

BETTING ON DEATH IN THE LIFE SETTLEMENT MARKET: WHAT'S AT STAKE FOR SENIORS?

HEARING

BEFORE THE

SPECIAL COMMITTEE ON AGING UNITED STATES SENATE

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

WASHINGTON, DC

APRIL 29, 2009

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BETTING ON DEATH IN THE LIFE SETTLEMENT MARKET: WHAT'S AT STAKE FOR SENIORS?

WEDNESDAY, APRIL 29, 2009

U.S. SENATE,
SPECIAL COMMITTEE ON AGING,
Washington, DC.

The Committee met, pursuant to notice, at 2:09 p.m. in room SD-106, Dirksen Senate Office Building, Hon. Herb Kohl (chairman of the committee) presiding.

Present: Senators Kohl [presiding], Udall, and Martinez.

OPENING STATEMENT OF SENATOR HERB KOHL, CHAIRMAN

The CHAIRMAN. Good afternoon to everybody, and thank you very much for coming to this hearing this afternoon.

In today's tough economic climate, millions of seniors have lost a big part of their retirement and investments in only a matter of months. Unlike younger Americans, they do not have time to wait for the markets to rebound in order to recoup a lifetime of savings.

For many, this means postponing retirement, or even returning to work in a difficult employment market, often staked against older workers. Needless to say, seniors are looking for ways to bolster their sagging savings.

Often they find that the most valuable asset they can afford to part with is their life insurance policy, which can have substantial cash value. New alternatives have become available for those who no longer have a need for their life insurance policy.

One of them is the life settlement business, a burgeoning, multi-billion dollar industry that has exploded in recent years. Life settlements can be a worthy alternative for seniors who are considering the sale of their life insurance policy, and offer a higher payment in the cash surrender value offered by the insurance company.

Today, we're here to inform seniors that selling one's life insurance policy is a complex transaction that can be filled with hidden pitfalls.

Over the last 9 months, Committee staff interviewed many honest and competent players in this industry. But as with any industry that balloons over a short period of time, there are sales practices and regulatory loopholes that need to be examined in the interest of seniors and consumers, at large.

Several State regulators are here to talk about the sales and marketing abuses that they have seen at the hands of life settlement brokers, who—in some cases—received huge commissions.

Many States, including my own State of Wisconsin, are working to implement legislation, or State regulations that would institute consumer safeguards. Initiatives include a requirement that brokers be licensed to sell life settlements, the establishment of guidelines for sales, marketing and promotional materials, and the mandatory disclosure of certain risks.

For example, most seniors do not know that when they sell their policy, their health records can be passed off to multiple third parties as their policy is resold, time and again.

Most seniors are also unaware of what their tax liabilities are, or that they may be uninsurable in the future. Furthermore, most seniors may not know that they are participating in insurance fraud if they purchase life insurance with the intent of flipping it for a life settlement.

Known as “stranger-originated life insurance,” or STOLI, such scams have led to a spike in litigation since 2005. In Florida alone, insurers have filed three multi-million dollar Federal lawsuits in the past year, alleging that the true nature of the life insurance transactions were misrepresented.

We’ll also examine how life settlements are being bundled, and sometimes used as risky investments by some of America’s largest investment companies.

We’ll hear about the risks associated with purchasing investments backed by life settlements, and explain why they are not generally considered suitable for non-institutional investors.

As States struggle to increase regulations and consumer protections, it’s crucial that the Federal role is made clear. I’ve sent a letter to the IRS, asking them to clarify the Tax Code with respect to life settlements, as the current lack of guidance may be creating loopholes. In a reply, Treasury Secretary Geigner stated that the Agency will soon publish tax guidance for people who sell their policies, and the investors who purchase them.

We’ve also asked the Securities and Exchange Commission to state its position on whether life settlement investments should be considered securities, as most State regulators are treating them. Mary Shapiro, Chairman of the SEC, responded last night and clarified the SEC’s jurisdiction over most aspects of life settlement transactions. She also assured us that they will look into the regulation of life investment brokers.

Finally, we’ve asked the Government Accountability Office to study the current size and scope of the life settlement market, and take a look at related consumer issues, as it’s clear that the industry is in need of more transparency and regulation, and we may be introducing legislation to address this issue.

We thank you once again for being here today, we thank our witnesses for being here today. We now turn to Ranking Member Mel Martinez, for his opening statement.

STATEMENT OF SENATOR MEL MARTINEZ, RANKING MEMBER

Senator MARTINEZ. Chairman, thank you very much, and thank you for calling this very, very important and timely hearing.

In today's turbulent economic environment, we want to preserve and protect seniors' assets and their liquidity options, as well.

We also want to ensure that primary and secondary financial markets are safe, transparent, efficiently regulated, and inspire investor confidence.

I'd like to thank our panelists for joining us today to discuss issues impacting those contemplating a transaction involving life settlement firms. I'm also looking forward to hearing what States are doing to bolster investor protection in the wake of several life settlement firms being exposed as fraud schemes.

It is my hope that we can bring greater attention to matters regulated by the States, to ensure both investor, and consumer, protection.

We'll also hear today from two firms engaged in the business of life settlements, and what they envision for their future, and the future of their industry. Speaking of what steps Congress, the States and regulators can contemplate to ensure consumers are fully appraised of their rights, and their obligations under such transactions.

Also important to this committee is a complete discharge of fiduciary duties on the part of brokers and providers.

Seniors should have comfort that they're receiving the best value for their assets, and this opaque life settlement market. They also deserve full accountability and transparency when engaging in these types of transactions, and we will be monitoring practices as we go forward.

Businesses practices, such as stranger-originated life insurance policies—or STOLIs, as mentioned by the Chairman—in my view are contrary to the fundamental precepts of the insurance market, and we would appreciate more on how to prevent these types of transactions.

We also need to learn the real-world task practices surrounding these life settlement transactions, including the gains on sale, the taxability of the death benefits, and the fair and equitable treatment of all tax filers.

Mr. Chairman, I want to ensure that those with a tax liability as a result of one of these transactions, No. 1, pays all of the taxes that they owe, and No. 2, that they be treated consistently, without regard to who prepared their return. In other words, I'd like to see a strong guidance from the IRS, and appropriate clarification, so that there is no ambiguities as to who owes what at what time.

I look forward to learning more from today's witnesses, and thank them all for appearing here with us today. Thank you.

The CHAIRMAN. Thank you, Senator Martinez.

We'd like now to introduce the members of our panel.

Our first witness on the first panel today will be Stephan Leimberg, CEO of Leimberg Information Services, which does provide analysis and commentary for financial services professionals. He is also CEO of an estate and financial planning software company. Mr. Leimberg has written and lectured extensively on the

topic of life settlements, premium financing, and stranger-owned life insurance.

Welcome.

Our next witness will be Mary Beth Senkewicz, the Deputy Commissioner of Life and Health of Florida's Office of Insurance Regulation. Ms. Senkewicz formerly served as Senior Health Policy Counsel, and Legislative Advisor to the National Association of Insurance Commissioners for over 11 years. She received her law degree from St. John's University in New York City.

Next we'll be hearing from Michael McRaith, the Illinois Director of Insurance. Mr. McRaith has led several high-profile insurance fraud investigations for the State of Illinois. He belongs to the National Association of Insurance Commissioners Senior Issues Task Force, and has testified before numerous Congressional committees on insurance-related topics, including marketing and sales abuses by Medicare Advantage, and prescription drug plans.

Finally, we'll be hearing—on the first panel—from Fred Joseph, the Securities Commissioner for the State of Colorado. Mr. Joseph oversees the regulatory agency that licenses stock brokers, brokerage firms, and investment advisors in Colorado. He's also President of the North American Securities Administrators Association, whose mission is to protect consumers who purchase securities, or investment advice.

So, we welcome you all here today and we'd be delighted to take your testimony at this time.

Mr. Leimberg.

STATEMENT OF STEPHAN LEIMBERG, CEO, LEIMBERG INFORMATION SERVICES, INC., BRYN MAWR, PA AND AMELIA ISLAND, FL

Mr. LEIMBERG. Legitimate, appropriate life settlements can benefit seniors. But I've been asked to discuss abuses. Here are six.

First, no State requires a holdfold analysis. There's no mandatory testing to see if a seller should "hold"—that is, keep, or "fold"—that is, sell a policy. Without analysis, existing life insurance may be stripped away from a family when it should be kept.

Second, rogue brokers, unscrupulous settlement companies rig bidding on policies. Sellers are cheated.

Third, few States have modern settlement laws—it's patchwork. Laws aren't close to being uniform. So, rogue brokers change the legal location of a transaction to avoid a tough State's laws. They move it to a lesser-regulated State, or to one with no law. Forty-two percent of all 2008 settlements were in States with no settlement law.

Fourth, disclosure. State regulators don't have authority to require needed information on settlement companies' ownership, operations, conduct, security, and any fraud procedures. Regulators have even been sued by big settlement companies who bully them from obtaining information essential to protecting seniors.

Fifth, no State—let me repeat—no State specifically restricts who can buy an existing policy on a senior's life. Once it's sold, you have no say, no veto. There are no limits on how many times a policy can be resold, or to whom. You'll never know who will own the policy on your life. No State has a staff that monitors buyers. So,

you'll never be sure that the contract on your life will not end up in the wrong hands.

Sixth, stranger-originated life insurance—STOLI. STOLI is a bet by strangers, a wager on how soon someone will die. Strangers can't legally buy insurance on a person's life, so like a teenager who finds and pays a homeless person to buy liquor, speculators line up, pay, and co-op seniors into lies and misrepresentations. The intent? Trick insurers into thinking the insurance is for the senior's family.

STOLI has already resulted in higher rates, stopped some insurers from issuing policies to seniors at all, and encourage seniors to aid and abet fraud. Unsavory settlement companies, more clever than ethical, enable STOLI by lobbying legislators to water down laws. Loopholes are inserted on the cynical pretense of defending property rights. Whose property rights? The very people co-opted into committing fraud to get the policy.

What's needed? No. 1, make a holdfold analysis mandatory. Require brokers to explain the advantages of keeping insurance. Require them to show sellers how much insurance is still needed. How can you make an informed decision that existing insurance is not needed, and should be sold, if no analysis has been performed? Require brokers to explain, in writing, alternatives to a sale.

