

BRING LIFE SETTLEMENTS UNDER FEDERAL SECURITIES LAWS, SEC SAYS

Life insurance settlements, whether securitized or not, should be subject to federal securities laws, says a report issued by the Life Settlements Task Force of the Securities and Exchange Commission (SEC).

Defining life settlements as “securities” under federal law would clarify the treatment of life settlements under both federal and state securities laws. This, in turn, would provide better transparency and protection for investors, SEC said.

The SEC Task Force report, which was issued July 22, devotes a section to stranger-originated life insurance (STOLI) and discusses why it poses risks to investors.

“As investments, STOLI policies may introduce particular risks for investors who purchase the policies, given the risk that insurers may contest them on grounds such as fraud (at least prior to the end of the contestability period) or violations of state insurable interest laws. There is some authority that the two-year contestability limitation does not bar an insurer from challenging a policy for lack of insurable interest. We understand that this risk may be compounded, because whether a settled policy is the result of a STOLI transaction may be very difficult to determine,” the report says (pages 13-14).

“Attorneys involved in litigation of STOLI cases indicated to the Task Force that they were aware of approximately 300 STOLI cases in active litigation. These cases are brought by insurance companies, investors, and parties such as family members, who might otherwise have been beneficiaries under the policies,” the report adds (page 14).

Frank Keating, president and CEO of the American Council of Life Insurers (ACLI), said that STOLI represents a financial and legal danger to unwary investors in life settlements.

“As life insurers learn more about STOLI and how these schemes are structured, they do a better job of screening

policy applications for STOLI. STOLI promoters respond by devising new ways to evade the best underwriting efforts of life insurers. But when a STOLI scheme is uncovered, there is a substantial risk that the life insurance company will try to rescind the policy. The investors could find that their investments are rendered worthless. Moreover, these transactions could be tied up for years in litigation,” Keating said.

“ACLI’s board adopted policy in February that securitization of life settlements should be prohibited by legislation or regulation. The reasons behind that policy decision were referenced in the SEC Task Force report. STOLI is an under-the-table transaction that may be difficult to detect initially. Securitization encourages STOLI promoters to package policies and sell shares to investors who will never know until its too late that the assets underlying their investments are corrupt,” Keating said.

“While ACLI believes life settlement securitization should be banned by legislation or regulation, we appreciate efforts by federal and state regulators to gain a better understanding of the life settlement market and upgrade investor protection,” he said.

Tom Currey, CLU, ChFC, LUTCF, president of the National Association of Insurance and Financial Advisors (NAIFA), agrees with Keating’s comments. “NAIFA adopted formal policy opposing the securitization of life settlements in November 2009. If the securitization of life settlements were to become more common and widespread, it would lead to an increase in the number of STOLI transactions in the marketplace, since there would be a greater need to create the products to be securitized. NAIFA has been a staunch opponent of STOLI, and strongly supports the efforts of state lawmakers to protect the interests of their senior citizens.”

The Task Force presented the SEC with five recommendations on oversight of life settlements:

- Include life settlements under the definition of “security” under federal securities laws.
- Monitor whether brokers and providers are meeting legal standards of conduct.
- Monitor the development of the life settlement securitization market.
- Encourage Congress and state legislatures to consider more significant and consistent regulation of life expectancy providers.
- Consider issuing an *Investor Bulletin* on life settlement investments.

'DISCLOSURE' PROVISIONS MAY IMPOSE SETTLEMENT COMPANY MARKETING COSTS ON POLICY OWNERS

Life settlement companies appear to be pursuing a novel strategy for acquiring high benefit amount life insurance policies from seniors; forcing seniors with lower benefit amount policies to potentially subsidize the settlement companies' marketing costs.

Under a deceptively-labeled initiative called "disclosure," life settlement companies are asking state lawmakers to essentially mandate that life insurers promote life settlements. And even though research shows that only a very limited universe of life insurance policies are of any interest to settlement companies (large benefit amount, beneficiary age 70 or older, universal life), settlement companies want information about the availability of life settlements sent to a wide range of policyowners. Most of these policyowners have no interest in a life settlement or own policies that the settlement companies will never touch because the benefit amount isn't large enough.

