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PERSONAL FINANCE

Consumer groups protest life insurers' plan to lower reserves

Easing capital requirements would increase the risk that an insurer would fail to pay all its obligations, the groups say. But the industry's proposals have the support of regulators.

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Two prominent consumer groups are up in arms over proposals that would reduce the amount of money life insurers must set aside to pay future claims.

The Consumer Federation of America and the Center for Economic Justice say the changes would increase the risk that an insurer would fail to pay all its obligations under life insurance policies and annuity contracts.

The revisions would ease capital requirements that the life insurance industry calls inflexible and overly conservative.

Both sides cite the country's current financial crisis in making their arguments.

The industry's effort to modify the rules has the support of regulators, who contend that it won't harm policyholders. "It would be irresponsible for us to suggest something that makes the product riskier," said Roger Sevigny, president of the National Assn. of Insurance Commissioners, which represents state insurance regulators.

Because all states require insurers to adhere to accounting rules set forth by the association, the organization can change the capital requirements without legislation or any action by individual state regulators.

The group is moving practically at the speed of light on the proposals, which emerged less than two months ago and could be enacted in the next few weeks, said Birny Birnbaum, executive director of the Center for Economic Justice and a former Texas Insurance Department chief economist.

The nine proposed changes would reduce the total reserves that life insurance companies need to hold by about $25 billion -- or about 7% of the industry's capital, or net worth, according to the American Council of Life Insurance, which asked for the changes.

Because insurers invest the money they set aside, last year's sharp price declines for stocks and many types of bonds have lowered the industry's capital levels.

The insurance council, in a statement about its proposal, says, "the current inflexible formulas coupled with the nation's financial turmoil may create undue stress on insurance companies' ability to carry on normal business operations."

But lowering reserve requirements could make some troubled insurers appear more solid than they are, said J. Robert Hunter, director of insurance for the Consumer Federation of America.

"What I am afraid of," he said, "is that there are a handful of companies that would be insolvent without these changes, and policyholders won't know."

Joseph Belth, professor emeritus of insurance at Indiana University and editor of the Insurance Forum, a trade publication, said he opposed the rule changes because he and two actuaries he consulted couldn't say how the revisions would affect individual companies or the industry as a whole.

"In the midst of the current financial crisis, it is unseemly even to discuss the idea of weakening the conservative statutory accounting rules that have long been in place for insurance companies," Belth wrote in a letter protesting the change. He said regulators should first assess whether the proposal "is in the long-term best interest of the insurance-buying public."

Capital requirements are important because you want to be confident that a life insurer will be around a long time -- at least as long as you'll be around. That's true whether you own a life insurance policy or an annuity that's supposed to pay you a certain amount each month for the rest of your life.

The issue is especially crucial because the safety net designed to protect you if your insurance company fails is nothing like the federal deposit insurance that protects the money you put in the bank.

Insurance benefits are backed by a patchwork of state-regulated industry guarantee associations. Their coverage limits aren't very high.

In most states, the associations guarantee at least $300,000 of a life insurance policy's death benefit, $100,000 of a whole-life policy's surrender value and $100,000 of the present value of the remaining payments under a fixed annuity.

But California's guarantee association will pay only 80% of your benefits -- and no more than $250,000 of a death benefit.

Moreover, although the Federal Deposit Insurance Corp. will pay bank depositors within a day of a bank failure, insurance guarantees are often paid out over time.

That's because state guarantee funds generally hold no assets in reserve. Instead, they assess surviving insurers when a company fails. And they are barred from assessing more than a set amount of the remaining companies' assets. So when a big company fails, as California's Executive Life Insurance Co. did in 1991, it can take years to pay off policyholders.

In addition, most guarantee funds have the right to lower the interest rate paid to a failed company's policyholders. That could reduce the future cash value of a life insurance policy or the amount paid each month to an annuity holder.

To learn more about insurance guarantees in your state, go to the website of the National Organization of Life and Health Insurance Guaranty Assns. at www.nolhga.com, which has links to each state's guarantee laws.

Kristof is a personal-finance author and syndicated columnist.

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