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Hearing on "Life Settlement Industry"  
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Mr. Chairman, Senator Kohl, and members of the committee, I am honored to testify in front of you today on behalf of Life Partners, as this panel examines the life settlement industry. Your Committee has demonstrated a deep commitment to protecting the rights of senior citizens, and it is a privilege to be able to provide our Company's insight on this topic as an industry representative.

For the benefit of the Committee, I will give you a brief background on Life Partners in order to help you understand our specific business model, as it greatly affects my subsequent remarks. Later, I will address some of the issues and concerns that have been appropriately raised by Chairman Kohl, and offer some straightforward recommendations that we feel will protect the private property rights of senior citizens to extract hidden value from their policies while at the same time shielding them from unscrupulous insurance agents who prey upon those who cannot afford to employ financial and legal advisors. It is these senior citizens, our parents and grandparents, who are most at risk and should be of greatest concern to this committee.

Life Partners is the oldest company in the life settlement industry – and the only publically-traded company operating exclusively in that industry. The company was founded in 1991, at a time when government regulations were either nonexistent or extremely ambiguous. From its inception, Life Partners recognized the potential for abuses in the transaction and structured our transaction to be easy to understand and fair to all parties.

Early on, Life Partners took an active role in working with the Texas Department of Insurance to help establish some forward-looking regulations that have helped provide operating guidelines for the industry and establish necessary protections for policy sellers. And, after recognizing the need to provide as much transparency into our business practices and operations as possible, Life Partners became a publically-traded company in 2000, and currently trades on the Nasdaq Global Select market. Our compliance with Securities and Exchange Commission rules regarding financial disclosure has provided all who do business with us with the assurance and comfort that such regulatory oversight provides.

At the outset, let me clarify a few misconceptions about our company's business model. The typical policy presented to Life Partners is a very large face value; typically one to ten million dollars and is owned either by a legal entity such as an insurance trust or by a financially sophisticated individual. In almost every case, these policies are presented to Life Partners and our competitors through a representative of the seller known as a life settlement broker. Often, during the course of the transaction, we also deal with the seller's personal advisors including attorneys, accountants or financial advisors. It is extremely rare for policy holders to approach Life Partners with a policy themselves.

As you will certainly conclude, most senior Americans do not own the types of large face value life insurance policies I am referring to. The policies Life Partners deals with insure the lives of extremely wealthy seniors.

Generally, the characteristics of a policy that is presented to us are:

1. Face value in excess of \$1 million
2. Premiums which are 3 to 6% of face value every year (e.g. for a \$10M policy, the premium could easily be \$400,000 every year)
3. A change in circumstances of the insured or the trust that owns the policy whereby the policy is no longer needed (such as estate tax liquidity issues) or there is a need for liquidity and the sale of the policy is the least objectionable asset to sell in order to provide immediate liquidity until the market for other assets and other financial products improves.
4. Settlement amounts for these policies can be sizeable – ranging from 18 to 25 percent of face value (for example, a \$10MM face value policy might yield a settlement of \$2MM – If the policyowner did not sell the policy, but simply stopped paying premiums and allowed it to lapse, the policyowner would receive nothing and that \$2MM in value would be lost).

Lately, with the economy in a stressed state, especially with the significant turbulence in the private equity markets, it might not surprise you to know that we are seeing an increase in interest for our services. And as the baby boomer-class begins to retire and enjoy the fruits of their labor, they will certainly view life settlements as a valuable financial option – unrelated to the state of the economy or financial markets.

Overall, we believe that the life settlement industry provides substantial benefits to senior Americans. Prior to the establishment of the life settlement industry, policies which are now sold would simply have been abandoned by policyowners and the inherent value in those policies given up as windfall profits to life insurance companies. We ask nothing more from the life insurance industry than for insurers to fulfill the contracts which they freely entered into.

