The New York Times

An Employee Dies, and the Company Collects the Insurance

By DAVID GELLES

June 22, 2014 10:43 pm

Employees at The Orange County Register received an unsettling email from corporate headquarters this year. The owner of the newspaper, Freedom Communications, was writing to request workers' consent to take out life insurance policies on them.

But the beneficiary of each policy would not be the survivors or estate of the insured employee, but the Freedom Communications pension plan. Reporters and editors resisted, uncomfortable with the notion that the company might profit from their deaths.

After an intensive lobbying campaign by Freedom Communications management, a modified plan was ultimately put in place. Yet Register employees were left shaken.

The episode at The Register reflects a common but little-known practice in corporate America: Companies are taking out life insurance policies on their employees, and collecting the benefits when they die.

Because so-called company-owned life insurance offers employers generous tax breaks, the market is enormous; hundreds of corporations have taken out policies on thousands of employees. Banks are especially fond of the practice. JPMorgan Chase and Wells Fargo hold billions of dollars of life insurance on their books, and count it as a measure of their ability to withstand financial shocks.

But critics say it is immoral for companies to profit from the death of employees, while employees themselves do not directly benefit. And despite a law enacted in 2006 that sought to curb the practice — companies now are restricted to insuring only the highest-paid 35 percent of employees, who must give their consent — it remains a growing, opaque and legal source of corporate profit.

“Companies are holding this humongous amount of coverage on the lives of human beings,” said Michael D. Myers, a lawyer in Houston who has brought class-action lawsuits against several companies with such policies.

Companies and banks say earnings from the insurance policies are used to cover long-term health care, deferred compensation and pension obligations.

“Life insurance is one of the ways of strengthening the long-term health of the pension plan and ensuring its ability to pay benefits,” Freedom Communications’ chief executive, Aaron Kushner, said in an interview.

And because such life insurance policies receive generous tax breaks — investment returns on the policies are tax-free, as are the death benefits eventually received — they are ideal investment vehicles for companies looking to set aside money to pay for pension plans. Companies argue that if they had to finance such obligations with investments taxed at a normal rate, they would incur losses and would not be able to offer the benefits to employees.

But in many cases, companies and banks can use the tax-free gains for whatever they choose. “If you want to take that money and go build a new bank branch, fine," said Joseph E. Yesutis, a partner at the law firm Alston & Bird who specializes in banking regulation. "Companies don't promise regulators they will use it for any specific purpose."

Hundreds of billions of dollars of such policies are in place, providing companies with a steady stream of income as current and former employees die, even decades after they have retired or left the company.

Aon Hewitt estimates that in new policies worth at least $1 billion are being put in place annually, and that about one-third of the 1,000 largest companies in the country have such policies. Industry analysts estimate that as much as 20 percent of all new life insurance is taken out by companies on their employees.

But determining the exact size of the market for corporate- and bank-owned life insurance is impossible. With the exception of banks, companies do not have to report their insurance holdings.

"There is no reliable reporting of the use of who's buying life insurance, of what they're buying it for," said Steven N. Weisbart, chief economist of the Insurance Information Institute.

Banks have to report their holdings because regulators want to know how much cash they could access if they had to redeem the policies in a pinch before the death of the insured employee.

That figure, known as the "cash surrender value" — or the amount they could withdraw immediately — provides a glimpse of just how big such policies can be.

Bank of America's policies have a cash surrender value of at least $17.6 billion. If Wells Fargo had to redeem its policies tomorrow, it would reap at least $12.7 billion. JPMorgan Chase would collect at least $5 billion, according to filings with the Federal Financial Institutions

Examination Council.

Because banks could collect the cash from insurance companies quickly, if needed, life insurance holdings are considered Tier 1 Capital, a basic measure of a bank's strength. Many banks have 10 to 25 percent of their Tier 1 Capital invested in life insurance policies, according to Goldstein Financial Group, a broker dealer.

Insurance industry experts say that most big banks have delayed new life insurance purchases, in part because of limits on how much insurance they can hold. Yet the value of existing policies continues to grow, with the gains from invested capital outpacing the benefits paid out as employees die.

Corporate- and bank-owned life insurance grew out of so-called key person insurance policies that protected companies against the economic consequences related to the death of top executives. The New York Times Company has taken out life insurance policies on some top employees.

But absent meaningful regulation around the practice, it grew unchecked, and soon companies were taking out policies on many poorly paid employees like janitors, then reaping millions in profit when they died.

A string of class-action lawsuits, some filed by Mr. Myers, went after companies abusing the practice. Several companies, including Walmart, settled the suits, paying millions to low-ranking employees who had been covered. The I.R.S. took companies including Winn-Dixie and Camelot Music to court for using policies as tax avoidance schemes.

Critics began calling the policies "dead peasant" insurance, an allusion to Nikolai Gogol's novel "Dead Souls," in which a con man buys up dead serfs to use them as collateral in a business deal.

Despite the criticism, companies and banks continued to use the policies to chase returns. In the years before the financial crisis, life insurers for banks including Wachovia and Fifth Third Bancorp invested their premiums in a hedge fund run by Citigroup.

As the value of the fund rose, the profits were recorded on the companies' balance sheets, raising earnings. But when the hedge fund collapsed during the market panic, so did the value of the policies, leading the banks to take substantial write-downs.

Efforts have been made to better regulate the practice. The 2006 Pension Protection Act included a set of best practices for companies taking out life insurance on employees.

"The government has taken great strides to clean it up," said J. Todd Chambley, who runs the executive benefits practice at Aon Hewitt.

Still, the notion of life insurance policies benefiting company balance sheets, rather than individuals, remains subject to criticism.

Responding to attacks on the Freedom Communications plan, Mr. Kushner defended himself in a letter to employees. "Life insurance is not ghoulish, nor are the people who sell it, nor are those who buy it," he wrote. "Life insurance, by its very nature, was created to benefit the people we love and care about most."

A version of this article appears in print on 06/23/2014, on page B1 of the