INSURANCE

Are the Horses Already Gone?

by Peter C. Katt, CFP, LIC

Prudential, the largest life insurance company in America, has been the subject of a multi-state task force examining their market conduct because many complaints have been filed against them, including a consolidated class action suit. The examination was conducted by insurance departments from 11 states and the District of Columbia, with the report being sponsored by 29 states.

As of mid-October 1996, 43 states had accepted the task force's recommendations, but a proposed settlement of the class action suit has brought some confusion as to how the task force's and class action's settlements will be coordinated. It is thought that Prudential may *lobby* state insurance departments to allow the more rigorous class action settlement to supersede the task force's settlement in order to get as many of these issues behind them.

For financial planners with clients affected by the pending Prudential lawsuit, actions may or may not have already been taken by the client at the time of publication of this column. If not, the planner may still be in a position to help the client and his or her attorney address the issues. Regardless, the following issues will not go away for the insurance industry. Planners need to be alert for the benefit of their clients, as future lawsuits are bound to arise. (Please refer to insurance and general media for timely information about the settlement specifics as they become known.)

Disclosure: Peter Katt works as an expert consultant and witness in numerous life insurance market misconduct cases, including several involving Prudential.

Summary of Settlements

There are three major market misconduct claims against Prudential.

1. Internal policy replacements with agents using the dividends from existing Prudential policies to pay the premiums for a new Prudential policy. The original promise of *free* insurance hasn't come true because dividends declined, making policy loans necessary in many cases. This is commonly referred to as piggybacking.
2. Vanish-premium-designed policies that now need significantly more premiums, again because of declining dividends.
3. Life insurance sold to consumers who expressly wanted to purchase an investment product to enhance their retirement income.

In November 1996, Prudential was scheduled to notify all life insurance purchasers from 1982 to 1995, some 10.7 million. Eligible policyowners will be given the choice to opt out of the settlement, thereby preserving their right of private action. The policyowner must affirmatively elect to opt out. By not responding, the policyowner opts in and gives up the right to sue Prudential separately. (The decision to get out of the lawsuit must be made by December 19, 1996.)

A second mailing will ask policyowners to select from three no-proof relief options: borrow at more favorable rates, buy more life insurance with enhanced values or buy an annuity with enhanced values. These options, requiring no proof, provide a modest value to policyowners.

The other option is to select the alternative dispute resolution process (ADR). ADR requires that the policyowner provide documentation on the claimed market misconduct by the selling Prudential agent. This evidence will be scored and relief will be provided based on the score achieved. If the policyowner doesn't agree with the score, there is a review mechanism to handle disagreements. The maximum restitution under ADR is calculated based on the level of guarantees or promises the policyowner can substantiate. Generally, this will result in a refund of premiums paid, with interest, or it may be possible to have the net death benefit of vanish-premium policies guaranteed without the payment of any additional premiums, but with no additional cash value build-up.

I was informed that it is possible for an eligible policyowner to obtain the maximum relief of the paid-up value for the original policy face amount; however, I would be surprised if more than a very small percentage have sufficient proof to win such an award. In any event, the basic ADR damages are supposed to be based on the *crime*. In addition, the class action suit's proposed settlement requires that an additional damages fund be established to be distributed based on a formula that has yet to be finalized. The amount in the additional damages fund won't be known until the ADR process is nearly completed because it is based on the percentage of ADR claimants who achieve scores of two or three (the highest scores) out of all eligible policyowners.

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