"While these initiatives are promoted as 'consumer-oriented,' they are anything but. Settlement companies want the imprimatur of government for a transaction that should stand or fall in the free market. If life settlement companies provide a valuable service to seniors, they should have no trouble advertising what they do and developing a large clientele. The fact that the settlement industry is asking lawmakers to mandate that insurers advertise for them should at the very least lead to some raised eyebrows in statehouses," said ACLI President Frank Keating.

"The problem with what the settlement industry is proposing is that most of the costs likely will be borne by those who will never use the services of a settlement company. First, the settlement companies are primarily interested in policies with death benefits of \$250,000 or more covering seniors who are 70 or older. Right away, most seniors are disqualified," Keating said.

"And for the remaining policies, only a fraction are actually sold to investors. According to ValMark Securities, an active participant in the settlement market, of the 93 policies it put on the market between January 2009 and February 2010, only 13 were sold. That's about 14 percent. In fact, according to ValMark, less than one percent of policies settle for more than the cash value," Keating said.

"To comply with these so-called disclosure provisions, insurance companies would have to substantially modify their data processing systems, train customer service personnel to answer policyowner questions, monitor and constantly upgrade these systems. This entails costs, costs that will be borne by insurance companies and ultimately by all policyholders," Keating said.

"If the life insurance industry went to lawmakers and asked them to mandate that stockbrokers tell their clients who are considering closing out their accounts that they should consider putting some of their assets into a life insurance policy, we'd be rightfully attacked for trying to use others to promote our products and services. Yet, that's precisely what the settlement industry is trying to do," Keating said.

"Life insurance is a great product. It protects families from the financial risk of an unexpected death and helps seniors protect a legacy they can pass on to the next generation," said NAIFA President Tom Currey.

"The life insurance industry has never had to run to government and ask it to force others to pay our marketing costs. It's time for the settlement industry to show it can do the same," Keating added.

HEADLINES IN THE NEWS MEDIA: STRANGER-ORIGINATED LIFE INSURANCE

The headlines and excerpts below are examples of the many articles highlighting the pitfalls of stranger-originated life insurance. Visit www.acli.com for links to the most recent media coverage.

"SEC Recommends Life Settlements Be Defined As Securities," by Jodi Xu, *Dow Jones Newswires*, July 22, 2010

"The life-settlements market calls out for enhanced and coordinated regulatory oversight to protect the emerging class of investors interested in this market, as well as the many seniors who consider selling their life insurance policies," said Chairman Mary Schapiro.

"Lawyer's Heirs Fight Insurers in \$56 Million Policy Intrigue," by Mark Maremont and Leslie Scism, *The Wall Street Journal*, June 11, 2010

"Days after New York attorney Arthur Kramer died unexpectedly at age 81, members of his family seated in a lawyer's office were told that in his final years, he had taken out \$56.2 million in life insurance. There was a catch: They weren't the beneficiaries. Mr. Kramer had bought seven large life insurance policies and quickly arranged a sale of the right to claim the benefits."

GAO CALLS FOR CONSISTENT REGULATION OF LIFE SETTLEMENTS

Regulation of life insurance settlements varies significantly across the nation, possibly providing less protection to policy owners in some states than in other states, says a new report by the United States Government Accountability Office (GAO).

The report, which was requested by the Senate Special Committee on Aging, said that the current regulatory framework of the life settlement market does not meet two standards developed by the GAO for assessing proposals to modernize financial regulation: (a) consistent consumer and investor protection and (b) consistent financial oversight.

ACLI President Frank Keating and NAIFA President Tom Currey said that ACLI and NAIFA strongly advocate legislation that combines the best elements of the models developed by the National Association of Insurance Commissioners (NAIC) and the National Conference of Insurance Legislators (NCOIL) and would like to see it enacted in every state.