From our vantage point, the life settlement industry provides a private sector solution to a public sector problem: meeting the liquidity needs of senior Americans who have been adversely affected by the current financial crisis. These needs are being met privately, discreetly and in a manner that is beneficial to both the purchaser and the seller of policies. And because of the sophisticated nature of the policyowners in these transactions, it is our opinion that further regulation could have the unintended consequence of limiting options for this class of policy holder. Indeed, the complicated and conflicting state laws which currently regulate these transactions have actually resulted in a demonstrable reduction in the settlement amounts which policyowners receive.

Because we deal with financially sophisticated policyowners, the need for strict regulation as it relates to these policyowners is minimal and should be unified under federal law which clearly preempts the conflicting regulatory schemes of various states. Recent attempts by the life insurance industry to curtail life settlements by influencing regulation or legislation which impedes the insurance consumer's right to sell their personal property is the most pressing issue for the insurance consumer. It is our experience that life insurance companies and their lobbyists attempt to paint a horrible picture of abuses which must be remedied by legislation. Such legislation discourages or impedes the sale of any policy on the secondary market and helps these companies retain their windfall profits by issuing policies, collecting premiums for as long as they can, then encouraging policyowners to simply let the policy lapse. The insurance lobby is extremely well-financed and influential with state legislatures, but it is not looking out for the best interests of senior Americans.

Unfortunately, life insurers persist in prohibiting their agents from even discussing the concept of a life settlement with policyowners. When insurance consumers purchase a policy, the insurance company tells them they are purchasing a valuable asset. However, if they wish to sell the asset, the same insurance company tells them it is valueless and encourages them to discard it. This is unfair and extremely detrimental to life insurance consumers.

Now that I have given you a sense for the business that Life Partners is engaged in, let me address some issues that the Committee is specifically investigating.

**1. The issue of soliciting seniors to purchase policies for later sale.**

We know that there is concern for senior citizens who might be duped by aggressive insurance agents into arrangements in which seniors are paid to purchase a policy with a contemporaneous arrangement to sell it at a future date. This practice has been called "investor initiated life insurance" or "stranger initiated life insurance." However, it really is nothing more than insurance companies promoting the sale of high premium, high face value policies and failing to adequately supervise their

agents. We have never engaged in initiating or promoting the issuance of life insurance, but it is important to note that this is an issue concerning the behavior of insurance agents, NOT life settlement companies. Insurance agents should adequately assess the needs of insurance consumers and answer all application questions truthfully, but it is up to the insurance company to make sure their agents follow these rules. Then, if the insurance company does issue a policy, they do so with the understanding that the U.S. Constitution permits the policyowner to sell that policy at some point in the future. Insurance companies should not be permitted to use their influence with state legislatures to impede that constitutional right for their own pecuniary gain.

**2. Regulation of Life Settlement brokers (and commissions).**

Perhaps one of the most important distinctions relating to effective regulation is recognizing the role of the parties to the transaction. Life Partners is a life settlement provider and is on the buy side of the transaction while life settlement brokers represent policyowners wishing to sell their policies. Understandably, persons who purport to represent the interests of senior Americans selling their policies are in a position of trust with those seniors. I personally drafted language, which has been adopted by many states, which clearly establishes a fiduciary duty of the life settlement broker to the seller he represents, irrespective of the manner of his compensation. In the past, there have been reported instances of some brokers being paid to not mention other more competitive offers to their clients and some brokers conveying an intentionally low offer to the seller, permitting him to make up the difference in an undisclosed higher commission. Now, with the maturity of the life settlement market and the financial sophistication of our clients, these practices appear to have vanished. It is important that the committee understand that life settlement brokers offer valuable advice and services to their clients and they deserve to be compensated for it. Life Partners encourages all policyowners, even those with a team of lawyers and accountants, to enlist the assistance of an experienced life settlement broker. However, because of their unique position of trust with insurance consumers, it stands to reason that uniform federal regulation of life settlement brokers may be appropriate in order to insure the quality of advice and to protect insurance consumers with limited access to third party financial advisors.

