NOT IN THE FINE PRINT: RECOMMENDED CHANGES TO LIFE INSURANCE POLICY DISCLOSURES REGARDING RETAINED ASSET ACCOUNTS

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I. INTRODUCTION

Tom is the primary breadwinner of his family. In order to protect his wife and children financially in the event that he passes away, he goes online and researches life insurance policies. After becoming familiar with the different forms of life insurance, Tom purchases a $250,000 life insurance policy from a large insurance company. When he purchases the policy, he makes his wife, Melissa, the primary beneficiary. Under the policy, in the event that Tom dies, Melissa is entitled to a lump-sum $250,000 payment.

Six months after purchasing the policy Tom dies in a car accident. Melissa, as beneficiary, is entitled to a lump sum $250,000 payment per the terms of the policy. In the past, this would have been no problem, the insurance company would merely write the $250,000 check to Melissa. However, in 1984, something changed.[1] Some large insurance companies rolled out a new form of payment, the Retained Asset Account.

Retained Asset Accounts ("RAAs") are created when life insurance carriers provide the beneficiary of a life insurance policy with a pseudo-checkbook instead of a single lump sum check.[2] Instead of being paid out with a check for the entire amount of the life insurance policy, the proceeds are placed into the insurer's general corporate account from which the beneficiary can draft funds with the use of the pseudo-checkbook.[3]

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1 ADVOCATE LAW GROUP P.C., RETAINED ASSET ACCOUNTS, http://www.retainedassetaccounts.com/ (last visited Mar. 18, 2012).

2 *Id.*

3 David Evans, *Fallen Soldiers' Families Denied Cash as Insurers Profit*, BLOOMBERG, (July 28, 2010, 10:00 AM), http://www.bloomberg.com/news/2010-07-28/fallen-soldiers-families-denied-cash-payout-as-life-insurers-boost-profit.html ("The 'checks' that Cindy Lohman wrote, the ones rejected by retailers, were actually drafts, or IOUs, issued by Prudential. Even though the 'checks' had

Because of this change, Melissa does not receive a lump-sum payment; rather she receives a pseudo-checkbook from the insurance company that appears to be drawn from Bank A. Confused by this, Melissa reads the policy disclosure and learns that this pseudo-checkbook entitles her to write checks against the Retained Asset Account up to the value of the insurance policy. With this knowledge, Melissa realizes that she has some options. She can write a pseudo-check for the full amount of the policy and deposit it into her own bank account or she can leave the funds, in whole or in part, in the Retained Asset Account until she has an immediate need for them.

As it turns out, the insurance company has not deposited any of Melissa's funds into an account at Bank A. Instead, the funds were deposited in the insurance company's corporate account at Bank C. When Melissa attempts to deposit a pseudo-check at her bank, Bank B, there is a delay. The delay is caused by the clearing process that the pseudo-check has to go through in order to be deposited. Instead of Bank B drawing the funds directly from Bank A, Bank B must go to the insurance company who then requests the release of funds from Bank C to Bank B. At the end of the day, Melissa still gets the money she is owed, it just takes longer than it would have if she had received an ordinary check for the full amount of the policy from the start.

The practice of providing Retained Asset Accounts in lieu of a lump-sum check was critically described in the article "Fallen Soldiers' Families Denied Cash as Insurers Profit," by Bloomberg journalist, David Evans.[4] The issue made its way into other media outlets and eventually lawsuits were filed in Federal District Court regarding the policy disclosures and administration of the Retained Asset Accounts.

This note expands upon the discussion in the mainstream media by presenting a description of both benefits and criticisms of Retained Asset Accounts as well as recommendations for changes to policy disclosures that would improve the image of this type of account. In Section II, the paper discusses the benefits and criticisms of Retained Asset Accounts. In Section III, disclosure issues are identified and solutions are presented. The note concludes that there are benefits to both the beneficiaries and to the insurance companies but there are also components of Retained Asset Accounts that are questionable and need to change. Because of these

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the name of JPMorgan Chase & Co. on them, Lohman's funds weren't in that bank; they were held by Prudential. Before a check could clear, Prudential would have to send money to JPMorgan, bank spokesman John Murray says.").

[4] *Id.*

questionable components of Retained Asset Accounts, it would be wise for insurance companies to improve their disclosure statements regarding Retained Asset Accounts in order to avoid both bad publicity and potential litigation.

II. RETAINED ASSET ACCOUNTS

In 2010, insurance companies had over $28 billion invested in Retained Asset Accounts.[5] Metropolitan Life Insurance Company ("MetLife") alone had 36 percent of that total and makes an estimated $100 to $300 million a year on Retained Asset Accounts.[6]

Retained Asset Accounts are created when an insurance company "pays the proceeds from a life insurance policy or annuity contract to a beneficiary by sending the beneficiary 'a checkbook instead of a check.'"[7] For example, if a life insurance policy is supposed to be paid in a lump-sum, instead of sending a check for the full amount of the policy, the insurance company will send a pseudo-checkbook that permits the beneficiary to write pseudo-checks (drafts) against the Retained Asset Account.

A. BENEFITS

While the mainstream media has provided several articles criticizing Retained Asset Accounts, there are some benefits to using them to pay life insurance benefits to beneficiaries.

First, the intention behind RAAs was to give beneficiaries immediate access to the proceeds from insurance policies.[8] Traditionally, lump sum checks issued by insurance companies took two weeks to clear once deposited in the beneficiary's bank account.[9] By providing the pseudo-checks attached to a Retained Asset Account insurance companies were, in effect, providing easier access to funds at the time families needed

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[5] *Id.*

[6] *Id. ("*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.").

[7] ADVOCATE LAW GROUP P.C., RETAINED ASSET ACCOUNTS, *supra* note 1.

[8] ADVOCATE LAW GROUP P.C., *Benefits of Retained Asset Accounts*, RETAINED ASSET ACCOUNTS, http://www.retainedassetaccounts.com/benefits-of-retained-asset-accounts.htm (last visited Mar. 18, 2012).

