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Beneficiaries Can Bank Proceeds, Bypass Life Insurer Accounts

By Alexis Leondis and Margaret Collins - Jul 29, 2010

Life insurance beneficiaries should take their proceeds straight to the bank rather than risk losing their cash by letting insurers hold onto it.

Policyholders may assume when buying life insurance that beneficiaries will get the payouts in a single bank check. That may not be the case, Bloomberg Markets magazine reports in its September issue. Insurance companies such as Prudential Financial Inc. profit by holding onto the money in their own accounts and issuing checkbooks, essentially IOUs, for survivors to access their money.

"The language they use at the time is all couched in reassuring phrases -- let me give you the security of not having to make an investment choice," said Lawrence Baxter, professor of the practice of law at Duke University School of Law in Durham, North Carolina. "It leverages off of that state of emotional distress."

After a loved one passes away, survivors must file a claim and provide a death certificate, according to Bob Hunter, director of insurance for the Consumer Federation of America in Washington. The insurer will then contact the beneficiaries with options for payment, which usually include keeping the money in an account with the insurance company, Baxter said.

"It's very easy for trusted companies to mislead naïve customers, and life insurance companies are trusted," said Daniel Kahneman, a professor of psychology and public affairs at the Woodrow Wilson School of Public and International Affairs at Princeton University and a Nobel Prize winner. "The fact that they seem to be outside the regulatory reach is shocking."

Writing a Check

Beneficiaries can withdraw some or all of the money immediately from the account by writing a check to themselves and depositing or cashing it at their local bank, Bob DeFillippo, a spokesman for Newark, New Jersey-based Prudential said in an e-mail. There are no fees associated with receiving a lump-sum check, which is typically sent within three days following approval of a claim, he said.

There are 1 million death-benefit accounts totaling $28 billion managed by insurers that aren't actually sitting in a bank backed by the Federal Deposit Insurance Corp., Bloomberg Markets reported. The FDIC insures accounts up to $250,000 for each depositor and potentially more depending on how accounts are opened.

About 40 percent of these so-called retained-asset accounts at the insurance companies still have money in them a year later, which means they're receiving interest rates as low as 0.5 percent without FDIC protection, according to Bloomberg Markets. Prudential's general account earned 4.4 percent in 2009, mostly from bond investments, according to U.S. Securities and Exchange Commission filings. Since the checks may resemble actual bank checks, beneficiaries often assume the money is actually in bank-insured accounts when it isn't.

More Money

"Leaving it with the insurance company is not going to give you more money -- don't let them hold onto it," said Hunter of the Consumer Federation of America.

A 3-year money-market certificate, for example, offered by the Pentagon Federal Credit Union for a $1,000 minimum deposit, is yielding 2.25 percent annually, according to their website.

Policyholders shouldn't assume that insurance companies don't fail, said Baxter, the law professor. And when they do, state insurance departments are supposed to back life insurance policies by raising money from other insurers that do business in their state. No states even keep track of how much money insurers are holding in retained assets, Bloomberg Markets reported.

Paying Benefits

The checkbooks are "a pretty widely accepted way of paying death benefits," said Paul Graham, vice president of insurance regulation and chief actuary for the American Council of Life Insurers, a Washington-based trade group. "We actually think it's a benefit to the beneficiaries to have these accounts."

Some states will take the proceeds if an account is idle for a certain amount of time. In New York, funds that haven't been touched for more than three years may be turned over to the state. Six states had rules regarding retained-asset accounts as of July 2009, requiring insurers to disclose fees and interest rates and tell survivors they can withdraw all money by writing a single check, according to the National Association of Insurance Commissioners.

The Department of Veterans Affairs and the New York State Insurance Department said yesterday they will investigate the practice of life insurance companies directing benefits into their corporate accounts.

USAA Policy

USAA Life Insurance Company, a subsidiary of San Antonio- based USAA, has a payout policy that differs from some other insurers. The company says its benefits are paid in a lump sum or deposited into the company's savings bank, which is FDIC insured, said Eric Smith, president of USAA Life. The firm provides insurance primarily to the military and their families.

"It isn't unusual for beneficiaries to be distraught, depressed and confused, and they don't know what they want to do," so they end up keeping the funds in these accounts, said Smith.

J. William Worden, a professor of psychology at Rosemead School of Psychology in La Mirada, California, who specializes in grief counseling and therapy, said one reason people may keep money with insurers when they shouldn't is because "there can be a sense that, I don't want this to have happened, so I don't want to confront things that remind me this has happened."

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