POLICY INSIGHT

A Policy Newsletter on Life and Health Insurance and Financial Security Issues

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Insurers Supporting Proposals to Protect Consumers and Maintain Confidence in Annuity Markets

Protecting consumers – particularly senior citizens – from unscrupulous sales practices and providing increased information on the financial products they purchase are two of the Texas Association of Life and Health Insurers (TALHI) top policy priorities for the 81st legislative session.

HB 1294, by Rep. Craig Eiland, would establish standards for the use of senior-specific certifications and professional designations in the sale or solicitation of life insurance and annuities. A second proposal by Rep. Eiland, HB 1293, would add further protections for purchasers of annuities by expanding disclosure requirements of key information related to the products they purchase. Both measures were adopted as model regulation by the National Association of Insurance Commissioners (NAIC).

Individuals selling certain financial products, particularly to seniors, often boast designations and credentials that use terms such as "certified," "accredited," "retirement planner," "senior advisor," or "senior consultant." HB 1294 is intended to provide protections from the use of misleading agent certifications that do not reflect genuine expertise in annuity and life insurance sales.

The proposal will set clear standards that will aid regulators, consumers, insurers, and agents in determining qualified certifications and designations. It will also help bring uniformity to state enforcement of proper credentialing and designation use.

"The improper use of designations is limited to a small group of rogue agents and is not common in the industry," said Jennifer Ahrens, executive director of TALHI. "This legislation is intended to send a clear message to all that such conduct will not be tolerated and that the industry is firmly behind strict enforcement of laws that protect consumers from this type of fraud."

HB 1293 would require detailed disclosure of annuity rates and how they change, a summary of options and restrictions for accessing money, as well as an outline of fees. The legislation would establish a timeline for disclosure of key information and requires that annuity applicants be provided an Annuity Buyer's Guide.

Annuities are an important option for consumers in the overall mix of products they use to plan for their financial future. Annuities allow individuals to prepare for anticipated financial needs by making deposits into a fund that will yield regular payments at a predetermined future date – most often retirement.

In 2007, Texas took an important step forward to strengthen consumer protections by adopting NAIC's Suitability in Annuity Transactions Model Regulation. This proposal set high standards to ensure that annuity products purchased are appropriate and suitable to meet the financial needs of the purchaser.

"Given the financial security that annuities offer, it is critical that consumers have confidence in the product and the industry that provides it," Ahrens added. "These proposals are intended to ensure that the integrity of the agents who provide these products and the financial security they promise remains intact."

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TALHI
Texas Association of Life & Health Insurers

The Life Insurance Industry: Withstanding the Financial Crisis

Like others in the financial service industry, life insurance companies are feeling the effects of a tight credit market and declining stock and bond values.

Despite the current economic challenges, the industry remains strong. The life insurance industry holds approximately three times the minimum capital required by law to remain solvent and operational. Life insurers continue to pay benefits, with an average of $1.7 billion paid to policyholders and beneficiaries each day.

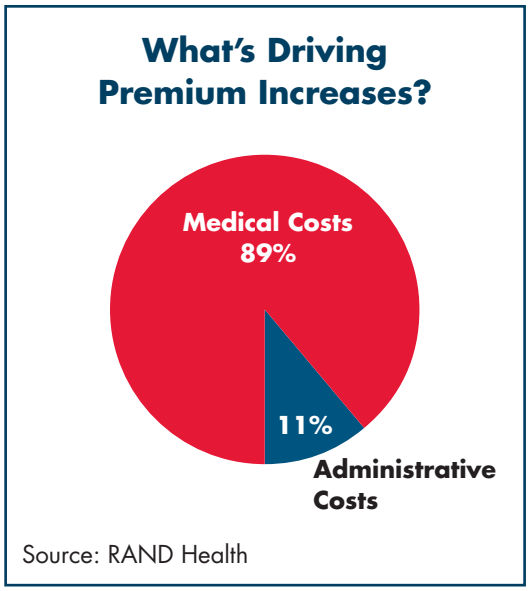
In addition to the industry's solid asset base, consumers enjoy the protections of state guaranty associations that provide protection to policyholders for their guaranteed contract benefits. These associations ensure that a policyholder receives benefits in the unlikely event that an insurer becomes insolvent.

State laws require insurance companies to be members of a guaranty association in every state in which they are licensed to do business.

Life insurers manage their assets to reflect the long-term nature of their commitments. This allows insurers to choose the most appropriate time to sell their holdings, avoiding the need to sell during depressed markets.

Mandatory Medical Loss Ratios Can Reduce Affordability of Coverage and Lower the Quality of Health Care in Texas

A proposal, rejected by most states, to limit insurers' administrative spending would likely impede efforts to improve the quality of health care and to maintain affordable health coverage. If approved, the proposal to mandate medical loss ratios could lead insurers to cut valuable programs that benefit consumers and the health care system or raise premiums in order to maintain administrative spending levels. The proposal is being offered as an attempt to reduce the cost of health coverage, when in fact it would likely have the opposite affect.



A medical loss ratio is the term used to illustrate the division of a premium dollar between medical and administrative spending. Advocates of the proposal suggest a higher ratio will mean less of the premium dollar will be spent on administrative costs, leading to lower premiums. Such a position assumes that administrative costs are a leading driver of the increases in the cost of coverage and that higher medical spending will mean more and better care. Research suggests neither is the case.

According to a recent RAND Health report, roughly 90 percent of health premium growth over a five year period was attributable to medical costs. The report underscores that it's medical costs, not administrative spending of insurers that is driving up the cost of health coverage.

Research has also demonstrated an inverse relationship between more medical spending and health outcomes. Mandatory medical loss ratios will not guarantee that more and better care is delivered.