Second, demand transparency. Require brokers to disclose all offers, require them to shop and show spreadsheet offers from potential buyers. Sellers should be shown who was offered their policy—let them see for themselves if the policy was shopped competitively. Provide sellers a written statement, not only of what they net, but what the other parties get, so they can know if they're being taken advantage of. Require settlement companies to provide more information to regulators, not less.

Third, forbid individuals from buying policies. Restrict the types of institutions that can buy policies, and monitor them.

Fourth, mandate licensing and rigorous continuing education.

Fifth, enact modern and more uniform settlement laws. Prevent predators from taking transactions to States that let them do whatever they want to do.

Six, give regulators broad examination and investigation powers. Enable them, and empower them, to seek injunctions, cease and desist orders, and impose meaningful fines and criminal fraud penalties.

Seventh, stop STOLI. Use laws such as Iowa's, North Dakota's, the laws that are proposed in Oregon.

My conclusion: insightful, effective law can't wait. Why not? Because what is at stake is not merely a senior's money. You can not—you must not—forget, we're talking about a wager, a bet on a human's life. The sooner the insured dies, the greater the investor's profits. If it is your responsibility to develop, monitor, and enforce settlement laws, remember a senior's life is, literally, in your hands.

[The prepared statement of Mr. Leimberg follows:]

Testimony of
Stephan R. Leimberg, Esq.
CEO, Leimberg Information Services, Inc. (LISI)
Creator/Editor: Tools and Techniques of Life Settlement Planning*

U.S. Senate Special Committee on Aging
April 20, 2009

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LIFE SETTLEMENTS DEFINED:

*According to the book, **Tools and Techniques of Life Settlement Planning** (National Underwriter Company),*

"a life settlement is the transfer of a life insurance policy in exchange for a consideration which is greater than the policy's cash surrender value. Policies are purchased from individual policy owners (individuals, trusts, for-profit entities, and tax exempt entities) either directly or through insurance agents and brokers and are typically sold to investment institutions or pension funds."

WHY LIFE SETTLEMENTS ARE BENEFICIAL TO SENIORS

Owners of life insurance now have an organized secondary market for their life insurance. A life settlement provides a senior with a source of cash and an alternative to a lapse, surrender, or exchange of a life insurance policy. With the advent of a robust and growing life settlement market, a senior's options and opportunities for fully utilizing the property values of a life insurance policy have grown significantly, making life insurance an even more valuable and unique asset.

Specific instances of the benefits of this market to sell life insurance include (1) relief from premium payments, (2) liquidity to fund pressing needs such as massive uninsured medical or unexpected retirement expenses.

Instances of where a senior should *consider* a life settlement include:

- A senior determines, after being *shown*, through an objective and professional “needs analysis,” that he/she no longer *needs* life insurance coverage to provide food, clothing, shelter, pay debts, or assure a given standard of living or education for dependent loved ones,
- A senior determines, *after* projecting reasonable growth in his/her estate to life expectancy, that the estate will not need life insurance to pay federal or state death taxes or other estate-related expenses,
- The senior’s beneficiaries are financially independent adults who have no need for the policy proceeds (or the senior has survived them),
- The senior truly can not (even *after* examining all viable alternatives) afford coverage and – absent a life settlement – would *have* to lapse or surrender the policy.
- Senior has a need for insurance coverage but is economically and tax-wise better off by selling a currently owned policy and applying the net proceeds to the purchase of a new contract.

RISKS TO SENIORS POSED BY LIFE SETTLEMENTS

The life settlement transaction is highly complex, legalistic, and largely opaque. Although *all* financial transactions (even balancing a checkbook) pose some legal and financial risks and challenges to elderly (and many even *not* so elderly) consumers, the problems presented by life settlements are *particularly* acute with respect to seniors. Some of the reasons include:

- The prime candidates for life settlements are, by definition (mainly 70 to 85) slowing down mentally – and some may be on the edge of becoming mentally incompetent. (Of course, many of the folks in this age range are very bright and very sophisticated – and *very* mentally

and emotionally healthy – but even *they* at some point “slow down”). So at least *some* of the senior population will be relatively easily subjected to predatory behavior.

- The typical attorney or CPA or even professional financial advisor
 - is largely ignorant as to how life settlements work,
 - will probably *not* know how to do (or check) a “needs” or “hold-fold” (keep the policy or sell it) analysis, how to oversee the “shopping for the best price” process, or how to be sure the terms of the life settlement are optimal from the client’s viewpoint, and that the client’s exposure to abuse is minimized.

So competent third party advice on and oversight of the life settlement process is difficult – if not impossible to find – even in major cities.

- Many retired individuals in their mid ‘60s to mid-‘80s (and I’m a good example) have moved to a location far from their “tried and true” professional support system (e.g. most of my neighbors here in Amelia Island, Florida have moved from large northeast cities to a very small town – where there are *very few* (if any) competent professional advisors on this topic). Again, competent, professional, third party advice and oversight is almost impossible to obtain.
- Seniors have no formal (or even informal) education or experience in how the life settlement process works (compare this with the purchase of life insurance that’s been around a long time – most seniors have made multiple purchases and have experienced two, three, or even four agents – and have some idea how things work, what they can expect, and who they can trust). Adult Education courses in financial planning regularly cover life insurance purchases but few cover life settlements. Few seniors can get competent advice from friends.
- The current state of the economy in general, media portrayal of darker times ahead, and the *real* plight and dire straits of many seniors have encouraged a state of emotional distress about the adequacy of cash flow and retirement security. This can easily lead to panic sales of *needed* life insurance coverage.

- Seniors can't find much *objective* and thorough information on life settlements. Most of the information that is available has been written to encourage the *sale* of life insurance and almost no brokers or agents perform a "needs" (do I need this coverage?) - "hold-fold" (should I keep this policy or should I sell it?) analysis for their clients.
- Even *with* consumer education – a senior will find it extremely difficult to unilaterally determine: (a) the *value* of an insurance policy (b) if he or she *should* be selling it, (c) if he/she is getting a good *deal*, (d) if he/she is well and properly *represented*, or (e) he/she is being obtaining the *best possible price* and the best possible *terms*.
- The life settlement market is not transparent – people can't go to the internet and search for the best price for their insurance. So they are totally dependant on the agent/broker to adequately and honestly "shop" the policy – *after* he/she determines – in a professional and objective manner - that selling it *is* appropriate.
- So of course, there are and will continue to be legal and financial risks – even if the life settlement industry *was* mature – which it is *not*. (One reason – as well as indicator of the state of maturity of the industry – is the dearth of solid and tested and relatively *uniform* state law. In fact, there are many (about 40% of all) states with NO or antiquated life settlement law – and many other states with weak and inadequate life settlement law.)
- There is a significant economic and knowledge "power imbalance" between the life settlement company and the seller; the settlement company is very well funded and is dictating the terms and conditions of the transaction. The seller may be forced by economic conditions to sell and it is highly likely that he/she has never engaged in a life settlement before. So the bargaining power is very one-sided.
- There is one *other* risk that makes a life settlement unique and distinguishes it from all other financial instruments – and makes the decision to engage in a life settlement a much more than merely financial decision. It is admittedly a slight risk, perhaps a very slight risk. But it is a *real* risk, one that can not be avoided and *must* not be ignored. A life settlement is nothing less than a transaction dealing

with (by definition) a large (typically \$1,000,000 or more) contract on a *human life* – that upon consummation – will be owned by and payable to - strangers. Those strangers are speculating on how *soon* the insured under the contract will die. Investors have no interest whatsoever in the insured's continuing to live. Nor will the senior selling life insurance know the identity of or have any say as to *who* the future owners of that insurance on his life will be – or how many *times* the policy on his/her life will be re-sold. The psychological aspects of these facts must not be underestimated by the senior – ***nor can those responsible for developing, monitoring, and enforcing laws ever forget that the subject of a life settlement is a contract on a human life. An exceptionally strong duty exists to protect the safety and assure the welfare of seniors where no less than a person's life is at stake.***

SPECIFIC ABUSES AND CHALLENGES THAT MUST BE ADDRESSED

There are many honest and highly professional individuals and companies in the life settlement community. Unfortunately, there have already been and will *continue* to be (as is the case with *any* sophisticated financial tool or technique) people and their companies in the life settlement market more clever than ethical – those able and willing to abuse seniors for monetary gain. (***"The history of this industry has been problematic."*** Commissioner Kevin McCarty, Florida Office of Insurance Regulation.)

Predators in the life settlement market have the motive, means, and, if left unchecked by legislators and regulators and by their own community, the opportunity to take advantage of seniors. This is especially true if the leaders of the life settlement industry choose to resist rather than embrace legislative reform.

Some of the potential abuses listed below are blatant and once uncovered are obvious. Other potential abuses or challenges are acts of omission, fiduciary duties that should – but that are not – being met, and potential problems inherent in the widely varying nature of regulation from state to state which too easily allows wrong-doers the use of state laws where no or minimal regulation exists.

Many states remain unregulated and the ones that are regulated vary (in some cases considerably) with respect to “what” and “how” they regulate.

- Few life settlement brokers perform a “hold-fold” analysis prior to a sale. No state presently *requires* one. The single greatest abuse in life settlement planning today – aside from Stranger Originated Life Insurance (STOLI) discussed below - is a failure to perform this analysis. Without it, a senior’s irreplaceable protection of *existing* life insurance may be stripped away from his or her family or business - *when* it should appropriately remain in place to serve its intended purpose. Without such an analysis, the consumer can not obtain the information needed to make an informed and intelligent decision.
- There has been - and continues to be - pricing that is not truly based strictly on competitive bidding forces and is therefore *not* in the senior consumer’s best interest. (In some documented cases *brokers* were being paid more from the transactions than the *sellers* of the policies).
- There have been sales of policies where one or more of the parties involved was not state-licensed (and therefore in violation of state regulatory law – if there *was* any). Consider the implications if, for any reason, there is no governmental authority or protective law to which a wronged individual can turn to.
- There have been invasions of privacy and harassment through contacts with excessively invasive “tracking terms” that allow a check to see if the insured is still living. Ideally, once each quarter should be sufficient.
- All too many states do not have modern life settlement statutes, many have *no* law whatsoever, and many of those that do have modern laws do not have staff adequate to monitor and enforce them. In some cases brokers have attempted to change the situs of a transaction or ownership of a policy to avoid state law, i.e. to move it from a regulated to an unregulated state. Viatical settlements are complicated transactions that when run through out-of-state trusts deprive consumers of the protections of a state’s laws.

