PRUDENTIAL, DISABILITY CLAIMS, AND ERISA

On February 18, 2010, a class action lawsuit was filed against The Prudential Insurance Company of America alleging that the company violated the Employee Retirement Income Security Act of 1974 (ERISA) in its handling of disability insurance claims. The complaint focuses on changes in the company's procedures relating to claimant appeals of adverse benefit determinations. (*Carol DaCosta et al. v. Prudential*, U.S. District Court, Eastern District of New York, No. 10-CV-00720.)

The Plaintiffs

The lawsuit has four lead plaintiffs. The complaint describes Prudential's handling of their appeals of adverse benefit determinations.

Carol DaCosta was human resources manager at Dentsu Holdings, Inc. In August 2006, she became disabled due to "temporal arteritis causing severe and frequent headaches, dizziness, tightness in her temple and neck and numbness in her head." In April 2008, Prudential determined she was no longer disabled and terminated her benefits. She filed an appeal. Kim Boivin, a senior appeals analyst, upheld the determination. Ms. DaCosta requested a copy of the claim file, but it was not provided. She filed another appeal. Based on opinions of the same physicians who reviewed the first appeal, Ms. Boivin denied the second appeal.

Wayne Cooper, M.D., was an obstetrician-gynecologist at Geisinger Medical Center. He became disabled "due to lumbar radiculopathy and extensive coronary artery disease necessitating cardiac surgery" and left his position. Prudential denied his claim for benefits. He filed an appeal. Ms. Boivin upheld the denial. Dr. Cooper requested a copy of the claim file, but it was not provided. He filed another appeal. Ms. Boivin denied the second appeal.

Dana DiCocco was a senior property manager for Winn Residential. She received chemotherapy for breast cancer, and became disabled with "severe Cognitive Disorder and Depression due to the chemotherapy." In January 2007, she began receiving disability benefits. In November 2007, Prudential determined she was no longer disabled and terminated her benefits. She filed an appeal. Susan Gatti, a senior appeals analyst, upheld the determination. Ms. DiCocco requested a copy of the claim file, but it was not provided. She filed another appeal. Based on opinions of the same physicians who reviewed the first appeal, Ms. Gatti denied the second appeal.

Melanie Green was a financial analyst. In January 2007, she was diagnosed with "severe depression and anxiety." In July 2007, Prudential terminated her benefits. She filed an appeal. Naucy Pichette, a senior appeals analyst, denied the appeal. Ms. Green requested a copy of the claim file, but it was not provided. She filed another appeal. Based on opinions of the same physicians who reviewed the first appeal, Ms. Pichette denied the second appeal.

The Procedural Changes

Prior to 2005, Prudential provided that appeals "were to be reviewed by individuals who were not involved in a claim decision at any prior level." In January 2005, the company made modifications that provided for similar procedures.

Drew DeChristopher is the manager of Prudential's appeals review unit. In an e-mail on November 18, 2005, he changed some procedures by saying that in certain instances an appeal can be handled by the same individual who handled prior appeals, that it is not necessary to use a different medical consultant, and that a *de novo* standard of review does not apply.

In 2006, Prudential issued a "Summary of Material Modifications of Claim Procedures." The summary did not mention the changes announced by Mr. DeChristopher in his e-mail. The complaint alleges that certain procedures violate the "full and fair review" standards required by ERISA.

The Plaintiffs' Requests

The plaintiffs seek class certification, injunctive relief, equitable relief, damages, costs, and attorneys' fees. The plaintiffs also ask the court to order Prudential to re-evaluate all denied, terminated, or suspended claims in full compliance with ERISA or retain an independent third-party administrator to do so.

Conclusiou

It will be interesting to see what happens in this case. In my view, it is inappropriate and inconsistent with the requirements of ERISA for the decision on an appeal to be based on opinions of the same physicians who were involved in a previous adverse determination. I also think it is inappropriate and inconsistent with the requirements of ERISA for the decision on an appeal to be made by the same individual who ruled on a previous adverse determination.

The lawsuit does not mention whether any state insurance regulators have received complaints about Prudential's procedures—or the procedures followed by other companies—in the handling of appeals of adverse determinations in disability insurance claims. I would welcome comments from anyone who has knowledge of any such complaints.