It is entirely possible that a health plan with higher administrative spending could be more affordable and out perform one that spends less.

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Mandatory medical loss ratios can also threaten the existence of smaller companies causing them to drop lower-priced products that families and self-employed individuals commonly purchase. Likewise, insurers' investments in health information technology, electronic medical records, 24-hour nurse hotlines, fraud detection, customer service, and disease management programs could be jeopardized as insurers are confronted with the need to reduce non-medical spending in order to lower administrative costs.

While mandatory medical loss ratios may be presented as sound public policy, in fact, they are not. Restricting an insurer's administrative costs through a mandatory medical loss ratio will do little to reduce premiums and could contribute to an increase in the cost of coverage as competition is reduced and programs to eliminate fraud and waste are eliminated.

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Overview: Stranger-Originated Life Insurance (STOLI)

What is STOLI?

STOLI stands for "Stranger-Originated Life Insurance." It involves a contrived arrangement in which an investor circumvents a state's insurable interest law to purchase a life insurance policy on a stranger in order to profit when the insured individual dies.

How does it work?

An investor will typically offer a financial inducement to an individual, often a senior citizen, in order to convince the individual to purchase a life insurance policy. Through a contract, the investor agrees to finance the premiums of the policy. After the two-year contestability period has expired, the policy benefits are transferred to the investor who profits when the covered individual dies. The sooner the death occurs, the higher the profit.

What's wrong with STOLI?

The goal of life insurance is to provide protection to families and businesses from the consequences of the unexpected death of a loved one or key business principal. States' insurable interest laws and numerous courts, including the U.S. Supreme Court, affirm that life insurance policies should not be used a means to wager on human life. In a STOLI scheme, the consumer is usually unaware of the taxes and legal fees he will face and the inability to purchase life insurance in the future.

How is STOLI different from a life settlement?

The determining factor in distinguishing the difference involves the existence of an insurable interest. Life settlements involve policies that were originally purchased by a consumer for the policies' intended purposes of providing financial protection for the consumer's family or a business. Life settlements allow consumers to sell their policies to third parties when a change in life circumstances occurs and the life insurance is no longer needed but a need for immediate cash exists. Most life insurance companies support legitimate life settlements. Unlike STOLI, life settlements do not involve financial inducements from an investor made for speculative purposes.

What's being done to address the STOLI problem?

According to the American Council of Life Insurers, more than half of the states are considering measures to help deter the growth of STOLI and to preserve the primary social purpose of life insurance – providing financial protection for families and businesses. Proposals by the National Association of Insurance Commissioners (NAIC) and the National Conference of Insurance Legislators (NCOIL) have been designed to provide consumers and insurers needed protections by placing a moratorium on the settlement of manufactured life settlements and by specifying that STOLI represents a fraudulent settlement act.

Cancellation of Health Insurance Policies Not an Issue in Texas

Fortunately statistics reflect that most Texans are honest and provide accurate information when applying for a health insurance policy. In those few instances when an applicant consciously misrepresents his medical history in order to obtain health coverage, the insurer issuing the policy must void the coverage. In this instance, the cancellation of the policy is known as a rescission. If the withheld information would have affected an insurer's decision to issue a certain policy, state law allows for coverage to be rescinded or cancelled due to the fraudulent conduct of the insured individual.

Information collected by the Texas Department of Insurance (TDI) indicates that only seven complaints on rescissions were filed against Texas health insurers between 2003 and 2007. Of the seven complaints filed, the agency determined that only one was justified.

To protect consumers from inappropriate rescissions, the Texas Insurance Code places a heavy burden of proof upon the insurer to demonstrate that the omission did occur and that it was relevant to the company's decision to issue a policy. Additionally, for 120 years the state's common law has also placed strict requirements on insurers to prove the deceptive intent of the insured in order to rescind coverage due to an insured's misrepresentation on a policy application.

The entire insurance industry employs 149,000 individuals in Texas, with a payroll of over $7 billion.

If an individual's policy is rescinded, the cancellation may be challenged by filing a complaint with TDI. If the agency determines that the rescission appears to violate Texas law, it may pursue enforcement action against the insurer. Sanctions against an insurer could include administrative penalties of up to $25,000 per violation, license suspension, license revocation, an emergency cease and desist order, and restitution to all affected parties. The Department may also require reinstatement of the insurance contract.

As indicated above, only one of seven rescission complaints between 2003 and 2007 was determined to be justified by TDI. Despite the rarity of policy rescissions in Texas, proposals during the current legislative session would place additional burdens and costs upon insurers to justify a rescission by requiring that the insurer not only prove that the misrepresentation occurred but that the consumer knowingly intended to deceive the plan. Additionally, proposals would require that rescissions be reviewed by a third party prior to cancellation of a policy. Only the state of Vermont requires such a review.

In addition to their belief that additional requirements are unnecessary and will only add to the cost of coverage, insurers have expressed concern that increasing their already high burden of proof will invite dishonesty on applications and hamper their ability to deal with fraud.

ABOUT TALHI: Texas Association of Life and Health Insurers

TALHI is the trade association for life and health insurers doing business in Texas. It was formed when Texas Life Insurance Association and the Texas Legal Reserve Officials Association merged in 1997.

Now representing the majority of insurers doing business in the state, TALHI has emerged as a leading voice for life and health insurers on legislative and regulatory matters.

TALHI is an open-door trade association boasting some of the most progressive life and health insurance company officials throughout the country. We are united for the mutual benefit and development of a healthy and competitive insurance market.

The work that TALHI does in the public policy arena is intended to strengthen the insurance market by enhancing insurers' ability to provide Texans financial security for their future.

We welcome the opportunity to work with you.