- Regulators typically do not have the authority to require much needed information on life settlement companies, their ownership, operations, and conduct. In some situations state regulators have been sued by life settlement companies in an attempt to prevent the regulators from obtaining information they deemed necessary to protect their state's citizens.
- Few states have laws specifically covering who can be the ultimate purchasers of the policies (it is important to note that, once sold, there are no restrictions in the settlement agreement between seller and original buyer on how many times the policy can be *resold* – or to *whom*). Nor does any state have a staff specifically tasked and sufficiently manned (think Atlantic City's or Las Vegas's Casino Control Commission) to follow-through after the initial sale and continually insure a policy on a senior's life will not fall into "the wrong hands."
- Stranger Originated Life Insurance (STOLI, a/k/a SOLI/a/k/a SPIN-Life) and all its attendant issues exists and continues to be supported and encouraged by some settlement companies. STOLI is the "manufacturing" (typically through insurance fraud) of insurance with the express intent of reselling the coverage to a life settlement company. STOLI has already resulted in higher life insurance rates for seniors, stopped some companies from selling insurance to those over 75, and encouraged otherwise honest citizens to aid and abet insurance fraud.

SUGGESTIONS FOR REDUCING RISKS AND ABUSES

LIFE SETTLEMENT COMMUNITY: The single most effective force of change to prevent abuse and meet the challenges of the future must originate from *within* the life settlement community and its leaders. Its leadership must decide to actively and aggressively encourage country-wide modern life settlement laws, statutes broad enough to realistically and honestly and effectively meet the problems discussed above and with enough stringent enforcement provisions to assure compliance. It must also institute and insist on compliance with industry-wide ethical guidelines that assure (1) abuses are minimized among its members and (2) that the challenges

described above are met and (3) the “best practices” suggested below are implemented.

LEGISLATORS AND REGULATORS: Legislators and regulators must consider the following:

- **MAKE A “HOLD-FOLD” SUITABILITY ANALYSIS**

MANDATORY: *Suitability* testing is essential. It should be *mandatory* – prior to a sale of a policy – for the life settlement broker to explain and illustrate the pros *and* cons of – as well as non-life settlement *alternatives* to – a sale of an existing life insurance policy. It should be required that, *prior* to a sale of a policy, the broker ascertain through a written “needs analysis” how much – if any insurance – the client *still* needs. (How can a broker claim a person no longer *needs* the coverage and should *sell* it, i.e. a life settlement is suitable – if no such analysis has been performed?). The broker should also illustrate – in writing - the *costs and downsides* to the *specific* potential seller - of selling an existing policy. Sellers should be informed of (a) transaction risks (investors owning a policy on their lives, (b) tax issues and risks, (c) potential impact on governmental or other benefits, (d) privacy issues, (e) reduction in insurance capacity. (In the life insurance field, many states *require* a replacement analysis before an agent can replace one policy with another. How much *more* important it is to do the same type of analysis if a person’s family/business is to be left with *no* life insurance at all or much *less* coverage?). The original copy of the suitability analysis should be given to the client and a seller-signed copy of the hold-fold analysis should be required to be held by the broker for inspection by the appropriate monitoring authorities. (See Ohio HB 404 Disclosure Requirements for an example).

- **REQUIRE BROKERS TO “SHOP AND SHOW”:** Transparency is essential. Brokers should be required to disclose *all* gross offers from providers and to “shop and “show”, i.e. to “spreadsheet” prices of at least three or four different potential buyers – and give prospective *sellers* a written statement of not only what *they* will be paid – both gross and more importantly - *net* – but also what the *other* parties involved in the sale receive (Dollar amount of compensation and method). Potential sellers should know who was shown their information and be able to see for themselves if the policy was

shopped competitively. Brokers should be required to keep these comparisons for review by the appropriate regulating body for at least three years. (See FINRA NTM 06-38 – Rule 2320 for example).

- **REQUIRE INFORMATION SO REGULATORS CAN MONITOR BOTH LIFE SETTLEMENT COMPANIES AND LIFE SETTLEMENT PROCESSES.** Life settlement companies should be providing *more* rather than less information to regulators. Being able to look at a company's business records will help regulators get a better picture of a company's *overall* business practices. Specifically, what is needed is disclosure by life settlement companies to a governmental body that has the authority and staff to (1) *demand* good faith responses and the appropriate data (without being unduly onerous and without risking revealing confidential information) and then (2) understand and analyze it to determine if abuses are present. For instance, by knowing how many policies were settled within two, three, four, and five years of purchase, it is possible to monitor STOLI activity. Without such information, it's impossible. (A high percentage of purchases of policies sold within a short period of time after purchase is indicative of "manufactured" policies. Seniors who purchase large policies in their '70s and '80s are buying them for specific needs such as payment of estate taxes or business succession planning and tend to keep them)
- **REQUIRE FORMAL LICENSING AND EDUCATION:** Most states currently require no formal licensing and/or education to sell or be involved in life settlements. No one should be allowed to be involved in life settlement transactions (in *any* state) who has not passed a test proving minimal competency and understanding and ethics training in this field (No state allows the sale of *insurance* by someone who has not passed a similar test) – as well as a criminal background check.) *Much* more agent/broker education, (not only for those who sell and are directly involved in life settlements but *also* for *all* life insurance agents and brokers who need to understand the product/process better so they can advise their clients of the pros and cons of a life settlement vs. various alternatives). For those involved in a life settlement sale, anything less than 15 hours of initial education and a minimum of six or so hours of annual education is insufficient. (NCOIL requires 15 initially and then 15 bi-annually).

An hour of “ethics”/“best practices” discussion each year should be part of this requirement. There should be regular governmental audits of compliance for both licensing and education requirements.

- **ENACT MODERN AND UNIFORM SETTLEMENT LAWS:** More (and more uniform) *modern* life settlement laws are needed – in all states and/or at a federal level to prevent predators from taking transactions to jurisdictions that let them do whatever they please.
- **REQUIRE TRANSPARENCY IN FUNDING.** Transparency of funding source should be mandatory. The seller should be told the identity of the *actual* owner of policy (rather than merely the provider they sell to). Sellers be *notified* and told the identity of the new owner each time the policy changes hands, has become part of a portfolio securitization, or becomes part of a derivative based index. A senior should have the *right* to know who owns a multi-million dollar policy on his/her life. (If federal law made it clear that the mere process of raising capital for investments in life settlements made them securities, some of these concerns could be minimized.)
- **PROVIDE A MANDATORY RESCISSION (“FREE LOOK” “SELLER’S REMORSE”) PERIOD.** Assure that seniors in all states would have a reasonable time (at least 15 days) to back out of a sale of a policy.
- **ESTABLISH GUIDELINES FOR SALES, MARKETING, AND PROMOTIONAL MATERIALS.** Specifically set out what is or is not permissible in public communications.
- **ENACT MEANINGFUL PENALTIES FOR VIOLATIONS:** Appropriate governing bodies must have powers of examination and investigation. Clear and effective (perceived as more than “a mere cost of doing business”) penalties for violations of life settlement laws must be enacted. Invest the appropriate regulators with the power to seek injunctions/cease and desist orders and impose meaningful fines as well as – where appropriate - criminal penalties.

- **STOP STOLI.** Use hybrid NAIC/NCOIL laws such as those enacted in North Dakota or Iowa. Examine Minnesota proposals as well.

CONCLUSION:

Insightful, effective nationwide law can't wait because what is at stake *here* is not merely a senior's *money*.

~~The one thing you can not must not forget is this:~~

~~At its heart a life settlement is a wager a bet on a human's life.~~

~~The sooner the insured dies the greater the investors' profits!~~

~~This must inform all your thinking on legislation.~~

~~So if it is your responsibility to develop, monitor, and enforce settlement laws, remember a senior's life is literally in your hands!~~

* My appreciation to Larry Rybka, CEO of Valmark Securities, Caleb Callahan, Director of Insurance Services & Life Settlements at Valmark Securities, and James Magner, Massachusetts attorney. All three are co-authors of Tools and Techniques of Life Settlement Planning.

The CHAIRMAN. Thank you.
Ms. Senkewicz.

STATEMENT OF MARY BETH SENKEWICZ, DEPUTY COMMISSIONER, LIFE AND HEALTH INSURANCE, FLORIDA OFFICE OF INSURANCE REGULATION, TALLAHASSEE, FL

Ms. SENKEWICZ. Thank you, Mr. Chairman. Good afternoon, and good afternoon Ranking Member Martinez, from the great State of Florida.

My name is Mary Beth Senkewicz, I am the Deputy Insurance Commissioner for the Florida Office of Insurance Regulation, and on behalf of Commission Kevin McCarty and myself, I would like to thank you for inviting me to discuss the life settlement industry.

To begin with, there is nothing inherently wrong with life settlements in and of themselves. It is well-settled law that insureds have a legitimate property right in their properly obtained life insurance.

In fact, the industry began with a noble purpose. The first phase of these products began in the 1980's and were marketed to AIDS patients who needed cash to defray medical expenses, and gain access to life-prolonging drugs. The problem now is the lack of transparency associated with these transactions.

For example, in Florida, the industry opposed a proposal that would require a disclosure of all fees, including commissions associated with the transaction. Another general problem is that persons wanting to sell their policies have no easy way of knowing if they are getting the best deal they can.

Our office has expended a tremendous amount of resources regulating this industry. To put it into perspective, Florida has issued licenses to 24 entities, which is now only 14 entities, due to revocations and surrendered licenses.

Since 1996, the industry has incurred 18 different legal orders, 2 administrative complaints, and 11 examinations or investigations resulting in additional consent orders, all with accompanying fines and costs of \$1.95 million. This is especially egregious when considering this industry represents only 14 of the 3,900 entities regulated by our office. Every time we try to insert some transparency into the system, such as the bill we proposed for the 2009 legislation to consider, the industry fights us. We have also been sued several times when we try to enhance transparency by rule.

Coventry First, LLC is a leader in this industry. After the State of New York sued Coventry, accusing the company of bid-rigging and other fraud in acquiring more than \$3.6 billion worth of life insurance policies, we conducted our own investigation.