"The approaches taken by NAIC and NCOIL are different but complementary. Together, they offer consumers and investors the highest standard of protection. The NAIC approach establishes a five-year moratorium on the settlement of policies that have the characteristics of STOLI. The moratorium removes much of the economic incentive from STOLI transactions and helps assure that investors in life settlements are not buying 'damaged goods,'" Keating said.

"The NCOIL approach establishes a statutory definition of STOLI, classifies STOLI as a fraudulent act, and gives state regulators the authority to collect information from the settlement industry, an industry that, as the GAO notes, has lacked transparency up to this point," Keating said.

"Unfortunately, the settlement industry fights effective anti-STOLI legislation at every turn. Hopefully, release of the GAO report, along with the report by the SEC Task Force on Life Settlements (see article on page 1), will add momentum to efforts to protect consumers and investors," Currey added.

Headlines in the News Media: Stranger-Originated Life Insurance, *continued*

"Potential Life Insurance Scheme Thwarted," *States News Service, Apr. 27, 2010*

"If someone offers to give you money to take out a life insurance policy on yourself for the purpose of selling it to an investor, they are probably involved in a stranger-originated life insurance (STOLI) scam, which is illegal in Ohio. Ohio Department of Insurance officials recently stopped such a scam from taking place."

"Investors Recruit Terminally Ill to Outwit Insurers on Annuities," by Mark Maremont and Leslie Scism, *The Wall Street Journal*, Feb. 16, 2010

"The arrangement, now under investigation by federal prosecutors and snarled in litigation, is the latest twist in a cat-and-mouse game between insurers and sophisticated investors. The investors comb through policies marketed to individuals and figure out ways to convert them into profit-making products for people with no emotional bond to the deceased."

"Grim Risks of Reaping Death's Rewards," by Leslie Scism and Larry Light, *The Wall Street Journal*, Feb. 6, 2010

"The increasingly popular practice of buying rights to older people's life insurance is risky, even downright perilous. People are living longer than actuarial tables say they should, and that is a problem, at least for the investor. Adding to the danger are a recent adverse tax ruling and some scam artists on the edges of the industry."

"Wall Street Pursues Profit in Bundles of Life Insurance," by Jenny Anderson, *The New York Times*, Sept. 6, 2009

"The earlier the policyholder dies, the bigger the return—though if people live longer than expected, investors could get poor returns or even lose money. Either way, Wall Street would profit by pocketing sizable fees for creating the bonds, reselling them and subsequently trading them. But some who have studied life settlements warn that insurers might have to raise premiums in the short term if they end up having to pay out more death claims than they had anticipated."

"Senators Decry Flipping of Life Insurance Policies," by David S. Hilzenrath, *The Washington Post*, April 20, 2009

"Members of the Senate Special Committee on Aging yesterday expressed concern about dangers for senior citizens from what the hearing agenda described as 'Betting on Death in the Life Settlement Market.' Panel Chairman Herb Kohl (D-Wis.) said selling a life insurance policy to investors 'can be fraught with possible hidden pitfalls'"

"When one man is insured 44 times, suspicions arise," by Nicole Garrison-Sprenger, *St. Paul Pioneer-Press*, April 17, 2009

"How many life insurance policies does one person need? Not as many as Michael Antonello sold his clients, state regulators said Friday. In the span of five years, Antonello sold 44 life insurance policies worth \$128 million to John R. Paulson, an elderly Twin Cities man, state regulators say. To do that, authorities say, Antonello misrepresented how much insurance Paulson already carried, an amount that far exceeded Paulson's net worth."

“Suit boosts Hilbert’s foul-play fears; Insurer: Outsiders took out \$15M policy on mother-in-law,” by Peter Schnitzler, *Indianapolis Business Journal*, Jan. 24, 2009

“Making matters worse, insurance regulators say senior citizens sometimes don’t understand what they have agreed to, including that people unrelated to their family will receive the entire windfall when a policy pays off. And in the process, the senior citizens may have forfeited the right to buy insurance intended for their own families.”