[9] *Id.*

it most. The immediate use of funds is not possible under the traditional single lump-sum check payment method.[10]

Second, RAAs provide continuous interest payments to beneficiaries as soon as the claim is approved and until the beneficiary withdraws all of the money they are entitled to.[11] As previously stated, it takes several weeks for a bank to clear a single lump-sum check, the clearing time effectively reduces the interest that can be earned on the lump sum payment. Combine this delay with the mailing delay of the check and RAAs pay interest on the funds for a longer period than a single lump-sum check. RAAs also allow the beneficiary to move the funds into higher yield accounts more quickly than they could with a single lump-sum check.

As originally designed, insurance companies guaranteed that RAAs would pay beneficiaries and interest rate that was equal to or greater than the average rate paid "banks and money market mutual funds on similar accounts."[12] In addition to guaranteeing a level of payment equal to or greater than bank rates, the insurance company also provided a floor, below which interest rates on RAAs would not fall.[13] In the current economic climate, this floor provides significant upside for RAAs due to extremely low interest rates on regular bank accounts.

In addition, RAAs were designed with consumer protection in mind. Instead of relying solely on the insurance company to back the accounts, they were designed to also be insured by State Sponsored Guarantee Associations ("SSGA").[14] While it is not FDIC insurance, State Sponsored Guaranty Associations do provide some protection against insurance company insolvency.

Finally, RAAs were designed in the mold of a standard bank account. They would pay interest, provide monthly statements and also provide mutual benefit to the beneficiary and insurance company that maintained the account.[15] In order to provide a return to beneficiaries, the insurance company has to use their funds to make money, similar to how a bank lends out money from a savings account at an interest rate higher than it pays to account holders.

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[10] *Id.*

[11] *Id.*

[12] *Id.*; AMERICAN COUNCIL OF LIFE INSURERS, *About Retained Asset Accounts*, (July 29, 2010), *available at* http://www.acli.com/Newsroom/Documents/80af916fc317435cb9340a17bdbaf052AboutRetainedAssetAccounts.pdf.

[13] AMERICAN COUNCIL OF LIFE INSURERS, *supra* note 12.

[14] ADVOCATE LAW GROUP P.C., *Benefits of Retained Asset Accounts*, *supra* note 8.

[15] *Id.*

B. CRITICISMS

Journalistic criticisms present several important questions about RAAs, these include: whether RAAs are a permitted distribution method per the initial contract with the policyholder; do beneficiaries understand how RAAs operate as a payment option; is interest paid on the funds in the RAA and, if so, is the rate competitive with financial alternatives; and are they as safe as depositing the funds into an FDIC insured bank account, a common alternative available to beneficiaries.

One problem highlighted in the journalistic efforts is the claim that insurance companies provide beneficiaries with pseudo-checks that the beneficiary believes to be the same as a check from their bank. What the insurance companies actually provide are drafts. Several beneficiaries have encountered difficulties when trying to use these drafts as several retailers have rejected the beneficiary's draft even though the Retained Asset Account had more than enough money in it to cover the transaction.[16] It has been suggested that beneficiaries do not generally understand that the funds in RAAs are not readily available for payment in the bank against which the pseudo-checks are drawn. This is based on the perception that insurance companies have intentionally refrained from disclosing important facts regarding Retained Asset Accounts.

Instead of paying the entire policy benefit in one lump sum payment, the RAA scheme permits life insurance companies to retain the funds in their general account and provide beneficiaries with a book of drafts.[17] The drafts are issued against the insurance company's general corporate account rather than an individual beneficiary account.[18] This scheme permits the life insurance company to retain substantial funds in their general corporate account, an account that earned over 4% interest in 2010.[19] While all of the insurance providers pay interest on the accounts, and several pay more than the average Money Market Account,[20]

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[16] Evans, *supra* note 3.
[17] *Id.*
[18] *Id.*
[19] *Id.*
[20] *Money Market Definition,* INVESTOPEDIA.COM, http://www.investopedia.com/terms/m/moneymarket.asp, (last visited Mar. 18, 2012) ("The money market is used by a wide array of participants, from a company raising money by selling commercial paper into the market to an investor purchasing CDs as a safe place to park money in the short term. The money market is typically seen as a safe place to put money due the highly liquid nature of the securities and short maturities, but

journalists have called attention to the spread between the return the insurance provider receives on its investment and the amount of interest it pays beneficiaries. [21] "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." Met Life also paid approximately 0.5 percent to beneficiaries with Retained Asset Accounts, a rate that was less than half the rate paid in some banks. The fact that there is a spread between the interest paid to beneficiaries and the earnings from retained funds by the life insurer is no different from the fact that any firm in the financial sector holding funds for an investor attempts to earn more on the retained funds than they pay to the investor. In order to be a valid criticism, it would have to be based on evidence that the risk-adjusted return to the RAA beneficiary is not sufficient and disclosed. The evidence suggests that some of the largest life insurance companies paid between 0.5% and 1.5% interest to beneficiaries on the retained RAA funds during between 2008 and 2010.[22] In addition to paying lower interest rates, if the money were put in a bank, it would be insured by the FDIC up to two hundred fifty thousand dollars ($250,000).[23]

By comparison, banks paid between 0.1% and 4.0% on their FDIC insured money market accounts during this same period.[24] RAA funds are offered some protection against insolvency by industry solvency protection plans but few non-governmental insurance plans match the risk protection provided in the government's FDIC plan. The level of protection against the insolvency of the insurer is another question that leads to criticism of industry disclosure practices.

While not relevant to the purpose of this paper, two similar classes of Retained Asset Accounts have been identified by the mainstream media; beneficiaries of military policies and beneficiaries of non-military policies. The main difference lies in the fact that military personnel *have* to use Prudential for their life insurance needs while non-military policyholders can get insurance from any insurance company that is legally able to offer life insurance in the state. Again, while not important for the purposes of

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there are risks in the market that any investor needs to be aware of including the risk of default on securities such as commercial paper.").

[21] Evans, *supra* note 3.