We then issued a Notice and Order to Show Cause, alleging violations of the Florida insurance code, including using fraudulent and dishonest practices, transacting business in bad faith, and employing individuals shown to be untrustworthy or dishonest.

Coventry denied the allegations, but ultimately entered into a consent order agreeing to pay \$1.5 million. Thereafter, the Office notified Coventry of a follow-up examination. Coventry moved for a preliminary injunction in Federal district court, arguing that our office does not have the authority to examine its policies that relate to violators who reside outside of Florida.

On March 31, 2009, the Federal Court ruled in our favor, explicitly recognizing the State of Florida's rights to examine all of Coventry's books and records in order to evaluate its business practices as a whole. Coventry has appealed that decision.

The newest development is called stranger-originated life insurance, or STOLIs. These transactions involve private investors soliciting elderly persons before they purchase a life insurance product. These promoters entice seniors to buy life insurance they might not otherwise have purchased. The motivation for seniors is not to access funds, but to profit on their ability to buy life insurance.

But these transactions may harm seniors—they may exhaust their life insurance purchasing capability, and the cash payments for selling their policy might subject them to an unexpected tax liability. Seniors may also have to give the investor, and subsequent investors down the line, access to their confidential medical records.

In conclusion, generally speaking, the life settlement industry needs far more transparency than it currently possesses. In particular, STOLIs provide little public benefit, or satisfy any legitimate financial need in the marketplace. These transactions exist solely to manufacture life insurance policies for profit. Those transactions can expose seniors to potential tax liabilities, policy rescissions, and traumatic litigation. These transactions subvert the original purpose of life insurance.

Thank you.

[The prepared statement of Ms. Senkewicz follows:]

Testimony of

**Mary Beth Senkewicz
Deputy Insurance Commissioner
Florida Office of Insurance Regulation**

**Life Settlements
and the Need for Regulatory Transparency**

**Before the
Senate Special Committee on Aging**

April 29, 2009

Good afternoon Chairman Kohl and Ranking Member Martinez. My name is Mary Beth Senkewicz, and I am the Deputy Insurance Commissioner of the Florida Office of Insurance Regulation responsible for the oversight of life and health products sold in our state. On behalf of Florida Insurance Commissioner Kevin M. McCarty and myself, I would like to thank you for inviting me here today to discuss the evolution of life settlements, and to give the Committee insight into Florida's regulatory experience with this industry.

Having one of the most elderly populations in the United States, Florida has been at the forefront of attempts to adequately regulate these products, first called "viatical settlements." Like other states, our state is struggling to understand the implications of developments in this market which include the emergence of life settlement contracts, and a related transaction – Stranger-Originated Life Insurance or STOLIs. The difficulties in regulating these complicated products have been compounded by the industry's lack of cooperation, administrative delays, and litigation.

I have four main points that I would like to make with my testimony today. Firstly, these arrangements are really investment or financial products that are only tangentially related to traditional life insurance. Secondly, we will not be able to make progress in protecting consumers from the negative aspects of these products without transparency to regulators and the public. My third point is the underlying reason investors can profit from life settlements is due to the exemption of life insurance proceeds from federal taxation.

My final point, which is the most important, is that we need to protect traditional life insurance products; this protection includes retaining the tax exempt status of life insurance proceeds to beneficiaries with an insurable interest in the deceased. I am concerned the emergence of life settlements and STOLIs may endanger this tax exempt status, which has historically been used by family members genuinely needing financial relief from the death of a loved one.

Overview of Life Settlements

Before we can commence a discussion of the implication of these products, and the regulatory oversight of these products, we must first begin with a history and definition of life settlement contracts. The basic structure of the transaction is simple: a consumer (often an elderly person) has an in-force life insurance policy. The elderly person “sells” his or her life insurance policy for cash to a third-party investor. The third-party investor becomes the owner (and beneficiary) of the policy and collects the face value of the death benefit (tax free) upon the demise of the insured.

This arrangement does have unseemly connotations, specifically, the third party has no insurable interest in the elderly person; to the contrary, investors have a financial interest in the death of this person. This has been referred to as “wagering” on a person’s life, which was initially against the law in most states. Like most states, Florida has an insurable interest law (Section 627.404, Florida Statutes), that requires the beneficiaries of a life insurance policy to have an “insurable interest” in the insured at the time the policy is purchased. This often includes a spouse, child, or other individual that is financially and emotionally dependent on the ongoing life of the insured.

History of Life Settlements

The first phase of the evolution of these products began in the 1980s. During this decade, the industry focused on obtaining life insurance proceeds for terminally ill insureds. Often marketed as “humane” products that provided terminally ill insureds with access to financial resources prior to their death – these products were often called viaticals. They were frequently marketed to AIDS patients as the mortality rates were very high for people with this disease, and death was relatively certain. Some ill patients sought to sell their life insurance policies to help defray medical expenses and gain access to life-prolonging drugs.

The first consumer oriented problems began during this period as viatical settlement companies acted as an intermediary for sick insureds and investors. Sometimes settlement companies misled investors about the health of the insured, and investors became

frustrated when their “investments” did not die within specified periods of time. Ironically, it was the access to the life insurance proceeds that often allowed insureds to purchase life extending drugs which prolonged their life and made the viatical investments a poor financial investment for speculators.

The industry evolved into its second phase in the 1990s when terminally ill patients were more difficult to identify. The increased availability of the “AIDS cocktail” also altered the medical landscape as new drugs extended the lives of patients. To counter this new development, the viatical industry shifted its focus to purchasing policies for non-terminally ill patients, and repackaged this product as “life settlements.” These were marketed to seniors who wanted access to the value of their life insurance during their lifetimes, but who were not terminally ill. The providers typically offered seniors cash amounts well above the cash surrender amounts offered by life insurance companies.

It is difficult to pin-point the third phase of this industry, but the current phase started sometime during the 21st century. This phase involves private investors or companies (even insurance agents or brokers) who solicit an elderly person *before* they purchase a life insurance product. These promoters entice seniors with inducements to buy life insurance they might not otherwise have purchased. The motivation for seniors was not access to funds, but to obtain “free insurance” and make a profit on their ability to purchase life insurance.

This is a very different scenario, as the purpose of the entire transaction was never intended to be insurance on the life of an insured, but instead, to initiate a life insurance policy for the sole purpose of selling it for cash to investors. To evade insurable interest laws, the insured and private investors often have a side-agreement or contract to “sell” the insurance policy after two years. One reason for the two-year timeframe is that many states have a two-year “contestability” period. After two years have expired, the insurance company is prohibited from rescinding a policy based on fraud.

These arrangements are marketed as “win-win” situations as the insurance company benefits by the sale of the product, the investor makes money upon the death of the insured, and the elderly person is compensated by the private investor. The only way this arrangement can benefit everyone is by taking advantage of a simple fact: life insurance proceeds are exempt from federal taxation. However, there are several hidden costs to seniors which will be discussed later in my testimony.

Regulatory Framework

Even from the beginning, the regulatory framework for this industry has been convoluted. Initially, these transactions were not regulated by any government entity as they were not traditional insurance products. In fact, Florida passed its comprehensive viatical law, Florida’s Viatical Settlement Act, Part X Chapter 626, Florida Statutes, in 1996. Currently, roughly half of the states regulate life settlements. In Florida, our state laws do not directly differentiate between viatical settlements and life settlements, and do not acknowledge the existence of STOLIs associated with life insurance policies.

Florida’s Viatical Settlement Act

The initial purpose of the act was designed to establish a regulatory scheme for the protection of “viators” (policy owners) by requiring the licensing of viatical settlement providers and viatical settlement brokers. The legislation required minimum disclosures affecting the rights of a viator and further provided a 15-day “free look” period that allowed a viator to rescind the transaction.

Due to increasing consumer complaints, in 1999 the Florida Legislature added additional consumer protections and additional disclosures to investors. Viatical/Life Settlement providers were required to inform investors the return on the investment was directly tied to the projected life expectancy of the insured and the investor could be responsible for premium payments should the insured outlive the projected life expectancy. The legislation also prohibited any person from misrepresenting the nature of the return on their investment or the life expectancy of a person with an insurance policy. Furthermore, it strengthened laws governing unfair trade practices.

The pace of regulatory change has also been influenced by developments in the court system. In February 2000, a Statewide Grand Jury was impaneled to investigate the viatical industry. The Grand Jury issued its first report on the viatical industry in Florida and as importantly, issued three indictments charging seven individuals and one corporation with 155 felonies relating to the viatication of life insurance policies. These policies had a face amount of approximately \$12.7 million. The Grand Jury also recommended a number of legislative changes to curtail fraudulent activity.

The Florida Legislature responded in 2001 by enacting most of the Statewide Grand Jury's recommendations. The most important change was to expand regulation explicitly to life settlement arrangements. The legislation also added consumer protections including a rescission period and additional criminal penalties for fraud. The legislation also clarified the state's jurisdiction over viatical settlement purchases with residents of states other than Florida if the company operated from Florida.

The legislative changes in Florida since 2001 have been modest. In 2002, additional requirements were passed for sales agents. In 2003, the current division of regulatory authority among state agencies was established, and in 2005, the Florida Legislature enacted legislation that definitively identified viatical settlement investments as securities subject to the Florida Securities and Investor Protection Act regulated by the Office of Financial Regulation. The new law required persons selling these investments to become licensed securities brokers. In addition, viatical settlement providers were now required to file with the Office audited financial statements on a calendar year basis. In 2007 there was a technical change involving the submission of audited financial statements by viatical settlement providers.

The Emergence of STOLI Arrangements

During the last few years, Florida has witnessed a new development, Stranger-Originated Life Insurance. Unlike life settlements, STOLI promoters actively solicit seniors before they have purchased an insurance policy, and convince them to purchase a policy with

the intent to “sell” their life insurance to an investor. Sometimes STOLI promoters are not officially regulated entities or individuals (agents, brokers, insurance companies), and often arrange to pay the premiums on behalf of the senior. (Premium financing is one indicator of these transactions.)

Some STOLI promoters encourage seniors to overstate their net worth on the life insurance applications to obtain higher-value life insurance. They also coach seniors how to “correctly” answer specific questions on the application to avoid detection by the insurance companies of their intent to re-sell the policy after two years.