“Seniors—Watch out for life insurance scams,” *Port Clinton News-Herald*, Sept. 12, 2008

“Many people count on life insurance to provide them with peace of mind and to help ensure that their loved ones will be financially secure no matter what the future may bring. Unfortunately, in a relatively new scheme called Stranger-Originated Life Insurance, investors are preying on seniors and misusing life insurance for their own gain.”

“Little-known insurance practice targets elderly,” by John Howard, *Capitol Weekly* (Sacramento, CA), Sept. 11, 2008

“The scope of the problem is unknown, although nationally, experts believe the assigned life insurance practice and STOLI involves about \$1 billion, some put the figure much higher. There are no estimates for California. The lack of data about the practices result in part from the fact that they are not regulated.”

“Rules target insurance scam: Elderly getting paid to buy a life policy, then assign benefits,” by Steve Wartenberg, *Columbus Dispatch*, Sept. 2, 2008

“A shady insurance scheme that started in Florida and Arizona, states chock full of wealthy and often vulnerable seniors, is starting to pop up here, Ohio Department of Insurance Director Mary Jo Hudson said.

“Gray Matters: SOLI: a stranger is your beneficiary,” by Saul Friedman, *Newsday*, Aug. 2, 2008

“Such SOLIs smack of cheating and salesmen, hungry for commissions, often pressuring the elderly into buying large policies to flip them, unaware that the taxes due on the payout could be high and that they will no longer be insured.”

“Covered for Life—by a Stranger,” by Kimberly Lankford, *The Washington Post*, June 22, 2008

“Deals with strangers are just one more type of policy clamoring for investors, and they lower the amount people can get for legitimate life settlements. It’s also against the point of insurance: to protect those who would suffer financially if you die. Several states are changing their laws to put an end to STOLI.”

“Tombstone Contracts,” by Brian Rooney, *ABC News*, Mar. 8, 2008

“Thousands of older Americans have entered similar deals and inevitably, some believe they have been misled.”

“Stranger-Originated Life Insurance a Bad Bet, Regulators Say,” by Paul Wenske, *Kansas City Star*, Mar. 8, 2008

“In what has to be the wackiest new trend in life insurance, many consumers are allowing total strangers to place bets on when they will expire—and the sooner they go, the bigger the payoff.”

“It’s called Stranger-Originated Life insurance, or STOLI for short.

“And it’s causing a stir in Kansas, Missouri and other states where officials say it is undermining the insurance industry and risking the finances, and possibly the lives, of consumers.”

“Kansas Commissioner Decries ‘Death Futures,’” by Mark Fagan, *Lawrence Journal-World*, Feb. 24, 2008

“‘There’s a concern that this is a little too much of a get-rich-quick scheme,’ said [Sandy] Praeger [Kansas commissioner of insurance and president of the National Association of Insurance Commissioners]...‘We’re just trying to protect people from participating in something that’s highly questionable. You’re buying insurance under false pretenses.’”

“Treating Death as a Commodity,” by Marc Lifsher, *Los Angeles Times*, Feb. 20, 2008

“‘Enticing seniors with offers of free case to allow the purchase of life insurance on their lives for the benefit of third-party investors is wrong...’, committee Chairman Michael Machado (D-Linden) said. He thinks state regulation is overdue.”

“‘This is a runaway freight train,’ said Frank N. Darras, a top California attorney specializing in senior citizen issues. ‘Somebody needs to put brakes on it or we might have a lot of people extremely distressed.’”

STOLI Alert is published by the American Council of Life Insurers and the National Association of Insurance and Financial Advisors.

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For further information about *STOLI Alert* and the issue of stranger-originated life insurance, please contact us.

American Council of Life Insurers

101 Constitution Ave., NW, Suite 700, Washington, DC 20001
Bruce Ferguson & Michael Lovendusky, 202-624-2000 www.acli.com

National Association of Insurance and Financial Advisors

2901 Telestar Court, P.O. Box 12012, Falls Church, VA 22042
Gary Sanders & Roland Panneton, 703-770-8100 www.naifa.org