procedures, systems, and operating policies of each business unit offering one or more of the types of products listed above, and determines the populations of data to request. The audit firm then makes data requests that generally include a cut-off year (for example, 1996), and requests all policies in-force at any time during the period from the cut-off year to the current year. That population is then reviewed for missing information (such as date of birth or social security number) and follow up information is requested. Once the population of each product is confirmed, a matching process starts, including iterations of exact and "fuzzy" matching. An example of a "fuzzy" match is where one document might list a person's whole name, such as Mary J. Smith, and another source lists Mary Smith. All potential matches would then be provided back to the company to be researched so that it may then provide the reason a payout has not yet been made, and any matches that are not documented would need to be paid to a beneficiary or, if the beneficiary information is not available, escheated to the state.

The settlement with the state of California, mentioned above, also involved the publication of a document called a Global Resolution Agreement (GRA), which outlined the steps John Hancock would take in reviewing their policies for potential deceased policy holders, as well as an agreement to follow similar steps in the future. The GRA outlined a matching procedure to the Social Security Master Death File,

which included not only exact matches on various data fields, but also prescribed a detailed "fuzzy match" methodology, mentioned above, which would allow the company to match potential transpositions related to birthdates or social security numbers, or name changes for policy holders. The industry reaction to the published settlement documents has been mixed. However, the states and their representatives have been validated by this settlement, suggesting that others in the industry should also enter into GRAs to shape their audit. In addition to the audits discussed above, which are related specifically to the unclaimed funds departments of the states, some insurance regulators have thrown their hat in the ring with these reviews. Both California and Florida have selected companies for Market Conduct Exams related to escheatment of funds, and New York has contacted many companies through a 308 letter, which requires companies to review and provide a narrative of their matching process going forward, as well as findings related to the matching process. Additionally, other states started the process by sending out surveys to various insurance companies related to their processes and procedures in this area.

It appears that the audit and regulatory activity surrounding the insurance industry from 2011 will roll over to 2012 as other states start to focus on the issue and the third party auditor expands its list of companies under audit on the states' behalf.

The deal of the day — Complex internet deals

Deal-of-the-day type deals are spreading and picking up momentum across the country. Fast on the scene to this ever growing new market, companies have continued to expand the type of deals being offered. As more and more merchants continue to turn to the deal-of-the-day promotions, we are seeing offers for meals, entertainment, product/merchandise, travel, and services to name a few. The type of deal structure and how that deal is set up can trigger different unclaimed property issues. Is the deal a gift card, electronic certificate, or a voucher? In one state a gift card may be exempt from escheatment, meaning the issuer of the card may not have to report the unused balance on the card as unclaimed property. In another, that same card may not be exempt from unclaimed property reporting. Even more so, one state may exempt traditional gift cards, but that same state could classify the deal-of-the-day transaction as an electronic certificate, thus not allowing the issuer of the card to benefit from any exemption.

Many states' AUP laws surrounding gift cards and gift certificates can be based on or coincide with consumer protection rules. With the development of the deal-of-the-day transactions, there has been much discussion at federal and state levels regarding the types of "vouchers" being sold and the potential issue surrounding the "use it or lose it" term limits. The shortened terms of usage by consumers and the limitation on the program offerings have gotten much

attention for consumer protection and consumer rights reasons, which is evidenced by some of the lawsuits popping up against some deal-of-the-day retailers.

As more and more states face revenue constraints, they are increasingly becoming more aggressive and creative in closing their budget gaps. These creative solutions may continue to expand as business transactions with individuals become more complex and the services and products grow through internet offerings.

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