[22] *Id.*

[23] *Id.*

[24] *Online Savings Account Interest Rates History*, THESUNSFINANCIALDIARY.COM (Jan. 21, 2009), http://www.thesunsfinancialdiary.com/personal-finance/online-savings-account-interest-rates-history.

this paper, the journalistic attention to RAAs appears to be stimulated by attention to the effect on the families of military personnel.[25]

Retained Asset Accounts are seen by the providers as a useful to beneficiaries, giving them time to think about what they want to do with the money they have received instead of having a single check which they "could lose" weighing heavily on them.[26] Insurance companies have been quick to point out that a beneficiary can withdraw all of the money in the account whenever they want, even on the day they receive the pseudo-checkbook. However, the insurance company has not adequately disclosed important information including the potential delay for each pseudo-check to clear, that the checks may not be widely accepted by retailers, and that holding funds in Retained Asset Accounts benefits the insurance company itself.[27]

Through proper disclosure, the insurance companies offering RAAs can reduce the misperception that beneficiaries think they are receiving their own personal account similar to that which they can obtain from their local bank. Insurers need to make a better effort to ensure that beneficiaries understand that instead of a single "lump sum" payment drawn on funds deposited in a bank account they receive a right to make a request for funds held in the insurance company's general corporate account without the security of FDIC insurance and used by the insurer for their corporate purposes until the beneficiary has closed the account by withdrawing all of the remaining funds due.

While there is likely no quantifiable harm done by lack of disclosure regarding Retained Asset Accounts and thus there will be no ability for beneficiaries to recover damages in court from this failure to disclose pertinent information to policy holders and beneficiaries until there is a failure of the insurance provider, regulatory agencies should still require clear and concise disclosure of the actual nature and extent of insurance backing of Retained Asset Accounts for the benefit of the reputation of the industry generally.

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[25] Evans, *supra* note 3.

[26] Bloomberg News, *V.A. Agreed to Withholding of Benefits, Documents Say*, N.Y. TIMES, Sept. 13, 2010, *available at* http://www.nytimes.com/2010/09/14/business/14insure.html?_r=1&src=twr.

[27] *Id.*

1. Federal Deposit Insurance Corporation

The Federal Deposit Insurance Corporation ("FDIC") is an independent corporation that insures deposits in banks and thrift institutions against failure.[28] The FDIC was created as part of the Glass-Steagall Act of 1933 in response to the over nine thousand bank failures during the Great Depression.[29] The FDIC insures deposit accounts for up to two hundred fifty thousand dollars ($250,000) per individual, per bank.[30] An individual could put $1 million in a single FDIC insured bank and be covered for only $250,000 of that sum or that same individual could spread that $1 million into 4 or more FDIC insured banks and be insured for the entire $1 million. The FDIC does have ways to receive more than $250,000 worth of coverage at one bank provided certain criteria are met, such as having accounts in different asset categories.[31]

Example 1: **Single Account** (owned by one person): $250,000 per owner.[32]

Example of Insurance Coverage for Single Accounts[33]		
Depositor	**Type of Deposit**	**Amount Deposited**
Jane Smith	Savings account	$25,000
Jane Smith	Certificate of Deposit	$250,000
Jane Smith	NOW account	$50,000
Jane Smith's sole proprietorship	Checking account	$50,000
Total Deposited		**$375,000**

[28] *Who is the FDIC?*, FED. DEPOSIT INS. CORP., http://www.fdic.gov/about/learn/symbol/index (last updated Aug. 11, 2011).

[29] Robert Stammers, *The History of the FDIC*, INVESTOPEDIA.COM (Jan. 6, 2009), http://www.investopedia.com/articles/economics/09/fdic-history.asp.

[30] *Who is the FDIC?*, *supra* note 28.

[31] *Deposit Insurance FAQ*, FED. DEPOSIT INS. CORP., https://www.fdic.gov/edie/fdic_info.html (last visited Jan. 21, 2011).

[32] *Id.*

[33] *Id.*

Insurance Available	**$250,000**
Uninsured Amount	**$125,000**

The FDIC is funded through premiums paid by banks and thrifts and from earnings on U.S. Treasury Securities.[34] These premiums are paid regularly and go into what is described by some as a "war chest".[35] "To provide an effective banking safety net, it is necessary for the FDIC to replace cash (of the failed bank) with cash from the FDIC at the moment the bank fails."[36] The FDIC insures traditional bank accounts, savings, checking, trust, certificates of deposit ("CDs"), money market savings accounts and IRA accounts.[37] Since its creation in 1934, no depositor insured by the FDIC has lost a single penny of insured funds as a result of a bank failure.[38] It is because of this success that the FDIC has gained such prominence and respect from individuals and businesses alike. A further discussion of more complex formations for FDIC coverage is discussed in the Appendix.

2. State Sponsored Guaranty Associations

The Metropolitan Life Insurance Company observed that the financial integrity of Retained Asset Accounts is provided primarily by the company's own financial strength but also through state insurance guaranty associations.[39] Like the banking industry, the insurance industry offers protection against the insolvency of an insurer. The insurance industry protection, however, is not a nationally uniform system like the FDIC is. This section describes some pertinent issues of the so-called State Sponsored Guaranty Associations. This issue important because Retained

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[34] *Id.*

[35] Peter G. Gallanis, President, Nat'l Org. of Life and Health Ins. Guar. Ass'n, Address at the American Bar Association's Insurer Relationship and Run-off: The Next Level, Tort Trial & Insurance Practice Session: NOLHGA, the Life and Health Insurance Guaranty System and the Financial Crisis of 2008-2009, at 9 (June 5, 2009), *available at* http://www.nolhga.com/resource/file/NOLHGA andFinancial Crisis.pdf.

[36] *Id.* at 10.

[37] *Insured or Not Insured?*, FED. DEPOSIT INS. CORP., http://www.fdic.gov/consumers/consumer/information/fdiciorn.html (last updated Apr. 11, 2011).

[38] *Who is the FDIC?*, *supra* note 28.

[39] Evans, *supra* note 3.

Asset Accounts are not insured by the FDIC and there is an open question about whether they are insured by SSGAs.