**3. State versus federal laws and regulations.**

One of the most highly disputed areas regarding regulation of commerce is the question of whether Congress or the individual states are more suited to issuing laws and regulations which are appropriate and effective to promote commerce and protect seniors. Currently, life settlement transactions are subject to a 'patchwork' of regulations between states that greatly impedes interstate commerce and has been proven to result in a reduction of amounts paid to policyowners. This is neither appropriate nor effective legislation. At its heart, the life settlement industry involves commerce – the sale of private property. Often, this commerce is between residents of different states. In our view, this point should not be the subject of much debate. Article 1, Section 8 of the U.S. Constitution authorizes Congress to regulate commerce among the several states. The burden of complying with a variety of state laws which often conflict with one another does nothing more than raise costs and lower the ultimate value paid to senior Americans.

Of course, state regulators have a role to play with regard to transactions which are intrastate in nature. However, the jurisdiction of state legislatures must end at their borders and state's efforts to extend their jurisdiction outside their borders and regulate interstate commerce must be clearly and completely preempted.

To date, Life Partners holds provider licenses in 12 states (with an application in another pending) and purchases policies from policyowners in states in which a license is not required. When purchasing from a policyowner whose residence is in a state in which a license is not required, we utilize forms mandated by the State of Texas and follow Texas Department of Insurance regulations as if that policyowner was a citizen of the State of Texas. This patchwork of state regulation should be replaced by uniform federal law that protects financially unsophisticated sellers and promotes the private property rights of all insurance consumers.

#### **4. Clarifying tax liabilities that incur as a result of participation in life settlement transactions**

Because we do not represent sellers of policies and are not qualified to provide tax advice, we do not take a position or offer any tax advice other than admonishing the policyowner to consult their tax advisor with regard to any tax consequences arising from the transaction. However, this area is exceptionally murky, even for experienced tax professionals, and we would urge the committee to consider legislation which clearly defines any tax liability for policyowners. In that regard, we

believe that the proceeds from a life settlement should be a capital gain and that the proper measure of whether there is any tax liability should be determined by subtracting the total amount of premiums paid for the policy from inception to the date of sale (the cost basis of the policy) from the amount of proceeds from the sale. If the transaction involves premium financing, the interest associated with the financing should be included in the cost basis, but the capital gain should be calculated on the gross amount of consideration received (whether any was used to pay off existing debt or not) because the policyowner would have constructive receipt of those proceeds and is simply directing that a prior lien be paid off from those proceeds. This treatment is similar in structure to the sale of real estate which has been financed.

**Overall recommendations to Congress for dealing with the life settlement industry:**

- Recognize that the secondary market for life insurance is not “the business of insurance” and should be regulated differently than insurance companies.
  
- Pass legislation which expressly federally preempts the entire field, establishing a uniform set of life settlement regulations at the federal level (at least for interstate transactions). This will promote interstate commerce, reduce uncertainty and provide value to insurance consumers. This concept has already been supported by Chairman Ben Bernake and by Representatives Royce and Bean who are expected to introduce a bill that would create a system of federal regulation of insurers.
  
- Recognize that many of the reported abuses or problems with issuance of policies to unqualified insureds rests with the practices of insurance agents and insurance companies, not with life settlement companies.
  
- Recognize that strict regulation may not be appropriate or necessary for accredited and sophisticated insurance consumers and establish an appropriate regulatory construct that recognizes a distinction between ordinary insurance consumers and sophisticated insurance consumers.

Mr. Chairman, Senator Kohl and members of the Committee, it has been a privilege to offer our company’s perspective on the life settlement industry. Life Partners has a firm commitment to helping protect the private property rights of insurance consumers as well as

providing access to a reliable, asset based alternative investment for our clients. We offer our assistance to work in any capacity the Committee might view as appropriate as it further explores this issue. We appreciate the Committee's consideration of our views as it undertakes important leadership on this issue.

I look forward to your questions.