

# STOLI ALERT

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## STATES TAKING ACTION TO ADDRESS STOLI

States across the nation are considering legislation to address stranger-originated life insurance (STOLI), efforts that STOLI promoters are trying to undermine. Ohio, Nebraska, Kansas, and Massachusetts, among others, have strong bills under consideration that would deter STOLI and protect the rights of good-faith policy owners to settle their policies. However, legislation in Kentucky would allow STOLI transactions to proceed largely unchecked.

The Kentucky legislation appears to be based on the Life Settlements Model Act developed by the National Conference of Insurance Legislators (NCOIL), which is supported by the life settlement industry (see page 2). In reality, the Kentucky bill guts key provisions of the NCOIL model, rendering it ineffective.

"It's unfortunate that while everyone involved in this issue claims to oppose STOLI, some of those so-called 'opponents' are working behind the scenes to scuttle the NCOIL model in states where it is being considered. But we are confident that state legislators will catch on to this," said Frank Keating, president and CEO, American Council of Life Insurers (ACLI).

"Life insurance agents who care about our industry are working in state capitals to expose the double-dealing of the STOLI promoters. We will not sit by quietly and allow those who violate the basic principles of life insurance just to make a quick buck define the future of our business," said Jeffrey J. Taggart, president of the National Association of Insurance and Financial Advisors (NAIFA).

Specifically, the NCOIL model defines STOLI as "a practice or plan to initiate a life insurance policy for the benefit of a third party investor who, at the time the life insurance policy is originated, has no insurable interest in the insured."

However, the STOLI promoters are trying to gut this definition by deleting the phrase "a practice or plan to initiate a life insurance policy..." and substituting "a written agreement for the procurement of a new life insurance policy...."

This deviation would render the NCOIL model ineffective. Under this change, the NCOIL model would only apply to written contracts, even though verbal contracts are enforceable under most circumstances. A "practice or plan" to engage in STOLI could be created and as long as it is not put into writing, the NCOIL model would not apply.

Similarly, a written contract signed a nanosecond after the policy is originated would escape oversight.

## WHERE WE STAND

Lawmakers must act to deter stranger-originated life insurance now, before it becomes a national scandal.

STOLI violates public policy against using life insurance as a vehicle for wagering on human life. It threatens to undermine the growing legitimate market for life insurance covering senior citizens. Seniors induced into participating in STOLI deals may face undisclosed costs and legal implications.

The National Conference of Insurance Legislators (NCOIL) and the National Association of Insurance Commissioners (NAIC) have each approved model laws addressing STOLI.

NCOIL's Life Settlements Model Act addresses all forms of STOLI by, among other things, defining and prohibiting STOLI transactions, requiring life settlement companies to annually report data to state insurance commissioners and prohibiting premium finance companies from having a stake in the death benefits of the policies they finance.

STOLI promoters are trying to eviscerate key elements of the NCOIL model, even while claiming to support it. These efforts must be opposed and a clean NCOIL model passed in jurisdictions considering it.

The NAIC's amendments to the Viatical Settlements Model Act target the most prevalent form of STOLI, transactions involving a policy settlement. The model's strictly limited five-year moratorium applies only to STOLI policies and will significantly reduce the incentive for abusive transactions. At the same time, it protects the rights of good-faith policy owners.

ACLI and NAIFA believe that a hybrid bill, including the best elements of the NAIC and NCOIL models, offers the highest level of protection to consumers and will do the most to deter this abuse of life insurance.

# LIFE SETTLEMENT GROUPS BACK NCOIL MODEL

Two of the leading voices of the life settlement industry have been quoted as praising the Life Settlements Model Act developed by the NCOIL, including its definition of STOLI, which is one of its key provisions.

Doug Head, executive director of the Life Insurance Settlement Association (LISA), said in an online statement that the NCOIL model represents “wisdom.” Michael Freedman, senior vice president of government affairs with Coventry, wrote in the December 2007 issue of *California Broker* that the NCOIL model “takes major steps” to address STOLI.

Frank Keating, president and CEO of ACLI, said he welcomes the support of the life settlement industry for the NCOIL model and hopes this will clear up any confusion among state legislators.

“Some legislators are sponsoring amendments to the NCOIL model that would severely weaken it, in particular by gutting the definition of STOLI. The definition is one of the key features of the NCOIL model. Without it, the model would lose much of its impact. The support for NCOIL expressed by Mr. Head and Mr. Freedman should help enact legislation to fully and finally address this problem,” Keating said.

“Make no mistake: ACLI still supports the model amendments to the Viatical Settlements Model Act developed by the National Association of Insurance Commissioners that would establish a strictly-limited five-year moratorium on the settlement of STOLI-related policies. The moratorium would take the economic incentive out of the most prevalent form of STOLI.

“But the broad support enjoyed by the NCOIL model—including both the life insurance industry and the life settlement industry—should smooth passage in many state legislatures,” Keating said.

Head’s praise for the NCOIL model came in a statement supporting the analysis by Judge Denny Chin in the case of *LPC v. Angel*, which addresses the issue of STOLI and the need for a policy applicant to have a good-faith intent to purchase insurance for the purpose of protection if a subsequent assignment of the policy benefits is to be valid (see page 3).

