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FISCAL IMPACT REPORT

SPONSOR <u>Nibert</u>	LAST UPDATED <u>2/21/23</u>	ORIGINAL DATE <u>2/5/23</u>
SHORT TITLE <u>Uniform Unclaimed Property Act</u>	BILL NUMBER <u>House Bill 165/aHJC</u>	ANALYST <u>J. Torres</u>

REVENUE* (dollars in thousands)

Estimated Revenue			Recurring or Nonrecurring	Fund Affected
FY23	FY24	FY25		
	(Indeterminate)	(Indeterminate)	Recurring	General Fund

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT* (dollars in thousands)

	FY23	FY24	FY25	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
	No fiscal impact	(\$94.2)	(\$138.4)	(232.6)	Recurring	TRD Operating Budget
	No fiscal impact	(\$150.0)		(150.0)	Nonrecurring	TRD Operating Budget

Conflicts with House Bill 26

Sources of Information

LFC Files

Responses Received From

Gaming Control Board (GCB)
Taxation and Revenue Department (TRD)
Regulation and Licensing (RLD)

No Response Received

Secretary of State (SOS)
New Mexico Municipal League
Department of Finance and Administration (DFA)
State Treasurer's Office (STO)

SUMMARY

Synopsis of HJC Amendments to House Bill 165

The House Judiciary Committee amendment to House Bill 165 includes minor changes including revised statutory references, renumbering of proposed statutory sections and tightened up language pertaining to new material. The major new section is set forth as follows:

SECTION 64. A new Section 7-8B-1002.1 NMSA 1978 is enacted to read: "7-8B-1002.1 [NEW MATERIAL] EXAMINATION OF FEDERALLY INSURED, STATE-REGULATED FINANCIAL ORGANIZATIONS.-- A. Notwithstanding the provisions of Section 7-8B-1002 NMSA 1978, for any financial organization whose deposits are federally insured and for which the financial institutions division of the regulation and licensing department is the primary regulator, the administrator shall not examine that financial organization unless the administrator has consulted with the director of the financial institutions division and the division has not conducted an examination of the financial organization for compliance with the Revised Uniform Unclaimed Property Act within the past five years. The director of the financial institutions division shall furnish to the administrator, for each such examination relating to the financial organization's compliance with the Revised Uniform Unclaimed Property Act within the past five years, the records obtained and records, including work papers, compiled, relating to compliance with that act. The records are confidential and are not public records. The director of the financial institutions division may waive in a record the provisions of this subsection in order to permit the administrator to examine one or more of these federally insured, state-regulated financial organizations for compliance with the Revised Uniform Unclaimed Property Act. B. Notwithstanding Subsection A of this section the administrator may, at reasonable times and upon reasonable notice: (1) examine the records of a financial organization whose deposits are federally insured and for which the financial institutions division of the regulation and licensing department is the primary regulator, if the administrator has reasonable grounds to believe that the financial organization has failed to comply with the Revised Uniform Unclaimed Property Act; and (2) adopt rules that describe conditions under which the administrator may have reason to believe that a financial institution is not in compliance with the Revised Uniform Unclaimed Property Act. C. An examination by the administrator pursuant to Subsection A or B of this section shall be governed by Sections 7-8B-1001 through 7-8B-1104 NMSA 1978. D. Nothing in this section shall be construed to limit the administrator's authority under the Revised Uniform Unclaimed Property Act to examine financial organizations that do not have deposits, whose deposits are not federally insured or for which the financial institutions division of the regulation and licensing department is not the primary regulator. Further, nothing in this section shall be construed to limit the authority of the financial institutions division to determine financial organizations.

"7-8B-1003. [NEW MATERIAL] RULES FOR CONDUCTING EXAMINATION.-- (a) The administrator shall adopt rules governing procedures and standards for an examination pursuant to Section 7-8B-1002 or 7-8B-1002.1 NMSA 1978, including rules based on national standards, which may reference any standards promulgated by the national association of unclaimed property administrators.