In a letter written by FDIC Chairman Sheila C. Bair to the National Association of Insurance Commissioners ("NAIC"), Ms. Bair expressly denied the fact that Retained Asset Accounts were insured by the FDIC.[40] The letter indicated that the only way Retained Asset Accounts could be insured by the FDIC is if the insurance company is holding the funds as a Fiduciary to the policyholders and beneficiaries.[41] In *Clark v. Metropolitan Life Ins. Co.*, the plaintiff filed a claim against Met Life for breach of fiduciary duty.[42] The claim was summarily dismissed when Met Life submitted a motion to dismiss on the issue indicating that the insurance company is not acting as a fiduciary in maintaining RAAs for beneficiaries.[43]

The National Organization of Life & Health Insurance Guaranty Associations ("NOLHGA") and State Sponsored Guaranty Associations, on the other hand, have been providing "security" for RAAs since 1983.[44] NOLHGA is "a voluntary association made up of the life and health insurance guaranty associations of all 50 states, the District of Colombia and Puerto Rico."[45]

State Sponsored Guaranty Associations "were created to protect state residents who are policyholders and beneficiaries of policies issued by a life or health insurance company that has gone out of business."[46] Most insurance companies licensed to write life and health insurance or annuities in a given state are required to be members of the state's SSGA.[47] Should one of these companies fail, the SSGA issues an assessment for funds to continue the coverage promised by the failing insurance company subject

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[40] *Retained Asset Accounts and FDIC Deposit Insurance Coverage*, FED. DESPOSIT INS. CORP. http://www.fdic.gov/news/news/financial/2010/fil10048.html (last updated Aug. 11, 2010).

[41] *Id.*

[42] Clark v. Metro. Life Ins. Co., No. 3:08-cv-00158-LRH-VPC, 2010 U.S. Dist. LEXIS 95097, at *19 (D. Nev. Sept. 10, 2010).

[43] *Id.*

[44] *Facts & Figures,* NAT'L ORG. OF LIFE AND HEALTH INS. GUAR. ASS'NS, http://www.nolhga.com/factsandfigures/main.cfm (last visited Jan. 21, 2011).

[45] *Id.*

[46] *Policy Holder Information: Frequently Asked Questions,* NAT'L ORG. OF LIFE AND HEALTH INS. GUAR. ASS'NS, http://www.nolhga.com/policyholderinfo/main.cfm/location/questions (last visited Jan. 21, 2011).

[47] Gallanis, *supra* note 35, at 3.

to the limits of the SSGA.[48] Unlike the FDIC, State Sponsored Guaranty Associations do not collect funds on the national level; instead they are collected only in the state of the failing insurance company and collections are based upon the market share of insurance companies from the previous year.[49] This has led some commentators to raise concerns about the sufficiency of the funds if some of the larger suppliers of life insurance were to fail.[50]

Each SSGA "is authorized by its enabling statute to assess and collect, from insurance companies writing covered lines of business in the state (the Guarantee Association's 'member insurers'), the amount needed to satisfy the Guaranty Association's obligations to policyholders."[51] Due to funding constraints, the limits of the SSGA may be lower than the limits of the failed insurer's contract.[52] The fact that the SSGA limits to the amount of coverage they will continue is not unlike the fact that the FDIC limits the return to a failed bank depositor. However, unlike the coverage provided by the FDIC, there is no national standard for SSGA coverage. SSGA coverage limits are established by state law and vary from state to state.[53] In the area of life-health insurance, most states provide at least the following coverage:

$300,000 in life insurance death benefits
$100,000 in cash surrender or withdrawal values for life insurance
$100,000 in withdrawal and cash values for annuities
$100,000 in health insurance policy benefits[54]

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[48] Advisory Commission on Intergovernmental Relations, STATE SOLVENCY REGULATION OF PROPERTY-CASUALTY AND LIFE INSURANCE COMPANIES 68 (Dec. 1992).

[49] *National Organization of Life and Health Insurance Guaranty Associations*, INVESTOPEDIA.COM, http://www.investopedia.com/terms/n/nolhga.asp (last visited Jan. 21, 2011).

[50] *Id.*

[51] Gallanis, *supra* note 35, at 9.

[52] *Id.*

[53] The National Organization of Life and Health Insurance Guaranty Associations and The National Conference of Insurance Guaranty Funds, *Joint Comments of NOLHGA and NCIGF in Response to FIO's Request for Public Input*, http://www.nolhga.com/pressroom/articles/NOLHGA-NCIGF%20FIO%20 SUBMISSION.PDF.

[54] *Policy Holder Information, supra* note 46; AMERICAN COUNSEL OF LIFE INSURERS, *supra* note 12.

In the event that an insurer is judged by regulators to be insolvent, the legal process of liquidation begins. The liquidation process allows the sale of the firms' assets and the use of the funds raised to pay liabilities. If and when the funds are not sufficient to pay liabilities, the SSGA supplies necessary funds from assessments on in-state insurers.[55] The SSGA member companies are obligated to pay the assessments, however the assessments, which are generally allocated based on the firm's market share from the previous year within the state and are generally limited to a maximum of 2% of collected premiums in the prior year.[56] With the exception of New York State, SSGAs do not have an FDIC style "war chest" available ready to pay claims *before* a company fails.[57] The SSGA's funding comes from assessments that are collected only when are needed. In other words funds are only collected *after* a failure occurs and income from the sale of firm assets is depleted.[58] The FDIC needs the war chest because bank accounts and checking accounts are "demand obligations" whereas life insurance and annuity products are generally promises to pay in the future.[59] Given that RAAs are modeled after standard bank accounts, it stands to reason that SSGAs should have a war chest to cover on demand obligations from holders of RAAs.

Like bank depositors, in order to recover the difference in coverage limits and contractual benefits, the policyholder would have to file suit against the estate of the failed insurance company and get in line behind all other creditors to receive a potential payout when the failed company's

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[55] *State Laws and Provisions Report,* NAT'L ORG. OF LIFE AND HEALTH INS. GUAR. ASS'NS, http://www.nolhga.com/policyholderinfo/main.cfm/location/questions (last updated Dec. 31, 2011).