“The *Angel* order repeatedly demonstrates the wisdom of the NCOIL model,” Head said.

“The NCOIL model provides a legislative definition of STOLI as ‘a practice or plan to initiate a life insurance policy for the benefit of a third-party investor.’ This is virtually identical language to the court’s holding in *Angel*,” Head wrote.

Head also praised NCOIL’s “pioneering” consumer affirmations—written certifications by the applicant such as “I have not entered into any agreement or arrangement providing for the future sale of this life insurance policy”—and its definition of a “life settlement contract.”

“All of these provisions, combined with the NCOIL model’s unique and aggressive inclusion of trust arrangements throughout the document, would have operated to regulate the arrangement in the *Angel* case before the policy was issued,” Head said.

In his *California Broker* article, Freedman said, “With its Life Settlements Model Act, NCOIL has sought to define STOLI accurately; added new measures for insurers to root out STOLI during the application process; and included important consumer protections to prevent abuses in premium financing,” Freedman said.

Jeffrey J. Taggart, President of NAIFA, said he is pleased a consensus is developing on the need to deter STOLI.

“In states considering the NCOIL model, I hope legislators will see that broad support exists for a clean bill. Attempts to weaken the NCOIL model are anti-insurance industry, anti-settlement industry and most important, anti-consumer,” he said.

## October 2007

## January 2008

### TIMELINE

For expanded Timeline, please visit [www.acli.com](http://www.acli.com)

### LITIGATION

Lincoln National files complaint in United States District Court seeking to rescind \$30 million in life insurance policies, charging the policies are STOLI-related (*Lincoln National Life v. Fishman*). See story on page 4.

### LEGISLATION

The Ohio House of Representatives approves legislation to deter STOLI-HB-404—by a unanimous vote.

# U.S. DISTRICT COURT REAFFIRMS DISTINCTION BETWEEN STOLI, SETTLEMENTS

“Only one who obtains a life insurance policy on himself ‘on his own initiative’ and in good faith—that is, with a genuine intent to obtain insurance protection for a family member, loved one, or business partner, rather than an intent to disguise what would otherwise be a gambling transaction by a stranger on his life—may freely assign the policy to one who does not have an insurable interest in him.” *Life Product Clearing v. Angel*, 2008 WL 170193, Jan. 22, 2008 (United States District Court for the Southern District of New York).

So said United States District Court Judge Denny Chin in an opinion that gets to the heart of the distinction between legitimate life settlements and STOLI. Judge Chin’s opinion reaffirms that life insurance may not be used as a vehicle for wagering on human life. Those who initiate the purchase of a life insurance policy must have a good faith intent at the time of the application to use the life insurance coverage for its intended social purpose, which is the protection of a family member, a dependent or a business or for charitable purpose. Laws and regulations that deter the transfer of life insurance policies that were not acquired in good faith do not violate anyone’s property rights.

Judge Chin’s analysis drew praise not only from life insurance companies and agents, but also from the life insurance settlement industry, which reaffirmed its support for the Life Settlement Model Act developed by the National Conference of Insurance Legislators (NCOIL).

The *Angel* case involves an eyebrow-raising transaction in which Leon Lobel, a 77-year-old retired butcher, applied for a \$10 million life insurance policy even though he could not afford the premiums. The controversy began when an intermediary approached Lobel to advise him of a “financial opportunity” in which he could receive an immediate cash payment by taking out a life insurance policy on himself for the benefit of a stranger-

investor. The investor, Life Product Clearing (LPC), would pay all the premiums, Lobel was told, and his only out-of-pocket expense would be \$1,000 for setting up an irrevocable trust that would purchase and own the policy.

While the trust was established for Lobel’s benefit, Lobel agreed to sell his beneficial interest to LPC in exchange for \$300,000.

“Lobel had no personal desire to obtain a life insurance policy for the benefit of his family or as part of an estate planning decision, and he could not afford one even if he so desired. He was attracted to the plan solely because of the promise of quick cash,” Judge Chin noted.

Just five days after receiving the payment from LPC, Lobel died. LPC sought a declaratory judgment that it, not Lobel’s estate, was entitled to the policy benefits. Lobel’s daughter, Linda Angel, who is personal representative of the estate, counterclaimed that the transfer of the policy benefits to LPC is void since it violates the public policy against using life insurance to wager on human life.

In rejecting LPC’s motion, Judge Chin cited United States Supreme Court precedents, as well as New York legal precedents, laws and regulations, in reaffirming that a legitimate insurable interest must exist at the time of the application. Moreover, Judge Chin noted, while an individual has an insurable interest in his or her own life, policy applicants must have a sincere intent to purchase life insurance for purposes of protection if a subsequent assignment of the policy benefits is to be considered valid.

“Courts consider factors such as whether the insured paid premiums and the length of time the insured held the policy before assigning it when deciding whether an arrangement is simply a sham transaction designed to evade the insurable interest rule or a genuine, good-faith assignment,” he wrote.