"7-8B-1004. [NEW MATERIAL] RECORDS OBTAINED IN EXAMINATION.-- Records obtained and records, including work papers, compiled by the administrator in the course of conducting an examination pursuant to Section 7-8B-1002 NMSA 1978 or 7-8B-1002.1 NMSA 1978 or received from the financial institutions division of the regulation and licensing department pursuant to Subsection A of Section 7-8B-1002.1 NMSA 1978: (1) are subject to the confidentiality and security provisions of Sections 7-8B-1401 through 7-8B-1408 NMSA 1978 and are exempt from disclosure pursuant to the Inspection of Public Records Act;....

As noted, the bill’s substantive amendments pertain to the examination of federally insured state regulated financial organizations.

Synopsis of Original Bill

Each agency analysis predates the HJC amendments. RLD is added to this FIR.

House Bill 165 amends Sections 1-19A-10 and 7-1-2 NMSA 1978 to include references to the Revised Uniform Unclaimed Property Act. The 137-page bill’s primary function is to introduce the Revised Uniform Unclaimed Property Act, repeal existing Sections 7-8A-1 through 7-8A-31 NMSA 1978, and to repeal and amend other relevant statutes. New Mexico’s current Unclaimed Property Act was enacted in 1995. This revision includes technological changes, as well as new forms of property and time-relevant holding and dispersion requirements. It clarifies tangible and intangible property, establishes events triggering presumed abandonment, revises dormancy periods, refines the duties of holders of unclaimed property, and adds security and confidentiality provisions.

The bill’s introductory section defines essential terms, including “owner,” “holder,” and “administrator.” It then clarifies foreign property, credit union, and patronage capital exclusions. Administrative rulemaking authorization follows.

The bill clarifies when property is assumed to be abandoned, including tangible property, tax-deferred retirement, and other tax-deferred accounts. The holder’s notification requirements follow. The bill then establishes presumptions regarding the abandonment of minor custodial accounts and safe-deposit box contents.

The following sections describe presumed abandonment of stored value or gift cards, securities, and related property. The next section clarifies an apparent owner’s indication of interest in property. That is followed by the knowledge of death of an insured or annuitant and deposit accounts for insurance or annuity proceeds.

The sections that follow pertain to addresses of: the apparent owner to establish priority, the apparent owner in New Mexico, multiple addresses, and New Mexico domiciled holders. Holder and administrator responsibilities are included in several of the following sections. The bill then addresses property disposition, statutes of limitation, sales, disposal and recovery of securities, property ownership and claims, military decoration, administrator deposits, and service charges.

GCB notes:

The proposed bill adds several new sections to the Unclaimed Uniform Property Act including definitions which specifically exclude game-related digital content and loyalty cards from the definition of “property.”

TRD states:

With the extensive changes to the Unclaimed Property Tax Act and the unfunded new mandates, TRD would not be able to implement this bill by the proposed effective date.

The effective date of this bill is January 1, 2024.

FISCAL IMPLICATIONS

There is no fiscal appropriation. Future estimated general fund revenue depletion from the return of unclaimed property is recurring and indeterminate.

The bill authorizes rulemaking for conducting property examinations; sets forth enhanced notice requirements; details the manner in which compliance is to be achieved; includes appellate procedures; and has a statute of limitations. The new material concludes with various provisions pertaining to the protection unclaimed property. Several required statutory amendments follow the new material. The updated bill will likely create a substantial fiscal impact by modernizing the unclaimed property act and its method of implementation.

As for the potential impact on TRD, House Bill 165 would require annual information system changes and updated forms, instructions, and publications. These changes would be incorporated into annual tax year implementation starting with tax year 2024 and each subsequent tax year and represent significant workload costs for TRD's Information Technology Division (ITD). TRD's additional fiscal expenditures will likely include the cost of employing additional administrative, accounting, legal, and IT staff, as well as, the equipment and supplies required to implement House Bill 165.

TRD's FY23 operating budget was \$113.8 million and its FY24 budget request is \$120 million. More analysis from TRD, LFC, and DFA staff will be warranted to know the fiscal impact of possible expansion needed to support the operating demands of House Bill 165. TRD's FY23 agency-wide vacancy rate has been over 20 percent. This reflects that, like other agencies, TRD is facing challenges with recruitment and staffing. TRD may have sufficient revenue in otherwise reverted funds to cover some of the implementation costs.

