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Fallen Soldiers' Families Denied Cash as Insurers Profit

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The package arrived at Cindy Lohman's home in Great Mills, Maryland, just two weeks after she learned that her son, Ryan, a 24-year-old Army sergeant, had been killed by a bomb in Afghanistan. It was a thick, 9-inch-by-12-inch envelope from Prudential Financial Inc., which handles life insurance for the Department of Veterans Affairs.

Inside was a letter from Prudential about Ryan's \$400,000 policy. And there was something else, which looked like a checkbook. The letter told Lohman that the full amount of her payout would be placed in a convenient interest-bearing account, allowing her time to decide how to use the benefit.

"You can hold the money in the account for safekeeping for as long as you like," the letter said. In tiny print, in a disclaimer that Lohman says she didn't notice, Prudential disclosed that what it called its Alliance Account was not guaranteed by the Federal Deposit Insurance Corp., Bloomberg Markets magazine reports in its September issue.

Lohman, 52, left the money untouched for six months after her son's August 2008 death.

"It's like you're paying me off because my child was killed," she says. "It was a consolation prize that I didn't want."

As time went on, she says, she tried to use one of the "checks" to buy a bed, and the salesman rejected it. That happened again this year, she says, when she went to a Target store to purchase a camera on Armed Forces Day, May 15.

'I'm Shocked'

Lohman, a public health nurse who helps special-needs children, says she had always believed that her son's life insurance funds were in a bank insured by the FDIC. That money -- like \$28 billion in 1 million death-benefit accounts managed by insurers -- wasn't actually sitting in a bank.

It was being held in Prudential's general corporate account, earning investment income for the insurer. Prudential paid survivors like Lohman 1 percent interest in 2008 on their Alliance Accounts,

while it earned a 4.8 percent return on its corporate funds, according to regulatory filings.

"I'm shocked," says Lohman, breaking into tears as she learns how the Alliance Account works. "It's a betrayal. It saddens me as an American that a company would stoop so low as to make a profit on the death of a soldier. Is there anything lower than that?"

Millions of bereaved Americans have unwittingly been placed in the same position by their insurance companies. The practice of issuing what they call "checkbooks" to survivors, instead of paying them lump sums, extends well beyond the military.

Touching Americans

In the past decade, these so-called retained-asset accounts have become standard operating procedure in an industry that touches virtually every American: There are more than 300 million active life insurance policies in the U.S., and the industry holds \$4.6 trillion in assets, according to the American Council of Life Insurers.

Insurance companies tell survivors that their money is put in a secure account. Neither Prudential nor MetLife Inc., the largest life insurer in the U.S., segregates death benefits into a separate fund.

Newark, New Jersey-based Prudential, the second-largest life insurer, holds payouts in its own general account, according to regulatory filings.

New York-based MetLife has told survivors in a standard letter: "To help you through what can be a very difficult, emotional and confusing time, we created a settlement option, the Total Control Account Money Market Option. It is guaranteed by MetLife."

No FDIC Insurance

The company's letter omits that the money is in MetLife's corporate investment account, isn't in a bank and has no FDIC insurance.

"All guarantees are subject to the financial strength and claims-paying ability of MetLife," it says.

Both MetLife, which handles insurance for nonmilitary federal employees, and Prudential paid 0.5 percent interest in July to survivors of government workers and soldiers. That's less than half of the rate available at some banks with accounts insured by the FDIC up to \$250,000.

Bank of New York Mellon Corp. handles the paperwork and monthly statements for customers with MetLife "checking accounts." The insurance company, not the bank, most recently reported holding

about \$10 billion in death benefits, in 2008.

The "checkbook" system cheats the families of those who die, says Jeffrey Stempel, an insurance law professor at the William S. Boyd School of Law at the University of Nevada, Las Vegas, who wrote 'Stempel on Insurance Contracts' (Aspen Publishers, 2009).

'Bad Faith'

"It's institutionalized bad faith," he says. "In my view, this is a scheme to defraud by inducing the policyholder's beneficiary to let the life insurance company retain assets they're not entitled to. It's turning death claims into a profit center."