To understand recent developments in the marketplace, the Office of Insurance Regulation (the Office) conducted a public hearing on August 28, 2008 and invited testimony from the life insurance industry, life settlement industry, and other professionals knowledgeable in this subject area. The Office issued its report which summarized the issues discussed in the hearing and issued its report in January 2009. A copy of the report including the complete transcript and video of the hearing is available on the Office’s web site at www.florir.com.

During the 2009 legislative session, the Office proposed legislation to address stranger originated life insurance (“STOLI”), which attempted to address several concerns uncovered during the public hearing. The proposed legislation mirrored elements of the NAIC Viatical Settlement Model Act and the NCOIL Life Settlement Model Act. The Office encountered considerable opposition to its regulatory efforts in promulgating new administrative code, as well as in the legislative arena. The proposed legislation will not progress during the current legislative session, and the Office’s bill did not even receive a committee hearing.

Non-Cooperation from the Life Settlement Industry

Currently, there are 14 licensed viatical settlement providers in the State of Florida. Since Florida began its regulation of viatical settlement providers 24 viatical settlement

providers licenses have been issued, four licenses have been revoked and six licenses have been surrendered. Furthermore, five applications for licensure were denied.

Since 1996, the Office has expended a tremendous amount of resources attempting to regulate these viatical settlement providers. The Office has finalized 18 separate orders (includes Orders to Show Cause, Orders to Cease and Desist, Consent Orders and other legal orders), filed two Administrative Complaints, and concluded an 11 investigations or examinations of additional entities which involved assessed fines and costs of \$1.95 million. Even from its inception this “industry” which includes all three phases of viaticals, life settlements, and now STOLI arrangements have not acted as “good corporate citizens.” The industry has consistently attempted to circumvent statutes, and has been vigorous in its opposition of the adoption of new administrative code, and in changing Florida law.

The Office has attempted to use rule making authority to adopt additional regulations to make the industry more transparent. Unfortunately, most regulatory attempts by the Office have been met with litigation. As an example, in 2007 the Office initiated promulgation of Rule 69O-204.101 Disclosure to Viator of Disbursement. The proposed rule required disclosure of payments connected to the transaction, thus making the fees and compensation more transparent to the policy owner. The Life Insurance Settlement Association (LISA) successfully challenged the rule through the administrative process.

The Office attempted again in 2008 by proposing Rule 69O-204.040 – Prohibited Practices and Conflicts of Interest. The rule was designed to ensure the broker maintained its fiduciary responsibility to the viator and prohibit double dealing of affiliated entities in the same transaction. The proposed rule was challenged successfully by Institutional Life Services (Florida), LLC and David Matthew Janeczek.

Despite repeated attempts, the Office has also been unable to formally adopt an Annual Report form. Once again, the industry has challenged the rule through the Florida Division of Administrative Hearings. As of this date, the Division of Administrative

Hearings has not issued a ruling on this challenge. The Office attempted a bill in the Florida Legislature in 2009 to expand the Office's statutory authority, but the industry prevailed in defeating any changes to the statute that would increase transparency to the industry.

Even those entities complying with the law have made attempts to frustrate government regulation. In 2008, six of the viatical settlement providers filing an Annual Report have designated such information as "trade secret," whether that is appropriate or not.

Coventry First LLC

To illustrate the challenges in the marketplace, one should look no further than Coventry First LLC (Coventry), a principal player in the market. On October 27, 2006, the state of New York's Attorney General, Eliot Spitzer, sued Coventry accusing the company of bid-rigging and other types of fraud in acquiring more than \$3.6 billion worth of life insurance policies. Spitzer alleged that Coventry made secret payments to life-settlement brokers in exchange for convincing the elderly and ill to sell their policies at lower prices to Coventry and to entice other buyers to withdraw rival bids.

As a result of these allegations, and subsequent investigation by the Office, on May 10, 2007, a Notice and Order to Show Cause was issued to Coventry alleging violations of the Florida Insurance Code by engaging in fraudulent or dishonest practices, dealing in bad faith with viators and employing individuals who have shown to be untrustworthy or dishonest. The legal documents detailed Coventry's transactions with eight (8) Florida viators. One transaction involved an individual with two (2) life insurance policies with a face value of \$19.4 million who received only \$968,832 of his policy while the brokers involved allegedly were paid over \$1 million. Coventry collected a \$247,707 bonus from the investor for keeping the total cost of the transaction under \$2.5 million.

The matter was resolved on September 28, 2007, by Consent Order, in which Coventry denied violating any provision of Florida law, but agreed to adopt a Business Practice

Enhancement Plan. Coventry agreed to pay the Office \$1.5 million in connection with the Office's investigation and examination, and agreed to a future examination.

As part of the follow-up from this settlement, during 2008 the Office notified Coventry of its intent to conduct an on-site examination of the company. To conduct the examination, the Office asked Coventry to produce specific information pertaining to its settlement business in Florida and nationwide. Unlike other regulated entities in Florida that welcome Office oversight as part of doing business in our state, Coventry responded by filing a Motion for Preliminary Injunction in the United States District Court for the Northern District of Florida, Tallahassee Division.

Coventry argued the Office does not have authority to review, regulate, examine or oversee its policies that relate to policy violators or policyholders who reside outside of Florida.

On March 31, 2009, the Office prevailed on this issue as the Federal Court issued an Order Denying Motion for Preliminary Injunction and Granting Motion to Dismiss. The Court explicitly recognized the state of Florida's rights to examine and investigate Coventry's out-of-state records. The Court concluded that being licensed in Florida is a privilege and "with that privilege comes the responsibility to adhere to the provisions of that act and any evaluations made by the Office regarding the 'personal fitness' of the licensee...This determination of the character of the settlement provider may be ascertained by evaluating the complete picture of Plaintiff and its business practices as a whole, both inside and outside the state of Florida." Coventry is currently appealing the decision in the U.S. Court of Appeals, 11th Circuit.

Although this issue has been resolved (pending an appeal) Coventry also challenged the Office on another issue. Coventry refused to file an Annual Report for the period ending December 31, 2008, as required by Section 626.9913(2), Florida Statutes. Coventry acknowledged the statute required an Annual Report, but argued it should not submit a statement because the form had not been adopted by rule. Coventry filed a Petition

Challenging Agency Statement As Rule with the Florida Division of Administrative Hearings on February 24, 2009, in which it argued the Annual Report form currently utilized by the Office was not currently required by statute or existing rule.

Ironically, one of the reasons the current proposed form for the Annual Report has not been approved, is because it has been challenged by the industry causing delays in the administrative process. Both LISA (the Life Insurance Settlement Association) and Coventry have objected to the submission of information pertaining to non-Florida regulated transactions. While the Office has prevailed on legal issues in conjunction with the viatical/life settlement industry generally and Coventry specifically, the sheer amount of lawsuits and other legal tactics have placed a tremendous strain on Office resources.

To put this into perspective, Florida has issued licenses to 24 entities to offer these products (which is now 14 regulated entities due to revocations and surrendered licenses). Despite the fact this is such a small industry relative to other lines of insurance, the industry has incurred 18 different legal orders, two administrative complaints, and 11 examinations or investigations with additional accompanying consent orders that included assessed fines and costs of \$1.95 million. The expenditure of government resources is especially egregious when considering this industry represents only 14 of the 3,900 regulated entities (or roughly 0.4%) of all entities regulated by the Office in 2008.

The number of viatical or life settlement contracts has expanded substantially as indicated by the following table based on data reported to the Office:

Florida Only			
Year	Number of Purchased Policies	Amount Paid for Purchased Policies (in millions)	Face Value of Purchased Policies (in millions)
1997	595	\$28	\$53
1998	926	\$43	\$113
1999	457	\$15	\$46
2000	226	\$9	\$25
2001	159	\$11	\$51
2002	149	\$30	\$169
2003	177	\$40	\$217
2004*	213	\$64	\$398
2005	263	\$101	\$612
2006	416	\$181	\$933
2007	580	\$289	\$1,423
2008*	529	\$257	\$1,326

** NOTE: The 2004 figures do not include the viatical transactions of Mutual Benefits Corporation. The 2008 figures do not include the viatical transactions of Coventry First LLC.*

Currently, viatical/life settlement transactions in Florida account for roughly one-fourth of the nation's total in terms of purchased policies, and face amount. The table above also shows that the mean face value of viaticated policies in Florida has increased from \$89,000 in 1997 to \$2.5 million in 2008.

These Arrangements Make Seniors the Victims

Florida is a unique state with over 17.6% of its population over the age of 65. From 1990 to 2000 the number of seniors residing in the state increased by 438,000, or 18.5%. While terminally ill patients were initially targeted by viaticals/life settlement providers, this has changed to targeting another group that may soon die – seniors. Although the industry has been fraught with fraud to encourage seniors to obtain life insurance policies for the purpose of selling them to investors, the outward appearance can be seen as victimless transactions. It is characterized as a “win-win” scenario.

However, there is potential harm to seniors for being induced to participate in these transactions. Seniors may exhaust their life insurance purchasing capability should they later want to purchase life insurance for traditional reasons. The incentives in the form of cash payments for selling their policy may subject seniors to an unexpected tax liability. Seniors may also have to give the investor, and subsequent investors, access to their confidential medical records when they sell their life insurance policy in the secondary market. This new strategy to use life insurance as an investment vehicle may also have unintended consequences for the industry including an increase in the cost of life insurance for those over 65.

Potentially the greatest harm to seniors is if the insurance company discovers a STOLI arrangement prior to the two-year contestability period. If insurance companies discover that misrepresentations were made by seniors to obtain a life insurance policy, the insurance companies have the right to rescind the policy, and file a lawsuit against the senior for incurred expenses. In addition, the investor or STOLI provider can also demand the seniors refund life insurance premiums paid on their behalf by investors to keep the insurance policy in force.

Conclusion

The life settlement industry has a checkered history on the whole. It lacks a basic transparency that should be available to consumers who legitimately obtained life insurance policies and want to access the value of their property in their lifetimes. Basic information, such as how much money the agent, broker, and life settlement provider are making on the transaction is not routinely provided. There is no vehicle for a consumer to “shop and compare” and see with what company he or she might get the best deal.