[56] *Id.* (Rhode Island maxes out at 3% and North and South Carolina max out at 4%); *Joint Comments of NOLHGA and NCIGF in Response to FIO's Request for Public Input*, NAT'L ORG. OF LIFE AND HEALTH INS. GUAR. ASS'NS, http://www.nolhga.com/pressroom/articles/NOLHGA-NCIGF%20FIO%20SUBMISSION.PDF.

[57] Gallanis, *supra* note 35, at 9.

[58] *Id.*

[59] *Id.*; *see also* Evans, *supra* note 3 (If one insurer is unable to meet its obligations, people could lose faith and demand payment from other companies triggering a panic similar to a bank run. The purpose of the FDIC was to put an end to bank runs, allowing insurance companies to act like this with Retained Asset Accounts could set the economy up for another failure due to an inability of insurance companies to meet their payment obligations should people lose faith in the system and demand immediate payment on their "accounts.").

assets are liquidated.[60] The likelihood of any significant recovery by a policyholder or beneficiary in this situation is very small.

3. The Financial Strength of the Insurance Company

As previously discussed, Retained Asset Accounts are not FDIC insured. Instead, the primary "insurance" for RAAs is the financial strength of the insurance company.[61] In light of recent economic events, including the scandals involving Enron, WorldCom, AIG, and Lehman Brothers among others, corporate assurances of financial might does little to instill confidence in beneficiaries.[62]

Perhaps the most well known example of why CEOs and corporate executives are not trusted by investors and the general public is the failure of Enron. Once a tremendous economic success, Enron's misrepresentation of its finances almost singlehandedly led to a nationwide recession. Between 1997 and 2001 Enron claimed substantial growth in annual profits.[63] Media outlets and financial analysts applauded Enron for its success only to learn later that it was all a sham.[64] In the end, even Enron had to admit that "[f]inancial statements for [1997 through the first two quarters of 2001] and the audit reports relating to the year-end financial statements for 1997 through 2000 should not be relied upon."[65]

Unfortunately analysts and investors did not hesitate to consider the complexity of Enron's financial statements before investing and they paid dearly for the trust they put in the public statements of Enron's Chief Officers.[66]

After Enron collapsed, WorldCom pushed the economy down further with its own series of questionable accounting decisions. Between 1999 and 2002 WorldCom used "shady accounting methods" to make its

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[60] Gallanis, *supra* note 35, at 2.

[61] *Id.*

[62] *See* Penelope Patsuris, *The Corporate Scandal Sheet*, FORBES (Aug. 26, 2002), http://www.forbes.com/2002/07/25/accountingtracker.html (for an in-depth look at the corporate scandals of the late 1990s and early 2000s).

[63] Dan Ackman, *Enron Says, 'Oops'*, FORBES (Nov. 9, 2001), http://www.forbes.com/2001/11/09/1109topnews.html.

[64] Howard Kurtz, *The Enron Story That Waited to be Told*, WASH. POST (Jan. 18, 2002), http://www.washingtonpost.com/wp-dyn/articles/A64769-2002Jan17.html.

[65] Ackman, *supra* note 63.

[66] Kurtz, *supra* note 64.

books look better than they were.[67] WorldCom accomplished this fraud in two ways. First, their accounting department "underreported 'line costs' (interconnection expenses with other telecommunication companies) by capitalizing these costs on the balance sheet rather than properly expensing them."[68] Second, WorldCom would inflate their revenues by using falsified accounting entries "from 'corporate unallocated revenue accounts.'"[69] On July 21, 2002, WorldCom filed for Chapter 11 bankruptcy in what would be the largest such bankruptcy filing in the history of the United States.[70] In 2003, it was "estimated that the company's assets had been overstated by $11 billion."[71]

The failure of Enron, WorldCom and many others are examples of why Met Life's assurances that their policies are insured by the financial strength of the company are not going to reassure investors and beneficiaries.[72] While these assurances may have meant something to investors in the early 1990s, because of the misstatements by others, these statements no longer hold water with investors and beneficiaries. This may be unfair, but it is true none-the-less. Because of this, insurance companies need to do more to inform beneficiaries about their products, specifically about RAAs.

In 1990, the House Subcommittee on Oversight & Investigations and the House Committee on Energy & Commerce investigated and reported on the current status of the regulation of insurance companies and on the financial condition of the insurance industry.[73] The report is known as the Dingell Report: Failed Promises. The House Committee indicated in this report that financial failures in insurance companies come with

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[67] *WorldCom Scandal: A Look Back at One of the Biggest Corporate Scandals in U.S. History*, YAHOO ASSOCIATED CONTENT, http://www.associatedcontent.com/ article/162656/worldcom_scandal_a_look_back_at_one.html (last visited Jan. 21, 2011).

[68] *Id.*

[69] *Id.*

[70] *Id.*; Luisa Beltran, *WorldCom Files Largest Bankruptcy Ever: Nation's No. 2 Long-Distance Company in Chapter 11 – Largest with $107 Billion in Assets*, CNN MONEY (July 22, 2002), http://money.cnn.com/2002/07/19/news/ worldcom_bankruptcy/.

[71] *WorldCom Scandal: A Look Back at One of the Biggest Corporate Scandals, supra* at note 67.

[72] Evans, *supra* note 3.

[73] *Id.*

consistent elements.[74] These elements are: "rapid expansion, over-reliance on managing general agents, extensive and complex reinsurance arrangements, excessive under-pricing, reserve problems, false reports, reckless management, gross incompetence, fraudulent activity, greed, and self dealing."[75] According to the report, the following list contains the primary causes of insurer insolvencies:

1. Inefficient, reckless, and deplorable middle and upper management, including personnel deficiencies;
2. Gross incompetence/bad business judgment;
3. Rapid and/or over expansion and diversification;
4. Over-reliance upon and a failure to monitor and supervise Managing General Agents (MGAs), including the improper delegation of responsibilities;
5. Expensive and complex reinsurance arrangements, including the problem of uncollectible reinsurance;
6. Excessive underpricing and inadequate pricing schemes;
7. Poor investment policies;
8. Inadequate reserve problems;
9. False financial reporting and fraudulent activity;
10. Greed and self-dealing;
11. Under-capitalization; and
12. Inadequate regulation by state regulators and/or independent public accounting firms, including the failure to identify and correct the insurer's problems.[76]

These issues consistently resulted in over-leveraged insurance companies that filed unclear or misleading statements of financial condition.[77] The

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[74] Steven W. Schwabb et al., *Caught Between Rocks and Hard Places: The Plight of Reinsurance Intermediaries Under U.S. and English Law*, 16 MICH. J. INT'L L. 485, 489 (1995); STAFF OF SUBCOMMITTEE ON OVERSIGHT & INVESTIGATIONS, HOUSE COMM. ON ENERGY AND COMMERCE, 101st Cong., 2d Sess., FAILED PROMISES: INSURANCE COMPANY INSOLVENCIES 2 (Comm. Print 1990) [hereinafter COMMITTEE REPORT].

