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Life Insurance Practice Under Fire

Retained-Asset Accounts Draw Scrutiny From Veterans Affairs And New York's AG

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The life insurance industry is roiling after a standard, decades-old business practice came under attack last week in a news story that led to investigations by New York's attorney general and a federal agency.

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At issue is the use of so-called retained-asset accounts, which were the subject of an article in Bloomberg Markets magazine. When a person with a policy dies, a life insurance company might, instead of paying a lump sum to the beneficiary, keep the claim money in an account. The insurer invests the cash and makes a very small interest payment to the beneficiary while keeping the rest.

At worst, it appears insurers are profiting from people at a time when they are most vulnerable – right after a family member's death, said Connecticut Attorney General Richard Blumenthal and New York Attorney General Andrew Cuomo. Additionally, the money could be at risk because it is not in an FDIC-insured bank account or some other place where it could earn more in interest.

Life insurers who engage in the practice include MetLife Inc., Prudential Financial Inc., The Hartford Financial Services Group and The Phoenix Cos., all of which have their headquarters or major operations in central Connecticut. Another life insurer with local operations, Lincoln Financial Corp., could not be reached late Friday.

Insurers say customers are clearly given the option of a lump sum up front, and they may withdraw their money at any time. Insurers also say the money is more secure with them than in a bank account because a state-required guaranty on claims covers a higher limit in most states than FDIC insurance.

"We believe this [Bloomberg] article … reflects a clear misunderstanding of how retained-asset accounts work," said Phoenix spokeswoman Alice Ericson. "We believe these accounts are a valuable option for life insurance beneficiaries, and they continue to be well received by Phoenix customers."

The article has set off a debate among regulators, insurers, financial advisers and others. It comes at an anxious

time for financial services firms, which face new federal regulations after a sweeping reform was passed by Congress and signed by President Barack Obama. A practice like retained-asset accounts could be banned or limited in the new rules that will be written to implement the reform.

Blumenthal, who in 2004 and 2005 went after a longtime agent compensation practice in property-casualty insurance, said he is ready to help Insurance Commissioner Thomas R. Sullivan in "attacking and remedying this unconscionable practice." Sullivan fired back saying the accounts were "created at the request of consumers to provide options for receiving benefits from a life insurance policy, and ... consumers have generally been happy with this flexibility."

On Thursday, Cuomo subpoenaed MetLife and Prudential, the top two life insurers in the country. Neither MetLife's Bloomfield operations nor Prudential Retirement in Hartford has anything to do with the retained-asset accounts, which are managed elsewhere, company officials said. Officials at The Hartford and Phoenix were not aware of a subpoena on their respective companies Friday.

The matter is also under investigation by the U.S. Department of Veterans Affairs to determine how the practice affects families of dead troops and other deceased veterans – a focus of the Bloomberg story. Defense Secretary Robert Gates has offered to help with the investigation.

The debate over retained-asset accounts comes down to two main questions. How well are beneficiaries informed that they have an option of receiving a lump sum? And how secure is the state guaranty system in protecting claims if an insurance company fails?

The Bloomberg article suggested that the accounts are used improperly by insurers as a default option, rather than the standard option being a lump-sum payment; and it suggested the lack of FDIC insurance creates a risk for beneficiaries.

The use of retained-asset accounts "doesn't pass the smell test," said Walter Dolde, associate professor in the finance department at the University of Connecticut. "They could accomplish the same thing – that is, not rushing people into deciding what to do with a large sum of money so close to the death of a loved one – but they could put it into a segregated account and pay interest on a regular basis. … It's the customer's money, it's not the insurance company's money. And it should be segregated for the customers earning a clear interest rate in risk-free government assets."

Prudential, MetLife and Phoenix all said they pay a competitive range compared with other options. But financial adviser Keith Amburgey said he would never advise his clients to keep their claim money with an insurance company. Amburgey, chief investment officer at Rutherford Asset Planning in Cresskill, N.J., which has clients in Connecticut, called the practice deceptive. While the risk isn't huge of an insurance company going bankrupt, it has happened as recently as the collapse of American International Group Inc.

Amburgey, like others, is using the issue to revive a longstanding debate about whether insurance regulation should shift from states to the federal government.

"I agree that more regulation is needed, but I fear it will be a long process," Amburgey said. "We clearly need a powerful insurance regulator at the federal level."

The industry says the accounts are safe.

"If the insurance company is unable to meet its obligations to policyholders and is placed in liquidation, all state guaranty associations will cover the accounts up to at least the FDIC's $250,000 level of coverage for bank depository accounts," said Sean McKenna, a spokesman for the National Organization of Life and Health Insurance Guaranty Associations. "In fact, 49 states cover to at least $300,000, and a few states offer guaranteed coverage up to $500,000."

Insurers are monitored for solvency – that they have cash enough to pay claims – by state regulators, and the oversight varies by state. Connecticut's insurance department said it monitors solvency every quarter. However, money backed by a guaranty can be "messy to collect on" if it is not separate from the insurer's general accounts, said Dolde, the UConn finance professor.

Disclosure is really a question of how each insurer explains to a beneficiary the option of receiving a lump sum. MetLife, Prudential Financial, Phoenix and The Hartford all said they clearly explain the options to beneficiaries. Then it is up to the beneficiary to decide.

Prudential Financial said in a written statement, "Beneficiaries who feel confident about making decisions right away have full access to their funds, which may be deposited in the financial institution of their choice, with funds earning interest until presented for payment."

In defense of retaining claim money, Prudential Financial also said, "We do not think it makes sense to force people to make decisions in a difficult and complex financial environment during a very emotional time in their lives."

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