

SENATE COMMITTEE EXAMINES STOLI; STATES PREPARE LEGISLATION

A United States Senate panel is probing stranger-originated life insurance (STOLI) as part of a broader examination of the life settlement industry and its impact on seniors, according to *Dow Jones Newswires*.

The examination by the Senate Special Committee on Aging comes as several states plan to consider legislation to deter STOLI. This activity follows a very successful anti-STOLI campaign in 2008 when 11 states approved strong bills to deter this fraudulent practice.

Frank Keating, president and CEO of the American Council of Life Insurers (ACLI), said he hopes the hearing by the Special Committee on Aging will shine a brighter national spotlight on a transaction that STOLI promoters would prefer to keep in the shadows.

"Committee Chairman Herb Kohl (D-WI) and Ranking Member Mel Martinez (R-FL) deserve the thanks of all senior citizens for launching a probe into STOLI schemes. They have so many pitfalls for seniors, including potential tax consequences and legal liability. The National Association of Insurance Commissioners (NAIC) and National Conference of Insurance Legislators (NCOIL) have responded to the challenge by approving excellent model laws that have been enacted by 12 states and are under consideration in many others. We're happy to see Congress step up and do its part to protect seniors," Keating said.

"The Aging Committee's investigation is welcome news and demonstrates that STOLI is a growing national concern. We hope the joint efforts of the states, the federal government, senior advocates and the insurance industry will put an end to this abuse of seniors once and for all," said Cliff F. Wilson, CLU, ChFC, LUTCF, CLF, president of the National Association of Insurance and Financial Advisors (NAIFA).

Keating noted that the Aging Committee is examining STOLI in the context of life settlements and reiterated the life insurance industry's long-standing position that it does not oppose legitimate, well-regulated life settlements.

"Sometimes, circumstances force consumers who purchased life insurance policies in good faith to consider life insurance settlements. We are not trying to shut down this option for consumers. Our legislative efforts are targeted at STOLI," Keating said.

"Life insurance agents deal directly with consumers and are committed to keeping the consumers' best interest uppermost in their dealings. Where a life settlement is in the consumers' best interest, it should be an available option. But STOLI is different. STOLI is a fraudulent transaction that undermines the social purpose of life insurance and exposes seniors to many dangers," Wilson added.

According to *Dow Jones*, the Aging Committee is likely to conduct an oversight hearing "in the very near future." The committee sent a list of questions to life settlement companies, life insurance companies, trade associations and regulators seeking information on the size of the settlement market, what information is disclosed to consumers, how life settlements are regulated and how life settlement-backed securities are marketed.

FLORIDA OFFICE OF INSURANCE REGULATION DOCUMENTS RISKS TO SENIORS FROM STOLI

In a first-of-its-kind report, the Florida Office of Insurance Regulation (FLOIR) outlined the substantial economic and legal risks facing seniors induced into participating in STOLI schemes.

Drawing on expert testimony, state statutes and ongoing litigation, the report documents how seniors can face unexpected taxes, allegations of insurance fraud and loss of insurance capacity if they participate in STOLI deals. Moreover, the report notes that when STOLI transactions unravel, seniors may even face legal claims from the STOLI promoters who lured them into the schemes in the first place.

The report—*Stranger-Originated Life Insurance (“STOLI”) and the Use of Fraudulent Activity to Circumvent the Intent of Florida’s Insurable Interest Law*—is available on FLOIR’s web site at <http://www.floir.com/pdf/STOLIpt012009.pdf>.

“Florida is a unique state with over 17.6% of its population over the age of 65 years. From 1990 to 2000, the number of seniors residing in the state increased by 438,000, or 18.5%. It is imperative that the State act to protect its seniors and all Floridians from becoming victims of fraudulent STOLI transactions,” the report says.