And now we have STOLI arrangements. These arrangements in particular provide little public benefit or satisfy any financial need in the marketplace. Instead these products exist solely for profiting on the tax exempt status of life insurance proceeds. Whatever meager benefits are achieved through this arrangement do not override public policy concerns of wagering on human life, and exposing seniors to potential tax liabilities and

litigation. They should be banned at the federal level, since the industry has been active, and successful, at the state level where states have been trying to clarify that these arrangements are illegal. And further, the federal government has an overriding interest in this issue because it affects national tax policy.

The CHAIRMAN. Thank you, Ms. Senkewicz.
Mr. McRaith.

STATEMENT OF MICHAEL MCRAITH, DIRECTOR, DIVISION OF INSURANCE, ILLINOIS DEPARTMENT OF FINANCIAL AND PROFESSIONAL REGULATION, CHICAGO, IL

Mr. MCRAITH. Chairman Kohl, Ranking Member Martinez, committee staff, thank you for inviting me to testify today. I'm Michael McRaith, Director of Insurance in the State of Illinois, and I speak today in that capacity.

I congratulate this committee and the staff for focusing on the plight of our aging friends and neighbors who may fall prey to abusive life settlement practices. In 2007, Illinois had more than 6.9 million individual life policies in force, and nearly 197,000 group policies, accounting for more than 5 million individual certificates.

For us, the importance of life settlement regulation and transparency can not be overstated. Some argue that life settlement regulation illustrates a pro-insurance industry bias. This is false. It is not one industry versus another, the issue is consumer protection.

To be clear, life settlements can be beneficial to individuals whose circumstances have changed, perhaps through divorce or terminal illness. When evaluating sales and marketing practices, our discussion must account for the retiree who worked hard, raised a family, saved whatever possible, but is not legally or financially sophisticated.

With postponed retirements and depleted portfolios, and often with few employment options, our seniors need protection. Unwitting seniors may seek income through a stranger-owned life insurance scheme that imposes unexpected taxes, or lost public benefits.

In Illinois, residents age 55 to 85 were invited to meet Mike Ditka, and learn why Wall Street wants to buy your annuity. Is there such a thing as free insurance? Are you in danger of outliving your life insurance? Ads like this prove that life settlements involve more than just the rich and the extremely wealthy.

Our Department supervises any individual or entity involved with the business of insurance. Late in 2007, we subpoenaed records from Coventry First, so we could understand how the industry operates within our borders.

Coventry filed suit to quash the subpoena arguing that it, Coventry, is beyond our regulatory reach. We prevailed at the trial court, and the suit is now on appeal.

In Illinois, for 17 months, we have labored through legislative negotiations with the insurance and life settlement industries. Our legislators have been Herculean in bringing Illinois to the brink of regulation that includes a hybrid of the best practices from the NAIC model law, and other States.

But we know Illinois law can not be molded to endorse, implicitly, the life settlement business model, because too much remains a mystery. Clearly, stranger-owned life insurance, or STOLI, violates a fundamental policy, premised on the tenant that a stranger should not want you to die. Our lives, regardless of age, should not be commoditized, packaged, and traded on Wall Street, like credit default swaps.

All responsible parties agree, STOLI should be banned. But as States, and as a nation, we lack answers to important questions, including who are the sources of capital for life settlements? What are the payment arrangements between the commercial parties? What are the roles and compensation for brokers, solicitors, promoters? Who are the life settlement consumers, and most importantly, what has been—or is—the impact of a life settlement on those individuals or their families?

We regulate to protect consumers. That regulation must include measures to reduce the opaque hieroglyphics of the life settlement industry. With annual reporting, complete disclosure, and stringent oversight, we will protect our aging population. Life settlement deal-makers, including solicitors and promoters, must be licensed and subject to examination, penalties and revocation.

Our economic crisis has been attributed to the failure of institutions and Federal regulators to understand assets and liabilities on which enormous institutional bets were placed. As this crisis proves, regulation must enhance transparency of otherwise mysterious financial products.

As legislators and regulators, on behalf of our parents, our aging neighbors, friends, and constituents, we need unmitigated transparency in the business of life settlements. For these reasons, while actively engaged on a State level, Mr. Chairman, we pledge to support this special committee, and offer our support for your continued efforts.

Thank you for your attention. I look forward to your questions.
[The prepared statement of Mr. McRaith follows:]

**Testimony of Michael T. McRaith
Director of Insurance
State of Illinois**

**Before the
Senate Special Committee on Aging
United States Senate**

**Regarding:
Life Settlements and the Need for Increased Transparency**

April 29, 2009

**Testimony of Michael T. McRaith
Director of Insurance, State of Illinois**

Introduction

Chairman Kohl, Ranking Member Martinez, and distinguished Members of the Committee, thank you for the invitation to talk with you about the financial safety of our aging population. My name is Michael McRaith. I am the Director of Insurance for the State of Illinois, and in that capacity I testify today.

State insurance officials have a demonstrable record of successful consumer protection and industry oversight. Twenty-eight (28) of the fifty (50) largest insurance markets in the world are individual States within our nation, but we also respond to more than 3,000,000 consumer inquiries annually. The US insurance market surpasses the combined size of the second, third and fourth next largest markets.

In 2007, 387 life insurance companies reported \$4,635,396,241 in direct Illinois premiums for Individual Ordinary Life policies and 219 companies reported \$1,664,187,690 in direct Illinois premiums for Group Life Business. As of 2007, companies reported 6,941,391 individual policies in force in Illinois and 196,860 group policies in force, the latter accounting for 5,027,538 certificates. With a market of this magnitude, Illinois is fertile ground for those who would prey upon our aging population.

Each day state regulators focus our responsibilities on ensuring that the insurance safety net remains available when individuals, families and businesses are in need. With a

proud record of success, insurance regulation constantly evolves, innovates and improves to meet the needs of consumers and industry.

For this reason, we are grateful to the Special Committee for shining additional light on this still-murky marketplace known as "life settlements," a pernicious subset of which is known as "stranger-owned life insurance" (STOLI). With more seniors in need of supplemental income due to the economic crisis and the concurrent degradation of retirement assets, now is the time for this discussion. As insurance regulators, consumer protection has been, is and will remain priority one, and the information deficit with which we function relative to STOLI causes grave concern.

STOLI -- Dangerous for Seniors.

STOLI is a problem for Illinois' aging population because such arrangements often lead to unanticipated problems, including:

1. income taxes on cash payments that lured the consumer into the scheme;
2. income tax liability on proceeds from the sale of the insurance policy, which are often unexplained;
3. income tax liability if the premium payment is determined to be a gift in excess of the gift tax limitations;
4. loss of access to public health or other aid programs;
5. loss of access to other insurance products with legitimate insurance purposes;

6. phone calls from Wall Street, or elsewhere, from unknown third parties inquiring about health status;
7. widespread, unregulated dissemination of a senior's health records; and
8. potential liability for the senior's estate if the life insurer rescinds the policy due to fraud.

Life Settlements – Regulation Must Protect Our Seniors.

This Committee's efforts, through this hearing and elsewhere, exemplify the national leadership that will greatly enhance our work at the State level. To this day, our nation remains largely uninformed about:

1. the mechanics of life settlement transactions;
2. the sources of capital for life settlement transactions;
3. the payment arrangements between the involved commercial participants;
4. the marketing and sales practices used to lure our aging population;
5. the identity and type of deal participants;
6. the identity of policyholders and beneficiaries;
7. the sources of profit within a transaction;
8. the regularity and substance of communications between investors and beneficiaries; and
9. the impact on tens of thousands of individual consumers.

In Illinois, our most significant challenges involve a life settlement marketplace about which little is known or can be determined based on reported information. As insurance

regulators, we aim to support legislators and to provide data and information on which rest critical consumer protection decisions and legislation. Our regulatory objectives can be stifled when we lack the factual foundation on which sound public policy can be based.

Since 1996, Illinois has regulated transactions commonly known as "viatical settlements," or transactions in which a life insurance policy is sold due to the terminal illness of the policyholder.¹ This law, based on the model developed by the National Association of Insurance Commissioners (NAIC), arose from the business model created during the mid-to late 1980's that afforded HIV/AIDS patients the ability to settle life insurance policies and receive funds for personal or medical expenses prior to death.

Fortunately, treatment and resources for those infected with HIV/AIDS improved. Regrettably, viatical settlements grew into the broader "life settlement" phenomenon, which then developed a strain of the predatory practices known as STOLI.

On September 11, 2007, the *Chicago Tribune* printed a full-page advertisement in which adults over the age of 55 were invited to meet former Chicago Bear Mike Ditka. Included in the "symposium" enticements was the opportunity to learn about "free insurance" and how not to "outlive your life insurance." A copy (8.5 x 11) of one-quarter of this advertisement is attached hereto as Exhibit A, and an actual-size version of the entire advertisement will be provided to Committee staff at the hearing on April 29, 2009.

¹ For purposes of this written testimony, the terms "viatical settlement" and "life settlements" shall have identical meaning.

Promotions such as this demonstrate that life settlements and STOLI are not marketed solely to wealthy, sophisticated consumers.

In this decade, the life settlement industry has reportedly exploded from an approximately \$2 billion enterprise to an approximately \$15 billion enterprise, although the exact size, volume and cumulative dollar value of transactions remains uncertain. Insurance regulators, media reports, and the former New York Attorney General, among others, raised public awareness about the explosive growth of STOLI, including abusive marketing and compensation practices. A frequent target of investigations, hearings and news stories has been Coventry First, L.L.C. ("Coventry").

Rather than rely upon allegations or findings by regulators or law enforcement from other states, we sought to scrutinize independently the size and scope of the life settlement industry in Illinois. We identified a need for Illinois to have state-specific information. Accordingly, in October 2007, we served Coventry -- reportedly the nation's largest participant in the life settlement market -- with a subpoena for Illinois-related records and information.

Rather than comply with the subpoena, Coventry filed a lawsuit in February 2008, contending that Illinois laws regulating viatical settlements do not regulate the life settlement industry. *See Coventry First, L.L.C. v. McRaith, et al.*, No. 08 CH 5537 (Cook County Circuit Court). Represented by the Office of the Attorney General of the State of Illinois, we (the State) prevailed in the Circuit Court, a decision which Coventry

promptly appealed. *See Coventry First, L.L.C. v. McRaith, et al.*, No. 08-1917 (Ill. App. Ct. 1st Dist.). Among other arguments, Coventry asserts that legislative activity in Illinois, and elsewhere, constitutes an admission that our current laws do not subject the Coventry business model to regulatory oversight. The appeal remains pending.

