SUBJECT: Restricting corporate-owned life insurance ("dead peasant") policies

COMMITTEE: Insurance — favorable, without amendment

VOTE: 5 ayes — Smithee, Seaman, Eiland, Gallego, Van Arsdale

1 nay — B. Keffer

1 present not voting — Taylor

2 absent — Bonnen, Thompson

SENATE VOTE: On final passage, May 15 — 31-0, on Local and Uncontested Calendar

WITNESSES: No public hearing

BACKGROUND: The 76th Legislature in 1999, through SB 1196 by Shapiro, enacted Insurance Code, art. 3.49-1, which permits any person of legal age to apply for life insurance and designate in writing any person, persons, partnership, association, corporation or other legal entity, or any combination thereof, as beneficiary. Previously, Texas law authorized only persons with a reasonable expectation of financial benefit or advantage from the continued life of someone, such as a spouse, child, or creditor, to be a beneficiary on a life insurance policy.

DIGEST: SB 137 would add Insurance Code, sec. 1103.057 to state that an individual covered by a life insurance policy could not designate or consent to the designation of an individual partnership, association, corporation, or other legal entity that was the individual's employer as a beneficiary of the policy, unless the employer:

- notified the employee in writing that coverage was being obtained on the employee's life, specifying the minimum initial death benefit;
- advised the employee that the employee's consent was required for the coverage to be obtained, that consent was irrevocable once given, and that the employer could maintain the coverage after the employee's employment had terminated; and

- obtained the employee's written consent to the coverage, including the minimum initial death benefit.

In addition, at least one of the following would have to apply:

- the employer was related by blood or marriage to the insured individual;
- the designation would be permitted under statutory provisions naming a corporation, joint stock association, trust estate, or a partnership or partner as beneficiary;
- the insured was a current or a former employee who met, or had met at retirement, executive, administrative, professional, or outside salesman criteria established in the Code of Federal Regulations; or
- at the time the employer was designated as a beneficiary, the insured was an employee or former employee who participated or was eligible to participate in an employee welfare benefit or pension plan under which benefits were payable to the employee or former employee, or a designated beneficiary, and the total amount of insurance coverage designating the employer as beneficiary was reasonably related to the costs of employee or retiree benefits already incurred in connection with the employee benefit plans, plus the protected future cost of the benefits as established by the employer.

An employer could not make an employee's written consent to life insurance coverage a condition of employment or retaliate against an employee for refusing to provide consent. Further, an insurer could not issue a policy or certificate to an employer insuring the life of an employee unless the insurer received the employee's written consent.

Benefits of a life insurance policy for which consent was coerced or not obtained would not be payable to the employer and would be payable instead to the estate of the deceased insured. A person or the estate of a person who had sustained damages as a result of the action of a current or former employer could pursue a civil action against the employer in district court.

The bill would provide that, in addition to satisfying policy form requirements in the Insurance Code, an insurer would certify to the commissioner that the policy complied with the written consent provisions of the bill. The insurer

also would submit a sworn affidavit executed by the employer and, in the case of a corporate employer, an officer of the corporation, certifying that the group insurance plan complied with the requirements of this bill for employers.

The bill would amend Insurance Code, sec. 1103.003 to include the life of a director among the entities that a corporation, a joint stock association, or a trust estate that was engaging in business for profit could insure and be designated as a beneficiary.

SB 137 would repeal sec. 1103.56, as effective June 1, 2003, that would allow for purchase of or application for an individual or group life insurance policy by a third party.

This bill would take effect September 1, 2003, and would apply only to an insurance policy delivered or issued for delivery on or after that date.

SUPPORTERS SAY:

SB 137 would help protect employees from the exploitive practice of some corporations while retaining a means for corporations or partnerships legitimately to insure key personnel and safeguard their business interests.

Corporate-owned life insurance (COLI) policies are taken out by employers on the lives of employees. Such policies often insure the lives of key officers of a company — owners, executives, partners, shareholders — whose deaths significantly would affect operations. Some companies, however, also take out COLI policies on rank-and-file workers, termed by the industry as “dead peasant” policies. In the past, there have been abuses of these policies, largely because the premiums were tax-deductible and the cash value of the policies could be used as collateral for the company’s borrowing power. Changes in corporate laws and accounting standards have eliminated some of these standards, yet abuses still remain.

Until 1999, COLI policies were not permitted in Texas. However, once the Insurance Code was amended to allow anyone with an “insurable interest” to be a beneficiary, employers legally could qualify with the insured individual’s consent. In the wake of the Enron scandal, the media revealed that Enron, like other corporations, used dead peasant policies to fund deferred compensation

and bonus programs for company executives. The workers whose lives were insured and their dependents never saw the benefits of these policies.

SB 137 would apply two significant reforms to the sale of COLI policies. It would require employees or retirees whose lives were being insured to consent in writing and to be given adequate notice. In addition, the total amount of COLI coverage purchased would have to be "reasonably related" to the unfunded liabilities in the corporation's employee benefits and pensions plans.

The bill properly would prevent an employer from coercing an employee into providing consent. Benefits of a policy for which consent was coerced or not obtained would be payable to the estate of the deceased employee or former employee instead of the employer, and employees could seek civil damages against employers who violated the terms proposed in this bill.

OPPONENTS SAY:

This bill would go too far in restricting a legitimate business practice. COLI policies can play an important financial role in funding employee benefit plans.

OTHER OPPONENTS SAY:

Corporate-owned life insurance policies should be banned entirely. Rank-and-file employees do not have the same bargaining power or business acumen as those at management level and likely would feel compelled to agree to life insurance coverage as a condition of employment — despite a provision in the bill to the contrary. Short of a complete ban, the provision allowing employers to maintain coverage after an employee's termination should be stricken, as it could encourage hiring abuses in order for employers to amass life insurance policies for which they were the beneficiaries. A revocation clause allowing employees to withdraw also would be appropriate, absent total elimination of these policies.

NOTES:

A similar bill, HB 152 by Wilson, was reported favorably by the Insurance Committee on May 10.

HB 3613 by Marchant, which would authorize the state to purchase or apply for an individual or group life insurance policy on the life of a retired public employee, was scheduled for hearing in the Pensions and Investments Committee on May 5, but was withdrawn.