“The Florida Office of Insurance Regulation deserves the appreciation of seniors across the nation, not just in Florida, for its thorough and compelling report on the growing scandal of STOLI and the terrible toll it can exact on our

most vulnerable fellow citizens. We hope legislators in every jurisdiction will read the report and answer its urgent warning to enact strong and effective anti-STOLI laws now,” said ACLI’s Frank Keating.

“The FLOIR report is a clear indictment of STOLI and the threat it poses to our senior citizens. As the report notes, the victims of STOLI schemes go far beyond those seniors induced to participate. The entire senior market could be at risk if life insurance rates increase. It would be a travesty if seniors who need life insurance for financial protection ended up paying the price so hedge fund investors can reap unseemly profits,” said NAIFA President Cliff F. Wilson, CLU, ChFC, LUTCF, CLF.

The report notes that while STOLI may appear to be a “victimless” crime, seniors face many risks:

- Seniors may exhaust their life insurance purchasing capacity and not be able to protect their own family or business.
- The incentives, especially cash payments, used to lure seniors to participate in STOLI schemes are taxable as ordinary income.
- Seniors may subject themselves or their estates to potential liability in the event the life insurance policy is rescinded by an insurer who discovers fraud.
- Seniors may encounter unexpected tax liability from the sale of the life insurance policy.
- The “free” insurance is not free and may be subject to tax based on the economic value of the coverage.
- Seniors have to give the purchaser, and subsequent purchasers, access to their medical records when they sell their life insurance policy in the secondary market so that investors know the health status of the insured. The investors want to know the “status” of their investment and how close they are to getting paid.

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TIMELINE

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MEDIA

Port Clinton (OH) News-Herald publishes warning about STOLI entitled “Seniors—Watch out for life insurance scams.”

Capitol Weekly (Sacramento, CA)

publishes article entitled “Little-known insurance practice targets elderly.” Article cites difficulty of estimating size of STOLI market because of a lack of data and the fact that these transactions are not regulated.

Columbus Dispatch

publishes article on Ohio’s anti-STOLI law entitled “Rules target insurance scam: Elderly getting paid to buy a life policy, then assign benefits.”

The report traces the history of insurable interests and the public policy against using life insurance solely as a vehicle for wagering on human life. It also clearly distinguishes between STOLI and legitimate viatical and life settlements. The key difference between STOLI and life settlements is whether the policy was purchased in good faith with a true insurable interest present at the outset, the report notes.

Also important, the report cites the definition of STOLI from the model law developed by the National Conference of Insurance Legislators (NCOIL). NCOIL's model defines STOLI as a "practice or plan to initiate or originate a life insurance policy" for the benefit of investors. The report goes on to say:

"STOLI is a scheme designed to procure life insurance policies on individuals, often using fraudulent means such as lying, misrepresentation or omission of material facts on the application, which may include misrepresentation of the true net worth of the proposed insured. Another facet is to encourage the insured to misrepresent the insurable interest of the intended policy owner to obtain a large face-value policy for the benefit of investors. Generally, the scheme involves the recruitment of senior citizens with high-net worth or those willing to misrepresent their net worth."

The NCOIL definition and the subsequent language in the Florida report are keys to understanding how STOLI transactions work. There is an ongoing scheme that begins with the approach to the senior citizen and continues through the transfer of the policy to the investors and ends only when the senior dies and the investors collect their profits. To identify STOLI transactions, insurance regulators and insurance companies must be able to examine the entire range of interactions between the STOLI promoters and their targeted seniors.

The NCOIL definition gives insurance regulators and insurance companies an important tool to identify STOLI. That's why STOLI promoters have tried to gut that definition in every jurisdiction that has considered the NCOIL model. The STOLI promoters want to undermine the NCOIL model by limiting it solely to situations where a **written** agreement to settle the policy existed at the time of application. Under such a limitation, insurance regulators and insurance companies could not examine the course of dealing between the STOLI promoters and the senior to determine whether there was an ongoing scheme, including whether an **oral** agreement to settle the policy existed. For all practical purposes, the change demanded by the STOLI promoters would allow STOLI to proceed unimpeded.