Judge Chin noted that LPC concedes that it never had an insurable interest in Lobel. Moreover, he said, under New York law, immediate surrender of a policy is permissible, but only if the initial acquisition of the policy was in good faith and there was no prior intent or agreement to transfer it to an otherwise disinterested investor.

Angel’s claim that Lobel never intended to obtain and hold life insurance for the benefit of his family but always intended, for a \$300,000 fee, to transfer beneficial interest in the policy to an investor, is “more than plausible,” Judge Chin said. Thus, he said, LPC cannot prevail as a matter of law at this stage of the litigation.

## February 2008

### LITIGATION

United States District Court in New York rejects request by investors to acquire the proceeds of a \$10 million life insurance policy taken out by a 77-year-old retired butcher who could not afford the premiums, saying it is “more than plausible” that the policy was always intended to benefit the investors (*Life Product Clearing v. Angel*).

### LEGISLATION

Kansas, Nebraska, Oklahoma, Massachusetts, West Virginia and North Carolina, among others, consider strong STOLI bills.

### MEDIA:

Television station *KCRA* in Sacramento, CA, airs a major segment on STOLI in which senior citizens were allegedly duped into applying for life insurance by participating in what was purported to be a “survey.”

The *Indianapolis Star* publishes article on STOLI, calling it “a twisted form of life insurance.

*Seattle Post-Intelligencer* article publishes report on legislation pending in Washington state addressing “death bonds.”

*CNBC* airs a segment on STOLI entitled “Grim Reaping,” focusing on legislation being developed by Sen. Michael Machado (D-Linden) to deter the practice.

# LIFE INSURERS SEEK TO IDENTIFY STOLI TRANSACTIONS

STOLI transactions are like stealth technology, designed to evade detection.

When insurance companies discover transactions that have clear, undeniable indications of STOLI, they take strong legal steps to deter the abuse and rescind the policies. The case of *Lincoln National Life v. Fishman*, which is now pending in the United States District Court for the Central District of California, shows how these transactions are structured and the amount of alleged misinformation insurers must untangle to identify STOLI-related policies.

According to the complaint, a retired physician named Gordon R.A. Fishman sought three life insurance policies from Lincoln National, each with a death benefit of \$10 million. Fishman, who was 77 years old at the time, said on the application that he had annual income of \$13 million and a net worth of \$90.75 million. The policies, he said, would be placed in an irrevocable life trust.

Before issuing the policies, Lincoln interviewed Fishman, during which Fishman made the following statements, according to the complaint:

- The policies were for estate planning purposes;
- There had been no discussions with third parties about selling or assigning the policies;
- There would be no premium financing; and
- He (Fishman) received no money for applying for the policies.

However, the complaint says, these statements, which were crucial to Lincoln's underwriting decision, were false.

The complaint charges that in reality, a STOLI promoter representing Mutual Credit Corporation (MCC) approached Fishman and proposed that Fishman receive \$1 million in exchange for applying for the policies. The policies would be effectively owned and for the benefit of MCC, which was a complete stranger to Fishman and had no insurable interest in his life, the complaint says.

After he agreed to participate in the arrangement, Fishman and MCC engaged in a series of transactions designed to give MCC an interest in the policies without Lincoln's knowledge, the complaint says.

First, Fishman created the Gordon R.A. Fishman Irrevocable Life Trust. While irrevocable trusts are common estate planning tools, the complaint says, in this case the purpose was to create an entity that would own the policies and be outside the control of Fishman or his family. The trustee had no prior relationship with Fishman and appears to have been appointed by either MCC or the promoter, who arranged the transaction, the complaint says.

Second, Fishman and his wife signed a consent and acknowledgement agreement under which MCC would advance money to the trust to purchase the policies while the Fishmans "unconditionally and irrevocably" agreed to the subsequent assignment of the policies to MCC, the complaint says.

Finally, the trust signed a non-recourse financing agreement with MCC which was structured in a way to assure that the trust would transfer the policies to MCC to satisfy the debt, the complaint says. Indeed, the complaint says, in this case, the finance charge was more than 100 percent of the amount loaned by MCC to the trust.

"Indeed, the money used to purchase the policies was lent at such a usurious and exorbitant interest rate that, when the note becomes due, the trust will not be able to repay the loan and will have no effective alternative but to forfeit the policies and assign them to the investor," the complaint says.

The complaint says that at no time during the application process did Fishman provide Lincoln with copies of the agreements with MCC.

"Lincoln was completely unaware of these arrangements prior to the issuance of the policies. Indeed, had Lincoln been aware that these policies were being sought as part of a STOLI transaction, Lincoln would have declined to issue the policies because MCC lacked an insurable interest in Dr. Fishman's life," the complaint says.

Lincoln is seeking to rescind the policies, or have them declared void, due to the alleged misrepresentations and MCC's lack of an insurable interest.

The deceptions alleged in this case demonstrate the difficulties insurers face in identifying and challenging STOLI transactions. States can help deter these abuses by passing laws based on the models developed by the NAIC and NCOIL.

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

Readers are encouraged to copy and share the information contained in *STOLI Alert*.

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](http://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](http://www.naifa.org)