[75] COMMITTEE REPORT, *supra* note 74, at 2.

[76] COMMITTEE REPORT, *supra* note 74, at Opening remarks of Chairman Rep. John D. Dingell (D. MI.); David W. Evans & Paul S. Cohen, Professional Liability Targets in Cases of Insolvency: Directors and Officers, and Accountants, 580 PLI/Comm 157, 161-65 (1991).

Dingell Report also "cited the states' failure to regulate the reinsurance market as another significant cause of insolvencies."[78] Specifically, the Dingell Report suggested that due to an absence of adequate supervision by state regulators, insurance companies maintained very low capital levels that could be manipulated as needed to continue operations.[79]

In addition to the Dingell Report, the Advisory Commission on Intergovernmental Affairs investigated the regulation of life insurance companies in 1992 and similarly found that capital reserves held by life insurance companies were not adequate given the level of business they were conducting during the period.[80] The Advisory Commission's report also notes that because insurance companies are able to predict their payout schedule with greater accuracy for life insurance policies than for other types of insurance, such as property-casualty insurance, life insurance companies are able to make more long term and speculative investments.[81]

Given the findings in the Dingell Report, the findings of the Advisory Commission, and the recent financial scandals at prominent companies such as Enron, WorldCom and AIG, it would be unwise to trust that the financial strength of an insurance company will insure Retained Asset Accounts against loss. Because of the criticisms discussed above, significant changes to policy disclosures should be made so that policyholders and beneficiaries are more aware of the pros and cons of holding funds in a Retained Asset Account.

III. DISCLOSURE

The issue with RAAs is not necessarily whether the "accounts" are actually insured by the FDIC but the perception that life insurance companies have not adequately disclosed the fact that these so called accounts are not insured by the FDIC. While State Sponsored Guaranty

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[77] COMMITTEE REPORT, *supra* note 74, at Opening remarks of Chairman Rep. John D. Dingell (D. MI.).

[78] *Id.*; David W. Evans & Paul S. Cohen, Professional Liability Targets in Cases of Insolvency: Directors and Officers, and Accountants, 580 PLI/Comm 157, 161-65 (1991).

[79] John L. Ingersoll et al., Federal Regulation of Insurance: The Industry's Response to H.R. 4900 and H.R. 1290, 23 SPG Brief 10, 11-12 (1994).

[80] ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS: STATE SOLVENCY REGULATION OF PROPERTY-CASUALTY AND LIFE INSURANCE COMPANIES 53 (Dec. 1992).

[81] *Id.*

Associations often provide coverage of $300,000 per life,[82] if an insurance company fails, there is both a question of whether the SSGA provides coverage for RAAs and the fact that some individuals are entitled to more than the amount provided by SSGAs and they will be forced to either take the loss or file suit against the failing insurance company in the hope that there will be enough money left over from liquidation to allow them to recover.[83]

The potential for beneficiaries such as the surviving spouse of a member of the Armed Forces to incur unanticipated losses or file suit against failed insurance companies are not ideal options for the beneficiary or the insurance industry. This is why adequate disclosure is necessary. With adequate disclosure beneficiaries are better able to appropriately assess the risks and rewards of the Retained Asset Account versus taking payment from the insurer and placing their money in a different and perhaps more secure investment such as a savings account, money market account or United States Treasury Bonds. Without appropriate disclosure individuals will not have sufficient information to make intelligent investment decisions.

Journalistic efforts suggest that insurance companies have presented Retained Asset Accounts to policy holders and beneficiaries as though they are Money Market Accounts or in the alternative as though they are accounts similar to bank accounts in that each beneficiary has their own account with their name on it where their money is deposited.[84] In *Clark v. Metropolitan Life Ins. Co.*, the issue of how Retained Asset Accounts are presented as though they are Money Market savings accounts was mentioned, but not thoroughly discussed.[85]

In their disclosure statements, Met Life's RAA is presented as the "Total Control Account Money Market Option."[86] In a recent suit over RAAs against Met Life, the U.S. District Court for the District of Nevada

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[82] *Facts & Figures*, *supra* note 44.

[83] *Policy Holder Information*, *supra* note 46.

[84] *See* Clark v. Metro. Life Ins. Co., No. 3:08-cv-00158-LRH-VPC, 2010 U.S. Dist. LEXIS 95097, at *2-14 (D. Nev. Sept. 10, 2010) (Met Life Retained Asset Accounts are formed when policy disbursements exceed $5,000. The funds are placed in an account named the "Total Control Account Money Market Option" (TCA for short). The account name was found to be "inherently deceptive" due to its implication that the funds were in a Money Market Account or its equivalent and that they were FDIC insured.).

[85] *Id.* at *12-13.

[86] *Id.*

found Met Life's use of the term Money Market "inherently deceptive."[87] The Court noted that using the term "Money Market" in their RAA description created the impression that the beneficiary would receive their own Money Market Account and that that account would be insured by the FDIC.[88] Although the court noted that the disclosure statement was "inherently deceptive," the court granted Met Life's motion for summary judgment because the beneficiary was unable to demonstrate suffering any harm from Met Life's breach.[89] The court limited its finding to the fact that because Met Life has not failed (been deemed insolvent by the SSGA), and thus the beneficiary had not lost any money, there was no recovery to be had.[90] While it did not decide the issue of RAA disclosure, it did lay the foundation for how courts will discuss Retained Asset Accounts in subsequent cases. If Met Life and other insurance companies continue to characterize RAAs as "money market" accounts, that name will likely be considered "inherently deceptive" by courts and in the event of a failure will likely result in a damage award. To avoid such a situation, it is in the best interest of insurance companies to correct the flaws in their disclosure statements that lead to criticisms of the true nature of their Retained Asset Accounts.