In January 2008, Senator William Haine, chairman of the Illinois Senate's Insurance Committee, and Representative Frank Mautino, chairman of the Illinois House's Insurance Committee, introduced parallel legislation to the Illinois General Assembly consisting of a modified version of the model act proposed by the National Conference of Insurance Legislators (NCOIL) and the model developed by the NAIC, respectively. The draft legislation now pending constitutes a hybrid of the best provisions of each model, including clearly articulated consumer protections and regulatory tools. Through seventeen (17) months, the effective and balanced leadership of Senator Haine and Representative Mautino have brought Illinois to the brink of effective consumer protection legislation.

Regulation of Life Settlements -- An Effective Solution.

If passed, Illinois law will recognize the valuable rights that policyholders have in a life insurance policy. Recognizing legitimate estate-planning needs and the often unanticipated volatility of life, any prohibition on STOLI should permit lawful life settlements when:

1. the viator exercises conversion rights arising from a group or individual policy, provided that the time covered under the conversion policy plus the time covered under the prior policy exceed twenty-four (24) months;
2. the viator is terminally or chronically ill;
3. the viator's spouse dies;
4. the viator divorces;
5. the viator retires from full-time employment;
6. the viator becomes physically or mentally disabled and a physician determines the disability precludes full-time employment;
7. the sole beneficiary is a family member and the beneficiary dies; and,
8. in any other condition that the regulator determines to be an extraordinary circumstance, as determined by rule.

Illinois' draft legislation does not prohibit family members from supporting one another in the purchase of a life insurance policy, but does prohibit the financing of a premium by a hedge fund or other third party. The draft bill allows viatical settlement transactions that do not constitute STOLI, as explicitly described in items 1 - 8, but prohibits those transactions in which the policy is initiated for the benefit of a third-party investor.

As noted above, STOLI and the business practice of "life settlements" has grown explosively. In recent years, investors who purchased large blocks of life insurance policies on the secondary market encountered solvency and liquidity problems if the individuals did not die in a timely fashion. STOLI business models have evolved so that

complicated series of trusts generate a veneer of a genuine "insurable interest," even though the veneer shields the identity of a third party investor.

Many justifiably argue that our current economic crisis was caused by the failure of federal regulators and rating agencies to understand the bundles of assets and potential liabilities on which much of the Wall Street wealth was based. Despite rating agency and regulator concerns, few actually knew and understood the sophisticated financial products on which institutional profit was based. Indeed, our current economic crisis illustrates the need for STOLI regulation that does not remain static but provides regulators with the tools and data on which to base public policy recommendations to legislators. In other words, effective STOLI regulation requires:

1. licensing of viatical settlement brokers, including solicitors and promoters;
2. licensing of viatical settlement providers;
3. regulation of viatical settlement transactions;
4. at least annual reporting by viatical settlement providers to the regulator;
and,
5. regulator authority to examine and impose appropriate penalties on all participants in a viatical settlement transaction.

Licensing and reporting requirements, combined with examination authority, provide the regulator with tools needed to protect our aging population. STOLI emerged, and has grown, as a business model because investors, providers and brokers generate enormous profits -- an incentive to circumvent any regulation. For this reason, as illustrated by the

credit default swap fiasco, mandatory, thorough and annual reporting will aid regulators so that applicable law and oversight can evolve with the marketplace.

Given the lack of information publicly available to State and Federal legislators regarding the impact of STOLI and life settlements on our aging population, many states, like Illinois, have moved forward with legislation to regulate the viatical, or life settlement industry. Effective regulation, however, will not statutorily endorse a business model about which policymakers and regulators remain largely ignorant. With more seniors growing ever more vulnerable, and with more investors looking for certainty of a return, *i.e.* as certain as death, the time for effective regulation is now.

Conclusion

STOLI arrangements are predatory, abusive practices that convert the lives of our elderly parents, friends and neighbors into commodities. The State of Illinois, led by two great legislators, Senator Haine and Representative Mautino, has drafted balanced but effective legislation that, if passed, will protect consumers, and preserve our seniors' ability to enter into legitimate estate-planning arrangements.

We welcome the interest of Congress and this Special Committee in this important consumer protection initiative. As we move forward with regulation of STOLI and viatical settlement transactions, we pledge to share our experience, expertise and Congress and to work with the members and staff of this Special Committee.

Regulation of all financial sectors must allow for innovation and efficiency. Not under any circumstance, though, should consumer interest be sacrificed for the benefit of market goals. In this instance, as we work to protect our aging population from predators, we must remain vigilant to limit, if not eliminate, the potential abuses of life settlement practices.

Thank you for the opportunity to testify, and I look forward to your questions.



ANNUITIES AND LIFE INSURANCE

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Special Guest Speaker Legendary

Mike

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ATTENDEES WILL LEARN ABOUT ANNUITIES:

- ▶ HOW TO GET OUT OF -(RESCUE)- AN ANNUITY YOU ARE UNHAPPY WITH
- ▶ WHEN BUYING AN ANNUITY IS A GOOD IDEA
- ▶ WHEN YOU DON'T NEED AN ANNUITY
- ▶ WHY VARIABLE ANNUITIES MAY BE A MISTAKE

The CHAIRMAN. Thank you, Mr. McRaith.
Mr. Joseph.

STATEMENT OF FRED JOSEPH, COMMISSIONER, DIVISION OF SECURITIES, COLORADO DEPARTMENT OF REGULATORY AGENCIES, ON BEHALF OF NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, DENVER, CO

Mr. JOSEPH. Thank you, Chairman Kohl, Ranking Member Martinez, and committee staff. I'm honored to be here today to discuss the impact life settlements have on our citizens, and the need for strong regulation of these financial products by the appropriate regulatory authorities.

Over the years, the North American Securities Administrator Association, or NASAA, and its members have been extremely active in dealing with the problems associated with viatical and life settlement investments, terms that have become interchangeable.

At the outset of my testimony, I'd like to offer 3 general principles that I believe should guide legislators and regulators as they address the continuing challenges arising from these products.

First, life settlements are complex financial arrangements involving both securities and insurance transactions. Consequently, regulating them effectively requires a joint effort by securities and insurance regulators, each applying their laws and expertise to different aspects of the product.

Second, although life settlements may serve a useful purpose by enhancing the value and liquidity of life insurance policies, they also pose significant risk to policy holders and investors. For example, thousands of investors—many of them senior citizens—have been victimized through fraud and abuse in the sale of viatical and life settlements. Notwithstanding substantial successes by State securities regulators with their enforcement actions, and higher standards among industry participants; abuses continue. Diligent oversight of these products remains necessary.

Finally, life settlements are constantly evolving in terms of product design, the policy holders involved, and the types of investors to whom they are marketed. Accordingly, lawmakers and regulators must carefully monitor these developments and respond to new challenges by creatively applying their existing laws and, where necessary, adopting new laws and regulations. This is one reason why I applaud the committee for convening this hearing today, and focusing attention on this important issue.

Traditionally, viatical settlements have involved two distinct transactions. In one, the viatical settlement provider pays the insured some portion of his or her death benefit, in exchange for an assignment of the sale of the insurance policy to the provider. This is an insurance transaction, properly regulated under State insurance law.

In the other, the provider arranges for interest in the settled policies to be sold to investors, with the promise of returns to be paid upon the death of the insured. This is a securities transaction, properly regulated by our State and Federal securities laws. The offer and sale of investments in viatical settlements has been marked by a wide range of fraudulent practices, and these abuses have been documented in scores of enforcement actions by securi-

ties regulators over the years, as well as scholarly articles profiling the industry.

In addition, in classic Ponzi schemes, promoters have used fraudulent life expectancy evaluations that are prepared by captive physicians, inadequate premium reserves, and false promises of large profits with minimal risk.

In short, while viatical transactions have helped some people obtain funds needed for medical expenses and other things, those benefits have come at a high price for investors, many of them senior citizens. To address these problems, State regulators and the SEC have fought strenuously to regulate viatical settlements under securities laws. Those laws require sales agents to be screened, licensed, and tested. Promoters must register their offerings with securities regulators, and make detailed disclosures to investors. The securities law impose strong financial anti-fraud standards, and they provide remedies to deter violations.

Using these laws, securities regulators have significantly reduced the incidence of fraud in the securities market. But our members continue to see evidence of bad actors that once characterized the entire industry.

For example, in May 2007, my office in Colorado filed an enforcement action against a company called Life Partners, and its affiliates and agents. We alleged that for 3 years, the defendants sold unregistered viatical settlement investments to over 100 Colorado investors, netting over \$11 million. We also alleged that Life Partners' sales agents were unlicensed, they marketed the investments using fraudulent misrepresentations.

In December of last year, the District Court held that the offerings were unregistered securities, marketed through unlicensed agents. Life Partners subsequently stipulated to a permanent injunction, and agreed to make rescission offers to all Colorado investors.

The viatical settlement industry has changed significantly since its early days, and it continues to evolve in terms of viators, investors and industry participants. For example, the role of institutional investors have become increasingly prominent in the life settlement market. Along with this development is a desire among some life settlement companies to raise standards of conduct, promote sound regulation, and establish a legitimate industry sector, untainted by past abuses.

In conclusion, lawmakers and regulators must follow all of these trends and must be prepared to acknowledge improvements in the industry, but also to address any new threats to viators and investors that may arise.

I look forward to the findings of the committee in this important area of financial services regulation, and I thank you, again, for the opportunity to share my views.

[The prepared statement of Mr. Joseph follows:]

Testimony of Fred J. Joseph
Colorado Securities Commissioner and
President of the
North American Securities Administrators Association, Inc.
Before the
United States Senate Special Committee on Aging
“Betting on Death in the Life Settlement Market – What's at Stake for
Seniors?”
April 29, 2009

Introduction

Chairman Kohl, Ranking Member Martinez, and members of the Committee:

I'm Fred Joseph, Colorado Securities Commissioner and President of the North American Securities Administrators Association, Inc. (NASAA).¹ I am honored to be here today to discuss the impact that life settlements have on our citizens and the need for strong regulation of these financial products by the appropriate regulatory authorities. As a representative of our nation's state securities regulators, I will focus my testimony primarily on the regulation of life settlements as securities. At the outset, I would like to offer three general principles that I believe should guide legislators and regulators as they address the challenges arising from these products.