Prudential's Alliance Account is helpful to families of soldiers, says company spokesman Bob DeFillippo.

"For some families, the account is the difference between earning interest on a large amount of money and letting it sit idle," he says. Prudential follows the law, he says.

"We fully and regularly disclose the nature and terms of the account to account holders," DeFillippo says. "We make it clear that the money can be withdrawn at any time by simply writing a draft."

Metlife spokesman Joseph Madden says his company's customers are very happy with the Total Control Account.

'Overwhelmingly Positive'

"The feedback from TCA customers has been overwhelmingly positive," he says. "The TCA affords beneficiaries security, peace of mind and time to make an informed decision -- while earning interest in the interim."

Madden says the company was paying some survivors 0.5 percent in July while some others got 1.5 percent or 3 percent, depending on the age and origin of insurance accounts. The accounts don't violate any laws, Madden says, and are authorized by New York state insurance law.

Insurers are holding onto at least \$28 billion owed to survivors, according to three firms that handle retained-asset accounts for about 130 life insurance companies. There are no public records showing how much companies are holding in these accounts.

The "checks" that Cindy Lohman wrote, the ones rejected by retailers, were actually drafts, or IOUs, issued by Prudential. Even though the "checks" had the name of JPMorgan Chase & Co. on them,

Lohman's funds weren't in that bank; they were held by Prudential.

Federal Bank Law

Before a check could clear, Prudential would have to send money to JPMorgan, bank spokesman John Murray says.

Insurance companies -- in addition to holding onto the money of survivors, paying them uncompetitive interest rates and giving them misleading guarantees -- may be violating a federal bank law. A 1933 statute makes it a felony for any company to accept deposits without state or federal authorization.

That means only banks or credit unions can accept deposits, says Arthur Wilmarth, a professor at George Washington University Law School in Washington who has testified before Congress about banking regulations.

If a prosecutor pressed an insurance company, retained-asset accounts could be outlawed because insurers say they deposit money into these accounts and don't have bank charters or banking regulation, Wilmarth says. MetLife also offers its own version of certificates of deposit.

"If it swims, quacks and flies like a duck, the court could decide that it is indeed a duck," he says. "You then potentially could have a criminal violation."

Potential Bank Run

This unregulated quasi-banking system operated by insurers has none of the protections of the actual banking system. Lawrence Baxter, a professor at Duke University School of Law in Durham, North Carolina, says the potential exists for a catastrophe.

If one insurer is unable to meet its obligations on retained-asset accounts, people could lose faith in other companies and demand immediate payment, triggering a panic, says Baxter, who has consulted with federal agencies on financial regulation.

The government established the FDIC in 1933 after frantic depositors tried to pull their money from banks. The federal government has no such program for death-benefit accounts.

"There's more than \$25 billion out there in these accounts," Baxter says. "A run could be triggered immediately by one insurance company not being able to honor its payout. The whole point of creating the FDIC was to put an end to bank runs."

No Federal Regulation

The sweeping financial regulatory legislation signed by President Barack Obama on July 21 doesn't address retained-asset accounts. It creates a new federal insurance office, which won't be a regulator. It will collect information, monitor the industry for systemic risk and consult with state insurance regulators.

An industry with \$19.1 trillion in potential liabilities will remain unregulated by the federal government. In 2008, insurers approved claims totaling \$60 billion in death benefits, according to the life insurance council.

The federal government doesn't even regulate the life insurance it supplies, via MetLife, to its own employees in a program called Federal Employees' Group Life Insurance. As the VA does for soldiers, the U.S. Office of Personnel Management sends handbook to nonmilitary government workers -- some 4 million active employees and retirees.

The handbook says their life insurance policies automatically pay out death benefits in the form of a "money- market-account checkbook." The 217-page handbook omits that the money isn't FDIC insured and will stay with MetLife until someone writes a "check."

'Unfair Advantage'

This lack of disclosure is unconscionable, says Harvey Goldschmid, a commissioner of the U.S. Securities and Exchange Commission from 2002 to 2005.

"I can't imagine why bank regulators haven't been requiring a prominent 'no FDIC insurance' disclosure," says Goldschmid, who's now a law professor at Columbia University in New York. "This system works very badly for the bereaved. It takes unfair advantage of people at their time of weakness."