Clark appears to have been a wakeup call for Met Life. Starting in July 2010, twenty-five years after Met Life began using Retained Asset Accounts, the customer agreement signed by the policy holder disclosed that Retained Asset Accounts will, at least initially, hold funds for their beneficiaries and that Retained Asset Accounts are not the same as the money market accounts one might hold at a local bank. The section goes on to inform the policy holder that the Retained Asset Account that will be designated for the payout of their benefits will not be insured by the FDIC in any capacity.[91]

While MetLife's actions are certainly a step in the right direction, they are not the only life insurance company using these accounts. Every company in the industry can be tainted by the behavior of a few. As such, more needs to be done in regulating proper disclosure this area of the insurance industry in order to make sure there are proper safeguards against collapse and to educate "account" holders on what they are really getting

[87] *Id.*
[88] *Id.*
[89] *Id.*
[90] *Clark*, 2010 U.S. Dist. LEXIS 95097, at *12-13.
[91] Evans, *supra* note 3.

when and insurance company informs them that the proceeds from their policy will be paid through a Retained Asset Account.

IV. CONCLUSION

Retained Asset Accounts have been subject to significant criticism by the mainstream media, however their criticisms do not tell the whole story. While insurance companies have failed to make adequate disclosure regarding the nature of Retained Asset Accounts, the accounts do provide several benefits to both beneficiaries and the insurance company. It has been noted that Retained Asset Accounts are not traditional savings accounts, checking accounts, CDs, or money market accounts, but they are similar financial vehicles. The mainstream media has criticized RAAs because of the misperception that the insurance company is making this money off of benefits that were supposed to have been paid out to beneficiaries. While it is true that the benefits were supposed to be distributed to beneficiaries, RAAs pay competitive interest rates and provide beneficiaries with time to decide what to do with the funds distributed to the by the insurance company.

Instead of paying out benefits in the lump sum, life insurance companies have been sending draft books that allow beneficiaries to draw against the balance of the Retained Asset Account. While this does not immediately raise any concerns, the way insurance companies have disclosed the nature of RAAs is a serious issue. The RAA disclosure statements have not clearly identified what a Retained Asset Account is, how it is insured, the interest rate paid and how it differs from a conventional checking, savings or money market account. While to date the only harm that has come from these accounts is psychological and emotional, in the event of another financial downturn or simply the failure of a large insurance company, the threat of harm is great. Because of this, it would be wise for insurance companies to adequately disclose the various benefit payment options and to adequately describe these options, specifically Retained Asset Accounts, so that purchasers and beneficiaries understand what type of security they hold.

Although NOLHGA and the insurance industry discuss State Sponsored Guaranty Associations as an equal to FDIC insurance, this is not an accurate representation of the SSGA system. SSGAs do not provide the same type of coverage as the FDIC, nor do they have the same amount of money available to them at a moment's notice. SSGAs rely on contributions from non-failing insurance companies at the time of failure to support an insurance company's obligations while the FDIC relies on a "war chest" made up of annual payments from banks into a central account to support its activities.[92]

Although the public statements of executives at insurance companies like Met Life indicate that SSGAs are a secondary insurance policy behind the financial might of the insurance company. The leaders of similarly situated companies such as Enron, Tyco, AIG, Lehman Brothers, and WorldCom, among others made the same statements regarding the investment quality of their securities. Each of these companies failed to live up to the promises made by their CEO. In the current economic climate, statements by the CEO regarding the financial strength of a company are taken with a grain of salt.

Insurance providers should be required to disclose exactly how they are planning to pay benefits in the event that they receive a valid claim on a policy. If they agree to pay a lump sum, they should describe how the lump sum will be paid, whether it is in a single check or through the use of a Retained Asset Account. This means that insurance companies must inform both the policy purchaser and eventually the beneficiary how their funds will be distributed at the outset of the insurer/insured relationship, rather than waiting until after a claim is made and benefits are paid out. Describing the payment options in detail will help policy holders understand what they are purchasing as well as improve the image of the insurance company as there will be no surprises when a beneficiary receives pseudo-checks when they were expecting a single lump-sum payment.

Only through adequate disclosure can potential harms resulting from insolvency in the insurance industry be avoided. Proper disclosure should accompany every life insurance contract so that policyholders and beneficiaries understand what they are entitled to should a claim be filed. By providing adequate disclosure, beneficiaries will be able to evaluate whether they want to keep a Retained Asset Account or transfer the funds to a safer investment vehicle. In addition, adequate disclosure will lessen bad press against insurance companies because they will have explained exactly what is being distributed to beneficiaries from the outset. Because of this, insurance companies should strive to provide adequate disclosure regarding Retained Asset Accounts.

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[92] Gallanis, *supra* note 35, at 9.

APPENDIX

FEDERAL DEPOSIT INSURANCE CORPORATION

The Federal Deposit Insurance Corporation ("FDIC") is an independent corporation that insures deposits in banks and thrift institutions against failure.[93] The FDIC was created as part of the Glass-Steagall Act of 1933 in response to the over nine thousand bank failures during the great depression.[94] The FDIC has successfully carried out its business without losing a single dollar of insured funds for over 75 years.[95]

The FDIC insures deposit accounts for up to two hundred fifty thousand dollars ($250,000) per individual, per bank.[96] The FDIC does more than insure a single individual for $250,000 worth of deposits. It insures a single individual for $250,000 in *each* FDIC insured bank that they maintain an account at. That means that an individual could put $1 million in a single FDIC insured bank and be covered for only $250,000 of that sum or that same individual could spread that $1 million into 4 or more FDIC insured banks and be insured for the entire $1 million sum. The FDIC does have ways to receive more than $250,000 worth of coverage at one bank provided certain criteria are met, such as having accounts in different asset categories.[97]

There are four main categories of assets, a single account, joint account, IRA and retirement accounts and revocable trusts. The FDIC explains the process by which their coverage works for each of these assets as follows:

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[93] *Who is the FDIC?*, *supra* note 28.
[94] Stammers, *supra* note 29.
[95] *Who is the FDIC?*, *supra* note 28; Stammers, *supra* note 29.
[96] *Who is the FDIC?*, *supra* note 28.
[97] *Deposit Insurance FAQ*, *supra* note 31.