State legislators considering the NCOIL model must maintain the integrity of the definition if the model is to be effective in deterring STOLI.

January 2009

MEDIA

Indianapolis Business Journal publishes case study of alleged STOLI transaction entitled "Suit boosts Hilbert's foul-play fears; Insurer: Outsiders took out \$15M policy on mother-in-law."

February 2009

REGULATION

Florida Office of Insurance Regulation releases major report on STOLI and its impact on seniors and the life insurance marketplace entitled "Stranger-Originated Life Insurance ("STOLI") And the Use of Fraudulent Activity to Circumvent the Intent of Florida's Insurable Interest Law." <http://www.floir.com/pdf/STOLipt012009.pdf>

CONGRESS

Senate Special Committee on Aging prepares for hearing on life insurance settlements, including an examination of STOLI.

STOLI PROMOTERS TRY TO UNDERMINE NCOIL'S EFFORTS TO ENHANCE DETECTION OF STOLI-RELATED APPLICATIONS

A new tool developed by state legislators that can help insurers screen policy applications to detect possible STOLI transactions is under fire by some STOLI promoters.

The tool is contained in the Life Settlements Model Act developed by the National Conference of Insurance Legislators (NCOIL) and is an essential component of NCOIL's anti-STOLI efforts. It would allow life insurers to ask certain questions on policy applications that would help identify STOLI risk. But this basic underwriting activity is now being smeared as "discriminatory" by STOLI promoters.

The NCOIL model, which is supported by leaders in the life settlement industry, would allow life insurers to ask policy applicants such questions as whether they have been asked by a party other than the insurer to undergo a life expectancy evaluation and whether they have discussed life settlements with a third party. Describing these questions as "discriminatory" is a cynical attempt by STOLI promoters to raise unfair suspicions about legitimate, necessary and legally-required underwriting activities.

The essence of insurance underwriting is the evaluation and classification of risks. Life insurers ask questions on policy applications to determine, for example, how certain lifestyle factors (such as smoking) or family issues (such as a history of heart disease) may affect the cost of life insurance. Honest answers to these questions are vital to the underwriting process and to assuring that the premiums charged fairly reflect risk.

Life insurers also need to ask questions concerning the purpose of the coverage. Life insurance is typically purchased to protect against economic loss resulting from the death of a provider or business owner. Absent a legitimate reason for purchasing a policy, life insurance becomes mere speculation.

No credible observer suggests insurance companies should not be allowed to ask questions related to risk on policy applications. Since STOLI is a risk that life insurers must confront, they must be able to use appropriate underwriting tools to screen policy applications for potential STOLI transactions. Asking applicants about whether a third party has raised the issue of life settlements is one such tool, as recognized by NCOIL.

Indeed, state law requires life insurers to evaluate risk to ensure that each policy applicant is charged the right price for the risk presented to the insurer.

Any suggestion that life insurers will automatically reject policy applications where the applicant has discussed a life settlement is totally without merit. As with all information obtained on policy applications, individual companies will factor the applicant's response into their unique underwriting guidelines and their overall evaluations of the application. Companies will differ as to the weight they give this information in the context of the complete record.

Allowing insurers to ask these questions on applications will give them an important tool to screen applications for possible STOLI transactions. That's why STOLI promoters are working so hard to undermine this vital element of the NCOIL model.

Critics of the life insurance industry's efforts to deter STOLI often say that life insurers simply need to do a better job of screening policy applications. Yet when life insurers ask for better tools to accomplish that very goal, these same critics oppose it, even when the tools are contained in the NCOIL model, which most of the life settlement industry helped develop and now supports.

State legislators should ignore the false arguments raised by STOLI promoters and enact effective anti-STOLI legislation as soon as possible.

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.

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