The closest relative to retained-asset accounts may be money-market mutual funds, which are pools of cash invested in short-term debt securities.

Money Market Rules

The SEC requires fund companies to warn investors that money market funds don't have FDIC insurance. It also mandates that fund managers provide a prospectus, that they invest in specific types of safe debt and that they post a detailed schedule of their investments monthly on their websites.

Insurers' retained-asset accounts have none of those regulatory protections.

A June 2009 MetLife standard condolence letter to survivors leaves out that accounts aren't in a bank and aren't federally insured. In June 2010, 25 years after MetLife invented retained-asset accounts, the company released a customer agreement that does disclose that retained assets aren't in a money market account nor in a bank and that they have no FDIC insurance.

"The assets backing the Total Control Accounts are maintained in MetLife's general account and are subject to MetLife's creditors," the agreement says. That language contradicts the federal employee handbook, which says survivors get a money market account.

Gerry Goldsholle, the man who invented retained-asset accounts, says MetLife makes \$100 million to \$300 million a year from investment returns on the death benefits it holds. A former president of MetLife Marketing Corp., Goldsholle, 69, devised the accounts in 1984. He's now a lawyer in private practice in Sausalito, California.

'This Is Crazy'

Goldsholle says he pondered the billions of dollars of death-benefit proceeds the company paid out each year.

"I looked at this and said this is crazy," says Goldsholle, who left the firm in 1991. "What are we doing to retain some of this money? It's very expensive to bring money in the front door of an insurance company. You're paying very large commissions and sales expenses."

So he came up with a way for MetLife to hold onto death benefits.

"The company would win because we would make a nice spread on the money," Goldsholle says, while customers would earn interest on their accounts. MetLife, he says, can earn 1 to 3 percentage points more from its investment income -- mostly from bonds -- than it pays out to survivors.

Misconceptions

The accounts Goldsholle invented have spread much faster than the ability of state regulators to track them -- or even to understand how they work. Ted Hamby, North Carolina's deputy insurance commissioner for life and health, says he believes retained-asset accounts have FDIC protection.

"Whatever money is on deposit in that checking account will be insured, up to the limits of the FDIC," he says. He's wrong. No retained-asset accounts have FDIC coverage.

In Connecticut, where 106 insurance companies are based, state insurance department manager for market conduct Kurt Swan also says that retained-asset accounts are kept in banks, with FDIC coverage.

"I think they're just trying to offer some flexibility to the beneficiary," he says. Swan and his colleague, William Arfanis, the department's principal financial examiner, both say the insurers don't profit from the retained-asset accounts. That too is wrong. The companies do earn investment gains on death benefits.

Some Rules

Just six states had any rules for retained-asset accounts as of July 2009, according to the National Association of Insurance Commissioners. Arkansas, Colorado, Kansas, Nevada, North Carolina and North Dakota require insurers to disclose fees and interest rates and to tell survivors they may withdraw all of the money by writing a single check.

Maryland, which isn't on the NAIC list, also has rules.

Pennsylvania Insurance Commissioner Joel Ario, whose state has no rules for retained-asset accounts, says he has asked his staff to prepare a regulation forbidding insurance companies from using such accounts as the default method of paying a death claim.

"I haven't heard a plausible argument about why these accounts are better for the consumer," Ario says.

If state insurance regulators have paid scant attention to retained-asset accounts, state bank regulators have taken an even more hands-off approach.

'Not Drawn Attention'

"Quite honestly, we deal with issues that our members want us to deal with," says Michael Stevens, senior vice president for regulatory policy at the Washington-based Conference of State Bank Supervisors. "This is not one that has drawn their attention."

Three companies have not only noticed but have also profited by handling retained-asset accounts for insurers. Open Solutions Inc., based in Glastonbury, Connecticut, oversees 400,000 accounts for 67 insurance companies.

Open Solutions sends out "checkbooks," prints periodic statements and computes accrued interest for accounts with total deposits of \$10 billion, says Jay Woldar, director of sales and account

management at Open Solutions.

