July 28, 2010

Death-Benefit Accounts Seem to Slight Survivors

By BLOOMBERG NEWS

The package arrived at Cindy Lohman's home in Great Mills, Md., 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 envelope from Prudential Financial Inc., which handles life insurance for the Department of Veterans Affairs.

Inside was a letter about her son's $400,000 policy. And there was something else, which looked like a checkbook. The letter told Ms. 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. In tiny print, in a disclaimer that Ms. Lohman said she did not notice, Prudential disclosed that what it called its Alliance Account was not guaranteed by the Federal Deposit Insurance Corporation, according to a report in Bloomberg Markets magazine.

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

As time went on, she said, she tried to use one of the checks to buy a bed, and the salesman rejected it. That happened again this year, she said, when she went to buy a camera.

Ms. Lohman, a public health nurse, said she had always believed that her son's life insurance money was in a bank insured by the F.D.I.C. That money — like $28 billion in one million death-benefit accounts managed by insurers — was not actually sitting in a bank.

It was being held in Prudential's general corporate account, earning investment income. Prudential paid survivors like Ms. 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.

The checks that Ms. Lohman wrote were actually drafts, or I.O.U.'s, issued by Prudential. Even though they had the name of JPMorgan Chase on them, her money was not in that bank; it was held by Prudential. Before a check could clear, Prudential would have to send money to JPMorgan, a bank spokesman, John Murray, said.

The practice of issuing checkbooks to survivors, instead of paying lump sums, extends beyond the military. Over the last decade, these so-called retained-asset accounts have become standard operating procedure in the insurance industry.

Neither Prudential nor MetLife, the largest life insurer in the United States, segregates death benefits into a separate fund.

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

MetLife, which handles insurance for nonmilitary federal employees, 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."

The company's letter omits that the money is in MetLife's corporate investment account and has no F.D.I.C. insurance.

The checkbook system cheats the families of the deceased, says Jeffrey Stempel, an insurance law professor at the William S. Boyd School of Law at the University of Nevada, Las Vegas.

"It's institutionalized bad faith," he said. "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, said a 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 said. Prudential follows the law, he said, and regularly discloses the nature and terms of the account to account holders.

A MetLife spokesman, Joseph Madden, said his company's customers were happy with the Total Control Account. "The T.C.A. affords beneficiaries security, peace of mind and time to make an informed decision — while earning interest in the interim," he said.

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.

Since 1999, the Veterans Affairs Department has allowed Prudential to send survivors checkbooks tied to its Alliance Account. Prudential's policies promise either a lump sum payout or 36 monthly payments. About 90 percent of survivors choose to receive the full amount upfront. When they do, they don't get a check; they get a checkbook.

Stephen Wurtz, deputy assistant director for insurance at the Veterans Affairs Department who has overseen the insurance program for 25 years, did not fully understand the nature of Prudential's program.

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

Mr. Wurtz said he had thought that the Alliance Account money went into a bank. After he learned that the payouts stayed in Prudential's general fund, Mr. Wurtz said, 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, he said.

Prudential, which has had the insurance contract with the department since 1965, pitched the checkbook payout in 1999 as an added benefit to survivors, Mr. Wurtz said.

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

In response to this report, the Veterans Affairs Department said it was investigating.

"The possibility that life insurance companies are profiting inappropriately from these service members' sacrifice is completely unacceptable," Michael Walcoff, acting under secretary for the agency's Veterans Benefits Administration, said in an e-mail. "The V.A. is conducting a full investigation into the life insurance companies and their procedures in this program."

The chairman of the House Armed Services Committee, Ike Skelton of Missouri, said survivors must be provided more information about how to handle death benefits. He said insurers should be examined to "make sure they aren't misrepresenting the options being offered to surviving family members."