TRD states:

This bill would reverse 2021 amendments that currently allow TRD to save taxpayer funds by using more efficient and cost-effective methods to connect abandoned property to its rightful owners. The 2021 amendments were advocated by TRD to reduce inefficient expenditures of taxpayer funds. This bill would once again require TRD to publish a lengthy and costly list of unclaimed property owners and their addresses annually in every county. Current law shortens the published notices significantly by simply requiring TRD to publish information to search unclaimed property online and how to contact TRD. If this bill is passed, the newspaper publication requirements will once again become more extensive. The notices will once again be longer, and therefore be more costly for TRD to publish. As detailed in the table below, TRD estimates this bill presents an unfunded recurring mandate of \$118 thousand, growing with inflation.

By contrast, after a local television news station featured unclaimed property in May 2019, TRD sent out about 4,200 claims. That three-minute local news segment yielded three times as many claims as the legal notices at no cost to the state. Further, every month since TRD launched its automated unclaimed property search system in September 2022, claims have been extremely high by historic standards.

The bill proposes new reporting requirements for TRD such as under Section 72 to produce an annual report to the governor, State Treasurer, and Legislative Council Service. This section is an unpaid mandate to create extensive new reporting of

unclaimed property administration, with the first report to be due three months after the end of fiscal year 2024.

TRD will need an additional full-time equivalent (FTE) to support the new annual reporting requirements and other unfunded mandates in the bill. The FTE costs are based on a management analyst supervisor.

GCB and RLD note no fiscal impact.

SIGNIFICANT ISSUES

This extensive bill is likely a necessary revision to New Mexico’s 1995 Unclaimed Property Act and supporting legislation. Ten states have now enacted this update. An informative website and several insightful articles written by the Uniform Law Commission’s Legislative Counsel may be found under the following links:

<https://www.uniformlaws.org/committees/community-home?communitykey=4b7c796a-f158-47bc-b5b1-f3f9a6e404fa>

<https://www.uniformlaws.org/viewdocument/enactment-kit-63?CommunityKey=4b7c796a-f158-47bc-b5b1-f3f9a6e404fa&tab=librarydocuments>

TRD’s comments document its hesitation with the passage of this uniform bill.

RLD states:

HB165 contains a potentially significant issue with regard to the “estimation, extrapolation and statistical sampling” methodology proposed as a part of abandoned property compliance examinations and, in particular, with contracting those examinations to a third-party auditor who stands to gain significant financial benefits based upon the fees collected under such methodology. This issue has come to the attention of the RLD’s FID in the past. In 2015, the FID found that companies who contract for such audits/examinations typically use a formula based on a company’s revenue and any volatility in that revenue. This measurement and methodology exponentially increase the company’s fee calculation and profit. However, when the company’s revenue is not considered in the value of the abandoned property, the fees charged are likely to be reasonable and more closely correlated to the actual value of abandoned property.

The estimation or extrapolation method used by the TRD and/or its contract auditors should be required, by statute, to be based on actual value of unclaimed property or related measures rather than other unrelated factors. For example, in *McKesson Corp. v. Cook*, C.A. No. 4920-CC (Del. Ch. Sept. 25, 2009), McKesson Corp. estimated it held \$19,337 of unclaimed property. However, an auditor contracted by the state of Delaware used an extrapolation method and computed an assessment against McKesson of approximately \$4.5 million. Assessments of this magnitude could jeopardize the safety and soundness of financial institutions and, as an unintended consequence, cause monetary harm to New Mexico citizens in the process should financial institutions fail due to extremely aggressive assessments. Additionally, if financial institutions either fail or shrink due to extremely large assessments, the FID’s revenue base for annual supervision fees, which is deposited to the general fund, would also be reduced.

The extrapolation formula used for this demonstration is the same as was observed by FID in 2015:

(Determined Liability for Base Year(s) with Records) / (Revenue for Base Year(s)) =
Escheat Percentage

(Escheat Percentage) X (Revenue for Year(s) with Insufficient or No Records) =
Projected Assessment

Assumptions made in the example are that the banks are the same size, have the same total income over a 10-year period, and have the same mix and level of abandoned property. Additionally, the assumption is made that due to technological obsolescence, only the most recent five years of escheatment records can be retrieved. With all other things being equal, only the volatility in revenue/income causes “Bank B” to be assessed triple the amount assessed to “Bank A”.