One of its competitors, Bank of New York Mellon, administers more than 500,000 retained-asset accounts holding a total of \$14 billion, including MetLife's retained assets. Chicago-based Northern Trust Corp. handles about \$4 billion in 125,000 accounts, spokesman John O'Connell says.

Survivors generally don't touch these accounts immediately.

Accounts Stay Opened

"About 40 percent of the money stays in for more than a year," Woldar says. Insurers can have use of survivors' money for years, even decades, says Randi Lichtenstein, a product line manager at Bank of New York.

"They can stick around for quite a while," she says. "There are accounts that all insurance companies have on these platforms that go back 10, 15, 20 years."

MetLife's Madden says most of its customers' retained-asset accounts are closed within one year. About 28 percent of survivors of soldiers and veterans keep their retained-asset accounts open for more than two years, the VA says.

During a routine audit completed in 2004, the New York State Insurance Department found that 1,476 retained-asset accounts, worth a total of \$33.5 million, at Hartford, Connecticut-based Phoenix Life Insurance Co., had been dormant for more than three years.

In New York, funds in an account that remains dormant for more than three years may be turned over to the state. Phoenix spokeswoman Alice Ericson says the company now has a policy of sending letters to people whose accounts have been inactive for two years.

Inactive Accounts

Almost one-third of the 6,890 retained-asset accounts run by Mony Life Insurance Co. were inactive for more than three years, New York auditors found in 2002. Mony is now owned by Axa SA, Europe's second-largest insurer by market value.

A few people have sued insurers over the use of retained-asset accounts. Prudential won a lawsuit in 2009 in which a survivor complained about the Alliance Account. MetLife has a case pending in which a survivor says that she was cheated by the retained-asset account. In court-filed papers, MetLife denies any wrongdoing.

There has been only one ruling by a federal appellate court on the substance of such accounts -- and it went against an insurance company.

After a federal judge in Boston dismissed a policyholder suit claiming that Chattanooga, Tennessee-based insurer Unum Group was stealing account earnings from survivors, the U.S. Court of Appeals for the First Circuit overruled the lower court in 2008. It reinstated the case.

'Euphemistically Named'

"The euphemistically named 'Security Account,' accompanied with a checkbook, was no more than an IOU which did not transfer the funds to which the beneficiaries were entitled out of the plan assets," the three-judge panel wrote.

Unum spokeswoman Mary Clarke Guenther says retained-asset accounts are a commonly accepted practice in the industry. The case is pending.

Absent regulatory or legal intervention, bereaved family members like Cindy Lohman will continue to find death benefits going into retained-asset accounts. Her son, Ryan, posthumously received a Purple Heart and Bronze Star Medal for sacrificing his life to save fellow soldiers in Afghanistan in August 2008.

He had ordered a Humvee to swerve to avoid an explosive device, exposing himself to its deadly blast.

'Accept The Reality'

Three days after learning of her son's death, Lohman says, an Army casualty assistance officer came to her home, explaining that Ryan had a life insurance policy and that her signature was needed to release the money.

"By signing that, it forced me to accept the reality that he was dead and not coming back," she says.

Since 1999, the VA has allowed Prudential to send survivors "checkbooks" tied to its Alliance Account. In 2009 alone, the families of U.S. soldiers and veterans were supposed to be paid death benefits totaling \$1 billion immediately, according to their insurance policies. They weren't.

Prudential's VA policies promise either a lump sum payout or 36 monthly payments. About 90 percent of survivors, including Lohman, choose to receive the full amount upfront. When they do, they don't get a check; they get a "checkbook."

Under a 2008 law, survivors covered by Prudential's VA policy are allowed one year to put death

benefits into a Roth IRA, allowing them to earn investment gains for the rest of their lives tax-free. Prudential never informed Lohman, she says.

'If They Had Told Me'

"I definitely would have done that if they had told me," Lohman says.

Even Stephen Wurtz, deputy assistant director for insurance at the VA, who has overseen the insurance program for 25 years, has been kept in the dark by Prudential.

"Prudential runs the program on a cost-reimbursement basis only," he initially said, referring to the \$4.2 million in fees the VA paid Prudential in 2009. "They're really good guys. They do it patriotically. They don't make any money from the Alliance Account."

