

Statement of



In connection with the hearing of

The Senate Special Committee on Aging

Regarding

“Betting on Death in the Life Settlement Market - What's at Stake for Seniors?”

April 29, 2009

The National Association of Insurance and Financial Advisors (NAIFA) appreciates the opportunity to share with the members of the Senate Special Committee on Aging our views regarding life settlements and in particular our concerns regarding the use of life settlements to facilitate stranger-originated life insurance (STOLI) transactions, which we believe pose significant risks for seniors. We welcome the Committee's interest in this issue, and NAIFA and its members strongly support your efforts to protect and advocate on behalf of America's seniors.

Founded in 1890 as the National Association of Life Underwriters, the National Association of Insurance and Financial Advisors comprises more than 700 state and local associations representing the interests of 200,000 agents and their associates nationwide. Members focus their practices on one or more of the following: life insurance and annuities, health insurance and employee benefits, multiline, and financial advising and investments. NAIFA's mission is to advocate for a positive legislative and regulatory environment, enhance business and professional skills, and promote the ethical conduct of its members.

NAIFA does not oppose all life settlements. Under the appropriate circumstances a life settlement may provide the policy holder with the means to access the maximum value from their policy if they determine that they no longer need the insurance coverage. Each policy holder must evaluate his or her individual circumstances and situation and make the determination of whether and when a life settlement is appropriate under their particular set of circumstances. NAIFA does support rigorous regulation and oversight of life settlements and settlement transactions, and towards this end we support the provisions of the National Association of Insurance Commissioner's Viatical Settlements Model Act. The National Conference of Insurance Legislators (NCOIL) has also adopted

a Life Settlements Model Act, and the NCOIL model also represents a viable option for regulating the life settlement market.

NAIFA does, however, view as problematic and is greatly concerned about life settlement transactions which are used in conjunction with premium financing arrangements to facilitate transactions that are commonly referred to as “stranger-originated life insurance”, or “STOLI”.<sup>1</sup> STOLI transactions are designed to evade state insurable interest and other laws and allow unrelated investors without an insurable interest in the insured to arrange in advance for their ownership of life insurance policies. The investors then use life insurance to profit from the deaths of people they do not know. In STOLI schemes, investors induce financially well-off seniors to take out life insurance policies on their own lives. The senior policy holder will receive one or more types of financial inducement for entering into this transaction: an upfront payment, a portion of the amount remaining when the policy is sold and the premium loan is paid off, “free insurance” for the two year period the policy is held, or a small continuing interest in the death benefit. It is the intent of all the parties at the time of policy inception that sometime after two years from the time of policy issuance the insured will transfer the policy benefits to those investors, who then profit when the insured dies. The sooner the policyholder dies, the greater the investor’s profit.

Life settlements which are used to facilitate STOLI transactions are fundamentally different from legitimate life settlements. In a legitimate life settlement, the insured initially took out the policy for a legitimate, recognized insurance purpose, such as to provide financial protection for family members. The decision to settle the policy is made sometime down the road when the insured’s circumstances change and the insured determines the original purpose for the insurance policy no longer exists. In contrast, life settlements which are used in STOLI transactions are initiated solely for the purpose of being sold in the future to investors without any interest in the continued life of the insured.

NAIFA strongly opposes all types of STOLI transactions, and has been at the forefront of efforts to restrict and prohibit STOLI since we first became aware of these transactions in early 2006. Our concern is that these types of arrangements evade the purpose behind state insurable interest laws, because in a STOLI transaction the life insurance policy is taken out by someone who has an intent to sell the policy in a couple of years to an entity

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<sup>1</sup> NAIFA does not oppose full recourse or adequately collateralized non-recourse premium financing arrangements where the intent is for the long-term retention of the policy and the motivation is to help the insured finance insurance that he or she needs and expects to keep. In these arrangements the insured typically pledges collateral in addition to the policy to secure the loan and is personally responsible for its payment. This is in contrast to the non-recourse policy loans that are typically used in STOLI transactions, where the lender relies for collateral solely on a guaranty of the policy's secondary market (settlement) "value" as determined by a viatical or life settlement company. Contrary to the way traditional insurance premium financing is typically arranged, in a STOLI transaction the policyholder is not personally liable to pay off the loan or is otherwise assured that the bank will accept the policy in full payment of the debt.

that could not have initially purchased the policy. NAIFA believes that STOLI violates the essential social purpose of life insurance, which is to provide protection. Life insurance protects families and businesses from the unexpected death of a breadwinner or the financial consequences of the death of an owner or key employee.

In contrast, STOLI arrangements involve using life insurance for speculative purposes. Life insurance was not designed to be used in this way. The essential social purpose of life insurance forms the basis for state insurable interest laws and numerous rulings by the United States Supreme Court. STOLI undermines the integrity of life insurance.

STOLI transactions also pose significant risks and dangers to the senior citizens who enter into these arrangements. These risks and dangers include:

- Senior citizens participating in these arrangements may not be aware that the sums they receive (either at policy initiation or upon sale of the policy) as well as the value of any “free insurance” during the time they hold the policy are generally considered to be taxable income and therefore they may receive substantially less compensation than expected.
- The life insurance policies used in the STOLI transaction may be far more valuable to the policyholder as estate protection rather than as a way to make a quick buck.
- People cannot purchase unlimited amounts of life insurance. Seniors participating in STOLI may use up their insurability and be unable to purchase needed life insurance in the future.
- Seniors who enter into STOLI transactions will be giving permission for someone to periodically check on their health and well-being.
- Misstatements or lies on the policy application, including questions completed by an agent that they acknowledge with their signature, could subject the policyholder to legal liability, a risk of litigation or the voiding of the insurance contract.

As stated above, NAIFA has been at the forefront of efforts to put a stop to STOLI before it can harm seniors and other consumers. NAIFA strongly supports the enactment in the states of legislation that will address the abuses occurring in the marketplace today from STOLI. We worked closely with the NAIC and NCOIL to develop amendments to the NAIC’s Viatical Settlements Model Act and to NCOIL’s Life Settlements Model Act that are designed to limit and restrict STOLI while not placing any undue restrictions on legitimate settlement transactions. We believe the best legislative solution is to combine provisions from both the NAIC and NCOIL models into hybrid legislation that contains the strongest elements of each model.

NAIFA, its state associations and their members played a major role in helping to enact anti-STOLI legislation in 12 states in 2008. (This brings to 15 the number of states that have enacted anti-STOLI legislation to date; North Dakota enacted a version of the NAIC model in 2007, and Arkansas and Washington state have had anti-STOLI measures signed into law so far in 2009). Our efforts included providing testimony at hearings,

meeting with key legislators and insurance department staff, and broad-based grass\roots activity to encourage rank and file legislators to support the legislation. State legislative activity for 2009 is well under way, and we are currently involved in legislative activity in over 20 states.

Thank you for your consideration of our views. We appreciate and share your strong interest in protecting the interests of senior citizens, and look forward to working with you as your efforts advance.