The escheat percentage (denoted as “X factor” on the spreadsheet) for the banks ranged from 2.55 to (2.15). One bank had an X factor of zero, two were negative, and the remaining 28 banks had a positive X factor, 11 of which were greater than one. The contract audit company that had discussed a contract with TRD in 2015 was found to have targeted the higher escheat percentage/X factor banks first, as they would have yielded the highest assessments when the contract audit company’s percentage of assessments was greatest.

HB165 Section 30 (7-8B-404) requires a holder to retain records for 10 years. However, the pace of technological change is ever increasing, and what is deemed today as the newest and best technology to retain records will likely be obsolete in only a few years. Based on the adoption of new technologies, record retrieval for the full 10-year retention period may be difficult or even impossible. Additionally, with cyberattacks and ransomware become increasingly common hazards for a multitude of industries, especially so for financial institutions, there is a moderate probability that older records (but those still less than 10 years old) may have been compromised or otherwise become inaccessible to the company through no fault of their own. Without accurate records to determine the actual value of unclaimed property, holders may be exposed to excessive liability assessments by TRD when using estimation/extrapolation methods to estimate the value of unclaimed property for the full 10-year record retention term.

Use of an estimation/extrapolation method may not survive challenges of Due Process and the Takings Clause of the 5th Amendment. For instance, an audit using an estimation/extrapolation method may treat property as abandoned without establishing “actual abandonment” by an owner. Thereby the owner of the property may not receive appropriate notice that their property has been deemed abandoned. Further, an estimation/extrapolation method may not consider the owner’s state citizenship at the time the property was abandoned, thereby depriving another state of the value of the abandoned property. Further, in the absence of accurate records, some states’ auditors use an estimation/extrapolation method to estimate the amount of unclaimed property back to the creation of the company or to the effective date of the UUPA. This estimation/extrapolation has resulted in excessive assessments in the millions of dollars like those in *McKesson Corp. v. Cook*. Therefore, using estimation/extrapolation

methodology may not provide a holder of abandoned property with either procedural or substantive Due Process, expose the State to illegal taking actions, and extensive litigation for assessments for abandoned property that never existed.

Financial institutions and the securities industry are already subjected to regular, vigorous examination by both state and federal examiners (such as the Office of the Comptroller of the Currency, the Federal Reserve Banks, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission, the New Mexico Regulation and Licensing Department, and others). HB 165 would increase regulatory burden on these already highly regulated entities in an area already subject to routine scrutiny by federal and state regulatory bodies.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

TRD states: “Conflicts with HB26.”

TECHNICAL ISSUES

TRD states:

[Sections 48 and 49]: On page 67, line 4, the bill references three years to liquidate securities. On the same page line 18 references an expiration of six years. These conflicting timelines may cause confusion.

[Sections 49]: On Page 67, line 24, it is unclear how market value, interest, dividends etc. are determined. If market value exceeds amounts received, it is not clear in the bill where the funds to replace increased value come from. TRD recommends a definition to assist in this determination. Further, if the market value is lower than the amount when received, a definition of recourse for the claimant to demand full value at time of receipt is recommended.

[Section 52]: This section references the tax administration suspense fund. Unclaimed property amounts are deposited in to the unclaimed property suspense fund. Additionally, this section refers to \$100 thousand as a base cash balance in the fund. This amount would be insufficient as TRD currently sets this amount with the Department of Finance Administration (DFA) at \$5 million.

[Section 54]: This section references expenses and service charges to occur before making a deposit of funds received to the general fund. For clarification, amounts are deposited at the time of receipt into the unclaimed property suspense fund and periodic transfers are made to the general fund. It is unclear if cost recovery amounts are intended to be a distribution. Depending on circumstances, amounts will vary, and as written, any amounts retained will remain in the unclaimed property suspense fund.

[Section 71]: On page 89, lines 1 through 10, the language prohibits related future employment or contractual services for an administrator or an individual employed by the administrator who participates in, recommends or approves the award of a contract for a period of two years. This section may conflict with The Governmental Conduct Act, NMSA 1978, Chapter 10, Article 16, regarding this length of time before accepting future employment.