Wurtz, 62, said he had believed that the Alliance Account money went into a bank. After he learned that the payouts actually stayed in Prudential's general fund, Wurtz says, he asked Prudential how much money the insurance company made from these accounts and how many dollars it held in retained assets.

Prudential declined to answer, saying that information was proprietary, Wurtz says.

'Maybe I Didn't'

Prudential, which has had the insurance contract with the VA since 1965, pitched the checkbook payout to the VA in 1999 as an added benefit to survivors, Wurtz says. The government agency accepted Prudential's offer, he says.

"Maybe I didn't ask enough questions," he says.

Printed on each "check," next to "Prudential's Alliance Account" is the name of JPMorgan, the second-biggest U.S. bank by assets. JPMorgan spokesman Murray declined to say how much the bank is paid for its role with Prudential.

The way Prudential has set up the "checks" implies that JPMorgan stands behind the accounts and that they are thus backed by the FDIC, Duke's Baxter says.

"That's misleading the beneficiaries," he says.

"We disclose the roles of all companies involved in administering these accounts," Prudential's DeFillippo says. JPMorgan's Murray declined to comment.

Prudential's general account earned 4.4 percent in 2009, mostly from bond investments, according to SEC filings. The company has paid survivors 0.5 percent in 2010.

'It's Shameful'

"It's shameful that an insurance company is stealing money from the families of our fallen servicemen," says Paul Sullivan, who served in the 1991 Gulf War as an Army cavalry scout and is now executive director of Veterans for Common Sense, a nonprofit advocacy group based in Washington. "I'm outraged."

Sullivan, a project manager at the VA's benefits unit from 2000 to 2006, says he was never told Prudential kept money and earned investment gains from soldiers' insurance payouts instead of sending it to survivors.

"There shouldn't be secret profits," he says. "This should be transparent. The lack of oversight is appalling."

It's not much different for the 4 million nonmilitary U.S. government employees and retirees -- including staff of the FDIC -- covered by MetLife policies. That program, begun in 1965, averages more than \$2 billion in death benefits claimed every year, the government says.

Payouts are handled by the Office of Federal Employees' Group Life Insurance. That makes it look like the government is taking care of its employees' insurance coverage. It isn't. That "office" is a unit of MetLife.

MetLife Holds the Money

Edmund Byrnes, a spokesman for the Office of Personnel Management, which oversees MetLife's federal employee contract, says MetLife segregates death benefits into beneficiary accounts after it approves death claims.

"Once MetLife transfers the funds to the Total Control Account, the monies are no longer under MetLife's control," Byrnes says.

MetLife spokesman Madden says something different.

"The assets that back the liabilities on all the TCAs are placed in MetLife's general account," he says.

Back at the Veterans Affairs office, Deputy Assistant Director Wurtz, who's a civilian employee, says he now understands for the first time that since he's covered by the federal insurance program, his

own wife could receive a MetLife "checkbook" someday.

'Ripping Off Their Own'

"Uncle Sam is ripping off their own," Wurtz says. "My wife would get the money, and they would blood-suck some of it out of her."

It took Wurtz, who's been working with insurers for most of his career, more than a decade to understand how retained-asset accounts work. Companies like MetLife and Prudential have never told millions of Americans with insurance policies that when they die, the insurer plans to hold their family's money in its own account to make investment gains from the death benefit.

"It's outrageous that somebody's profiting off other people's grief," says Mark Umbrell of Doylestown, Pennsylvania. His 26-year-old son, Colby, an Army Airborne Ranger who earned a Bronze Star and a Purple Heart, was killed in Iraq in May 2007. Umbrell was among those who got a "checkbook" account.

"I think we're being taken," he says.

The question for Umbrell, Lohman and a million others with these accounts is whether anything will change. State bank regulators say if there are to be any reforms, they should be made by insurance departments. Officials at those state agencies often say they don't even understand what a retained-asset account is.

"It's flown under the radar," professor Stempel says. "Regulators have not done their job."

Until public officials wake up, the bereaved will remain a secret profit center for the life insurance industry.

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