Example 1: **Single Account** (owned by one person): $250,000 per owner.[98]

Example of Insurance Coverage for Single Accounts		
Depositor	**Type of Deposit**	**Amount Deposited**
Jane Smith	Savings account	$25,000
Jane Smith	Certificate of Deposit	$250,000
Jane Smith	NOW account	$50,000
Jane Smith's sole proprietorship	Checking account	$50,000
Total Deposited		**$375,000**
Insurance Available		**$250,000**
Uninsured Amount		**$125,000**

Example 2: Joint Accounts (two or more persons): $250,000 per co-owner. "[Assume] John and Mary have three joint accounts totaling $600,000 at an insured bank. Under FDIC rules, each co-owner's share of each joint account is considered equal unless otherwise stated in the bank's records. John and Mary each own $300,000 in the joint account category, putting a total of $100,000 ($50,000 for each) over the insurance limit."[99]

Joint Account Example		
Account Title	**Type of Deposit**	**Account Balance**
Mary and John Smith	Checking	$50,000
John or Mary Smith	Savings	$150,000
Mary Smith or John Smith	CD	$400,000

[98] *Id.*
[99] *Id.*

Total Deposits		**$600,000**	
Insurance coverage for each owner is calculated as follows:			
Account Holders	**Ownership Share**	**Amount Insured**	**Amount Uninsured**
John	$300,000	$250,000	$50,000
Mary	$300,000	$250,000	$50,000
Total	**$600,000**	**$500,000**	**$100,000**

In this example, both John and Mary have ownership shares in the accounts of $300,000 [in other words, each one of them has ownership of one half of the checking account ($25,000), one half of the savings account ($75,000), and one half of the CD ($200,000), for a total of $300,000]. As discussed above, because each individual is insured for up to $250,000 per bank, Mary's coverage in the joint ownership category is limited to $250,000, and $50,000 is uninsured. The same is true for John, giving him $250,000 worth of coverage and leaving $50,000 uninsured.

Example 3: IRAs and other certain retirement accounts: $250,000 per owner.[100]

Example of Insurance Coverage for Self-Directed Retirement Accounts	
Account Title	**Account Balance**
Bob Johnson's Roth IRA	$110,000
Bob Johnson's IRA	$75,000
Total	**$185,000**
Amount Insured	**$185,000**

[100] *Id.*

Example 4: Revocable trust accounts: "Each owner is insured up to $250,000 for the interests of each beneficiary, subject to specific limitations and requirements."[101]

Example — POD Accounts with Multiple Owners and Beneficiaries			
Account Title	**Account Balance**	**Amount Insured**	**Amount Uninsured**
Husband and Wife POD 3 children	$1,500,000	$1,500,000	$0
Husband POD wife	$250,000	$250,000	$0
Wife POD husband	$250,000	$250,000	$0
Husband POD niece and nephew	$500,000	$500,000	$0
Husband and wife POD grandchild	$600,000	$500,000	$100,000
Total	**$3,100,000**	**$3,000,000**	**$100,000**

[102]

The FDIC is funded through premiums paid by the banks and thrifts and from earnings on U.S. Treasury Securities.[103] These premiums are paid regularly and go into what is described by some as a "war chest."[104] "To provide an effective banking safety net, it is necessary for the FDIC to replace cash (of the failed bank) with cash from the FDIC at the moment the bank fails."[105] The FDIC insures traditional bank accounts, savings, checking, trust, certificates of deposit ("CDs"), money market savings

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[101] *Id.*
[102] *Id.*
[103] *Who is the FDIC?*, *supra* note 28.
[104] Gallanis, *supra* note 35, at 9.
[105] *Id.* at 10.

accounts and IRA accounts.[106] The FDIC does not, however, insure mutual funds, safe deposit boxes, annuities, stocks or bonds.[107] Since its creation in 1934, no depositor insured by the FDIC has lost even a single penny of insured funds as a result of a bank failure.[108] To give an idea of how incredible this accomplishment is, the FDIC reports that since the year 2000, 457 banks have failed.[109] It is because of this success that the FDIC has gained such prominence and respect from individuals and businesses alike.

In addition to its role insuring deposits after a bank failure, the FDIC acts preemptively by "examining and supervising financial institutions for safety and soundness and consumer protection."[110] "The FDIC is a recognized leader in promoting sound public policies, addressing risks in the nation's financial system, and carrying out its insurance, supervisory, consumer protection, and receivership management responsibilities."[111] In carrying out its duties, the FDIC produces Annual Reports to the President of the United States and Congress, a Privacy Program, Strategic Plans about the FDIC's short and long-term strategic goals and Financial Reports on its internal business.[112]

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[106] *Insured or Not Insured?*, *supra* note 39.

[107] *Id.*

[108] *Who is the FDIC?*, *supra* note 28.

[109] *Failed Bank List*, FED. DEPOSIT INS. CORP., http://www.fdic.gov/bank/individual/failed/banklist.html (last updated Mar. 31, 2012).

[110] *FDIC Mission, Vision, and Values,* FED. DEPOSIT INS. CORP., http://www.fdic.gov/about/mission/index.html (last visited Jan. 14, 2011).

[111] *Id.*

[112] *Privacy Program,* FED. DEPOSIT INS. CORP., http://www.fdic.gov/about/strategic/report/index.html (last updated Jan. 14, 2011); *Annual Reports,* FED. DEPOSIT INS. CORP., http://www.fdic.gov/about/privacy (last updated June 16, 2011).