On February 24, I asked a Prudential spokesman to comment on the case. He said the company does not comment on pending litigation.

Prudential is domiciled in New Jersey. On February 25, I asked a spokesman for the New Jersey department of banking and insurance to comment on the case. He declined to do so.

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APPENDIX A

STATEMENT BY THE ACLI

(February 3, 2010)

The American Council of Life Insurers (ACLI) recommends that the securitization of life settlements be prohibited by legislation or regulation.

Securitization may encourage promoters of these packages to prey upon senior citizens by urging them to settle their life insurance policies even if a settlement is not in their economic best interests.

Insurers are also concerned about public policy implications of stranger-originated life insurance (STOLI), where promoters of life settlements induce seniors to buy life insurance policies that they would uot otherwise purchase in anticipation of profit from the sale of the policy to investors at the end of the policy contestability period. Since there are only a limited number of insured individuals who want or need to sell their existing insurance policies and are of an age and expected mortality profile to be of interest to settlement providers, promoters of life settlements artificially manufacture new life insurance sales to generate an inventory of policies for investors. Seniors are offered a variety of inducements, including cash payments and promises of "free insurance" obtained through the use of forgivable premium financing, to participate in the fraudulent origination of policies.

Securitization of life settlements will exacerbate the STOLI problem. Securitization is a very effective means of market-making and encouraging rapid expansion of a "product," in this case, life settlement contracts. Promoters will use capital generated from securitization to create larger inventories of life settlement contracts which, in turn, will fuel more securitizations and more STOLI.

Life settlement securitization also poses risks for the investors purchasing settlement securities, sometimes referred to as "death bonds," "blood pools" and "collateralized death obligations." This is true for at least two reasons.

First, securitization divorces the life settlement provider from the ultimate risk associated with the purchase. The provider which purchases a senior's policy should be responsible for accurate settlement risk assessment and not insulated by securitization from such responsibility. This is comparable to what happened with the mortgage securitization market, which facilitated and fueled the proliferation of subprime and "no-doc" mortgages. The ultimate risk to life settlement investors is that the senior will live longer than expected and hence "ruin" the investment return.

- Investing in a life settlement contract only makes economic sense when the insured person has a relatively predictable—and shortened—life span. The life settlement investors must pay premiums to keep the policy in force until the pay-day death of the insured. This cost, combined with the amount paid to acquire the rights to the death benefit and related broker fees, can exceed the death benefit if the insured lives "too long." Medical innovation, cures for disease and better elder care are detrimental to the value of the investment.

- Unlike the residential mortgage market, where there was a credible argument that securitization of mortgages freed capital for additional consumer lending, there is no capacity issue when it comes to the resale of existing life insurance policies. In fact, even without securitization, some promoters of life settlements have created artificial insurance transactions (STOLI) in order to fuel the demand for life settlement contracts. Investors in life settlement securitizations will have no hard assets as security for the inevitable default and fraud losses that attach to these investments with alarming regularity. This is unlike mortgage securitizations, where there is at least some tangible asset base guaranteeing some value.

- Rating agency experts advise that there is no standard method and no common set of assumptions used by life settlement providers to predict the life expectancies of the insured seniors whose policies are being purchased, either at the time of the elderly owner's entry into the life settlement contract or at the time of a contract resale. They advise that, if there are no restrictions on the pooling and securitization of life settlement contracts, there is little incentive for life settlement providers to "get it right" in terms of medical underwriting and respect for insurable interest requirements.

Second, there is a lack of transparency for investors in the securitization since they are not permitted to perform due diligence by examining the settlement underwriting files. While protection of the personal medical information about the person whose life is insured is important, other details about individually settled policies and the senior lives which are insured are needed by investors for risk evaluation. This information includes the current age of each insured and his/her life expectancy, the amount paid to the policy owner for purchase of the life policy, future annual premium amounts, the date of each policy's issuance and when it was transferred (sold) to the life settlement provider. The amount and quality of information that will be made available to investors in life settlement securitizations is insufficient for any

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