[Sections 81 and 82]: Both these sections refer to civil penalties and interest. It is assumed these amounts would be deposited into the unclaimed property suspense fund, however, the distribution of these amounts requires clarification.

OTHER SUBSTANTIVE ISSUES

TRD states:

Policy Issues: The Revised Uniform Unclaimed Property Act creates numerous new definitions, procedures and requirements for the Taxation and Revenue Department. The National Association of Unclaimed Property Administrators (NAUPA) develops and adopts policy and engages in legislative and regulatory advocacy. They state the purpose of unclaimed property laws is to protect the public by ensuring money and property owed to them is returned to them, rather than remaining permanently with financial institutions, business associations, governments, and other entities. It is unclear if the proposed revision to the Unclaimed Property Act meets NAUPA standards.

ALTERNATIVES

TRD states:

TRD suggests an implementation date of January 1, 2025.

NAUPA’s model language for uniformity **does not** require advertisement of names and addresses for each property holder. Recommendations require both first class mail and email, if the owner has consented to electronic communication from the holder. Some of the states, however, such as Colorado and Indiana, permit notice to be sent via first class mail. Other states are pursuing adopting advertisement language similar to New Mexico from HB98 in the 2021 legislative session. Currently, New York is the only remaining state that requires advertisement with names and location. This bill would add New Mexico to that list of States, undoing a move towards best practices for unclaimed property outreach.

AMENDMENTS

RLD states:

The FID of the RLD suggests consideration of an amendment to provide that financial institutions and entities in the securities industry who are already vigorously examined by state and/or federal regulators be exempted from the examination portion of HB165. The State of Illinois, where the Uniform Law Commission is headquartered, has recognized the duplication of state agencies examination efforts state regarding state-chartered/licensed financial institutions. The recommended language below, based on the current Illinois statute, might best be inserted as a new section of statute 7-8B-1002.1, page 80, after line 14.

7-8B-1002.1 EXAMINATION OF STATE-REGULATED FINANCIAL ORGANIZATIONS

- (a) Notwithstanding Section 7-8B-1002 of this Act, for any financial organization for which the Financial Institutions Division of the Regulation and Licensing Department is the primary prudential regulator, the administrator shall not examine such financial institution unless the administrator has consulted with the Director of the Financial Institutions Division and the Financial Institutions Division has not examined such financial organization for

compliance with this Act within the past 5 years. The Director of the Financial Institutions Division may waive in writing the provisions of this subsection (a) in order to permit the administrator to examine a financial organization or group of financial organizations for compliance with this Act.

- (b) Nothing in this Section shall be construed to prohibit the administrator from examining a financial organization for which the Financial Institutions Division of the Regulation and Licensing Department is not the primary prudential regulator. Further, nothing in this Act shall be construed to limit the authority of the Financial Institutions Division of the Regulation and Licensing Department to examine financial organizations over which they have statutory authority.

If estimation, extrapolation, and/or statistical sampling are allowed for financial institutions and the securities industry, the FID of the RLD suggests that they only be used in circumstances where purposeful or negligent material non-compliance with escheatment procedures, other than unretrievable data for more than five (5) years, is noted. With the speed of recent technological advances, ten (10) years is a very long time to expect that software programs, no matter how robust, will continue to be maintained by software vendors who often profit by phasing out and discontinuing maintenance and updates on older systems/programs.

The FID of the RLD further recommends that HB 165 be amended to include a mandate that if/when the estimation, extrapolation, and/or statistical sampling methodology is used, that the underlying measures strongly correlate with actual abandoned property levels, rather than arbitrary and/or unrelated measures, such as income/revenue or volatility in income/revenue. An example, as used in a depository institution, would be a correlation between the average dollar amount of abandoned property to the average total dollar amount of deposit liabilities for the same period, as reported by the depository institution in their quarterly call reports to the Federal Financial Institutions Examination Council, the National Credit Union Administration, or other governmental body.

These significant and other substantive issues, if not addressed, could lead to negative unintended consequences for New Mexico citizens and companies.

JT/rl/ne/al/rl