

STOLI ALERT

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WHERE WE STAND

Stranger-originated life insurance (STOLI) in all its manifestations must be deterred. STOLI violates public policies against using life insurance as a vehicle for wagering on human life. It can leave insureds with unknown or undisclosed costs and legal implications. It threatens to undermine the growing legitimate market for life insurance covering senior citizens, STOLI's targeted market.

STOLI transactions can take many forms. Sometimes, speculators induce senior citizens to take out life insurance policies under an expressed or implied agreement that the policy will be sold to the investors after two years—a transaction called a life settlement. In other cases, policies are not settled. Instead, speculators set up trusts as a mechanism to mask the nature of the arrangement and the absence of an insurable interest. However they are structured, STOLI arrangements diminish society by reducing human life to the status of a commodity that can be auctioned off.

While most life insurance companies do their utmost within the limits of the law to screen policy applications for STOLI transactions, it is impossible to catch all or even most of them. The article on page 2, "STOLI or 'SPIN Life,' Hard to Detect," helps explain why. New tools are needed to reinforce public policies against wagering on human life and implement the public policy expressly supported by all participants in this segment of the industry—life insurance companies, agents, settlement brokers, settlement investors and premium finance companies—to prevent STOLI.

In that connection, we strongly support the amendments to the Viatical Settlements Model Act approved in June, 2007 by the National Association of Insurance Commissioners (NAIC). The NAIC's limited five-year moratorium on settlements that have the characteristics of STOLI will significantly reduce the economic incentive for abusive transactions while having no impact on policy owners who purchased their policies legitimately and decide to sell them in the secondary market. The moratorium would not apply to policies purchased with the insured's own money. In addition, the moratorium would

not apply if the policy owner wants to sell the policy due to a change in life circumstances, such as divorce, illness or the death of the beneficiary.

The NAIC's approach is incremental, in that it only addresses STOLI transactions that involve settlements. The NAIC's Life Insurance and Annuities (A) Committee now appears to be poised to take the next step and consider ways to address non-settlement STOLI transactions. We encourage and support this effort.

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We encourage representatives of the life settlement industry to join us in this effort. It is in the interest of all legitimate participants in the life settlement market to fight STOLI and assure that life insurance is not used as a vehicle for wagering on human life. Already, a spate of news articles has highlighted actual and potential cases of consumer abuses. (For a summary of these articles, please see the September, 2007 edition of *STOLI Alert*.)

These abuses demonstrate the need to take strong measures against STOLI now. As STOLI proliferates, state legislators will face intense questions over what they are doing to address this issue in light of significant evidence of problems in the marketplace. An aggressive, proactive but targeted approach that deters STOLI in all its manifestations will reassure the nation's consumers, especially senior citizens, that their state legislators are alert to the danger and working to protect them.

NCOIL should seize this opportunity to advance its stated objective of deterring all forms of STOLI by approving a model that has teeth and addresses STOLI once and for all.

STRENGTHENED NCOIL MODEL COULD DETER STOLI

The National Conference of Insurance Legislators (NCOIL) can go a long way toward achieving its stated goal of deterring all forms of stranger-originated life insurance (STOLI) by adopting key changes to its draft Life Insurance Settlements Model Act.

The current NCOIL draft, which leaves in place the current two-year state-law moratorium on settlements, would still allow many transactions to go undetected.

“We enthusiastically share NCOIL’s goal of eliminating STOLI once and for all. However, for that goal to be accomplished, NCOIL must strengthen key provisions the draft. Otherwise, we believe STOLI transactions will continue to proliferate,” said a statement from associations including the American Council of Life Insurers (ACLI) and National Association of Insurance and Financial Advisors (NAIFA).

The associations submitted recommended changes to the draft that would advance NCOIL’s objective by:

- Prohibiting contrived or “manufactured” life settlements and other types of STOLI transactions involving the use of trusts and other vehicles;
- Requiring transparency in life settlement provider reporting so that STOLI transactions can be detected and eliminated; and
- Increasing penalties for those who circumvent the law.

“Inclusion of these amendments in the final NCOIL Model is fundamentally important to the Model’s ability to achieve its goals and our organizations’ ability to support it,” the associations said.

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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STOLI OR ‘SPIN LIFE,’ HARD TO DETECT

State lawmakers must act to deter STOLI. Existing insurable interest and anti-fraud laws are insufficient to address these illegitimate transactions. STOLI promoters are adept at creating a paper trail that masks the true nature of the transactions even when insurers meticulously inspect the documentation, say two legal experts.

“The beauty of SPIN Life, from the perspective of investors, is that it appears to be three legitimate activities rolled into one: (1) the sale of an insurance policy, (2) using premium financing, (3) followed by a life settlement transfer,” said Thomas Hetherington and David McDowell of the law firm of Bracewell & Giuliani at a recent life insurance conference. (SPIN Life refers to speculator-initiated life insurance, another term for STOLI.)

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“Assuming SPIN Life promoters comply with all applicable regulations of these three activities, **all of the documentation involved may well appear legitimate.** In these situations, it may be difficult to successfully challenge them solely based on the lack of an insurable interest, as the insurer would have the intensive factual burden of proving that the transfer was a sham perpetrated from the policy’s inception,” they wrote (emphasis added).

Similarly, while misrepresentation of the intended policy owner’s true identity may well be a valid reason for rescinding a policy within the contestability period, prevailing in court is a tough legal challenge, Hetherington and McDowell said.

ACLI and NAIFA believe it is up to state lawmakers to provide the life insurance industry with the tools needed to combat STOLI. NCOIL can advance that objective by approving a Life Insurance Settlements Model Act that is effective and targeted to the problem.