First, life settlements are complex financial arrangements, involving both securities and insurance transactions. Consequently, regulating them effectively requires a joint effort by securities and insurance regulators, each applying their laws and expertise to different aspects of the product.

Second, although life settlements may serve a useful purpose by enhancing the value and liquidity of life insurance policies, they also pose significant risks to policyholders and to investors. For example, thousands of investors, many of them senior citizens, have been victimized through fraud and abuse in the sale of viaticals and life settlements. Notwithstanding substantial successes by securities regulators in their

¹ The oldest international organization devoted to investor protection, the North American Securities Administrators Association, Inc., was organized in 1919. Its membership consists of the securities administrators in the 50 states, the District of Columbia, the U.S. Virgin Islands, Canada, Mexico and Puerto Rico. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

enforcement actions, and higher standards among some industry participants, abuses continue and diligent oversight of these products remains necessary.

Finally, life settlements are constantly evolving in terms of their product design, the policyholders involved, and the types of investors to whom they are marketed. Accordingly, lawmakers and regulators must carefully monitor these developments and respond to new challenges by creatively applying their existing laws, and where necessary, adopting new laws and regulations. That is one reason why I applaud the Committee for convening this hearing today and focusing attention on this important issue.

Overview of State Securities Regulation

The securities administrators in your states are responsible for enforcing state securities laws. They license broker-dealers and investment advisers, register certain securities offerings, examine financial firms, and investigate cases of suspected investment fraud. When our members find violations, they file enforcement actions to enjoin illegal activity, recover restitution for victims, and deter future violations through fines and licensing sanctions. Our members also provide a variety of investor education programs to your constituents.

We are often called the “local cops on the securities beat,” and I believe that is an accurate characterization. When new investment offerings appear, such as viaticals, our members are often the first to receive complaints from investors and the first to respond with investigations and enforcement actions.

Over the years, NASAA and its members have been extremely active in dealing with the problems associated with viatical and life settlement investments.² Our members have taken countless enforcement actions against viatical settlement providers selling unregistered investments and committing fraud and abuse against Main Street investors. Our members have also fought successfully for statutory amendments and regulations that expressly define viaticals as securities under state law, to remove any uncertainty about their legal status. NASAA itself has issued model viatical guidelines to promote strong and uniform regulation of these products. NASAA has filed numerous amicus briefs in state and SEC enforcement actions arguing that viaticals are securities and must be regulated as such for the benefit of investors. Every year, NASAA issues a review of the most prevalent investment frauds confronting our citizens, and we have included viaticals in many of those annual compilations.

More recently, in recognition of the need to protect policyholders as well as investors, NASAA has supported the efforts of state insurance commissioners to regulate the insurance aspects of viatical and life settlement transactions. We have expressed our views in an amicus brief defending the validity of Virginia's viatical settlement act, and in comments that the National Conference of Insurance Legislators (NCOIL) invited us to submit on their model viatical settlement act in the Fall of 2007.

The Nature of Viatical Settlements

Viatical settlements first emerged in the early 1990s in response to the AIDS crisis. They created opportunities for terminally ill patients to obtain needed funds by

² Under many state securities laws, "viaticals" have now been broadly defined to include all types of settlement, regardless of whether the policyholder is suffering from a terminal illness. Accordingly, the terms "viatical settlement" and "life settlement," although they have different historical origins, are largely used interchangeably, as in my testimony.

selling their life insurance death benefits for much more than the cash surrender value available from their insurance companies. As the market has expanded, viatical settlement providers have turned to new classes of viators, including the elderly and the chronically ill.

Traditionally, viatical settlements have involved two distinct transactions, each with their own legal character. In one, a viatical settlement provider pays the insured some portion of his or her life insurance death benefit, in exchange for an assignment or sale of the insurance policy to the provider. This is an insurance transaction, properly regulated under state insurance law. In the other transaction, the provider arranges for interests in the settled policies to be sold to investors, with the promise of returns to be paid upon the death of the insured. Those returns hinge on a combination of factors, including the difference between the discounted price paid for the policy and the death benefit ultimately received, the costs of maintaining the policy in force until the insured passes away, and the accuracy of the life expectancy determination made for the insured. This sale of interests in settled insurance policies for investment purposes is a securities transaction, properly regulated under state and federal securities law.

Abuse of Investors and the Remedies Available Under the Securities Laws

The offer and sale of investments in viatical settlements has been marked by a wide range of fraudulent practices aimed at investors. These abuses have been documented in scores of enforcement actions by securities regulators over the years, as well as scholarly articles profiling the viaticals industry. At one time, the industry was

characterized as “infected with scam artists, ‘ponzi’ schemes, and other fraudulent activities.”³

Fraudulent practices targeting investors have been wide-ranging. In addition to Ponzi schemes, where no settled insurance policies are obtained, they include fraudulent life expectancy evaluations prepared by captive physicians; inadequate premium reserves that increase investor costs; and false promises of large profits with minimal risk.⁴

Viatical settlement providers have also perpetrated fraud by concealing material information about the risks and costs of the investments. For example, rates of return can vary significantly, depending upon the accuracy of life expectancy calculations. If viators do survive beyond their life expectancies, investors may be forced to pay premiums to avoid lapse of policies and loss of any recovery. Investors receive no payments whatsoever until viators pass away and claims for death benefits are properly filed and paid. An investor needing access to his or her funds has little recourse, since a secondary market for viatical investments contracts is virtually non-existent.⁵

There are other risk factors and fees associated with viaticals that may not be disclosed to investors. For example, policies may still be in their contestable periods, and term or group policies may be subject to subsequent contract changes.⁶ The bankruptcy

³ Lisa M. Ray, *The Viatical Settlement Industry: Betting on People's Lives Is Certainly No Exact*, 17 J. CONTEMP. HEALTH L. & POL'Y 321, 322 (2000).

⁴ See, e.g., Report and Recommendation of Magistrate Barry L. Garber, issued on November 10, 2004 (“Magistrate’s Report”), in *SEC v. Mutual Benefits Corp.*; see generally Brief of NASAA as *Amicus Curiae* in Support of SEC, filed in *SEC v. Mutual Benefits Corp.*, No. 04-14850-C (11th Cir. filed Dec. 8, 2004), and cases and authorities cited therein.

⁵ See Michael Cavendish, *Policing Terminal Illness: How Florida Regulates Viatical Settlement Contracts*, 74 FLA. B.J. 10, 14 (Feb. 2000).

⁶ See *Eterna Benefits L.L.C. v. Hartford Life & Accident Insurance Co.*, 1998 WL 874296 *1 (N.D. Tex. Nov. 25, 1998).

of a viatical company can result in a total loss for investors.⁷ The administrative fees charged in connection with these investments can be substantial. Finally, viatical companies and their principals have often concealed disciplinary histories replete with investor complaints, enforcement actions, and even criminal prosecutions.

In short, while viatical transactions have helped some people obtain funds needed for medical expenses and other purposes, those benefits have come at a high price for investors, many of whom have been senior citizens.⁸

To address these problems, state regulators and the SEC have fought strenuously to regulate viatical investments under the securities laws. By the mid-1990's, both state and federal securities regulators were asserting jurisdiction over viatical investments and taking enforcement actions against viatical promoters, principally on the ground that viaticals were investment contracts under the *Howey* test.⁹ In *Howey*, the United States Supreme Court held that an investment offering is a security if it involves: (1) the investment of money, (2) in a common enterprise, (3) with the expectation of profits, (4) derived principally from the efforts of others. Viatical settlements clearly meet this test.

In 1996, however, the SEC suffered a major setback in the United States Court of Appeals for the D.C. Circuit.¹⁰ In *Life Partners*, the court applied the *Howey* test in a highly technical fashion, and held that the viaticals at issue were not investment contracts because the promoter's key managerial efforts – the determination of life expectancy – happened to occur before money was accepted from investors. The D.C. Circuit also held that *after* investors parted with their money, the viatical promoter's tasks were only

⁷ Alexander D. Eremia, *Viatical Settlement and Accelerated Death Benefit Law: Helping Terminal, But Not Chronically Ill Patients*, 1 DEPAUL J. HEALTH CARE L. 773, 777 (1997).

⁸ See, e.g., Lawrence A. Frolik, *Insurance Fraud on the Elderly*, 37 TRIAL 48, 51-52 (June 2001).

⁹ *SEC v. W. J. Howey Co.*, 328 U.S. 293 (1946).

¹⁰ *SEC v. Life Partners, Inc.*, 87 F.3d 536 (D.C. Cir.), *rehearing denied*, 102 F.3d 587 (D.C. Cir. 1996).

“ministerial” in nature, and the profitability of the investment really hinged upon the mortality of the insureds.

Although the decision in *Life Partners* was quickly and widely criticized, it nevertheless had a chilling effect on the SEC’s enforcement of the federal securities laws against those offering viatical investments.¹¹ State securities regulators continued to assert jurisdiction over viaticals, and were largely successful. State appellate courts and administrative tribunals emphatically rejected the *Life Partners* decision as bad law and bad policy.¹² But states were often confronted with defenses based on the *Life Partners* decision, and while state courts generally declined to follow the federal court’s ruling, they occasionally ruled in favor of the defendants.¹³ Even when enforcement actions were successful, state regulators found themselves having to devote significant litigation resources just to establish their jurisdiction.

In recent years, the *Life Partners* decision has been largely neutralized. At the federal level, the SEC eventually won a favorable decision from the United States Court of Appeals for the Eleventh Circuit in a major viatical case.¹⁴ In *Mutual Benefits*, the SEC filed an action against a viatical promoter that had sold over \$1 billion in viatical investments to 29,000 investors through a fraudulent marketing campaign. The defendant invoked the decision in *Life Partners* to challenge the SEC’s jurisdiction, but the Eleventh Circuit squarely rejected that challenge. Citing to the lack of a persuasive rationale underlying *Life Partners*, and to Supreme Court precedent requiring a flexible –

¹¹ See JOSEPH C. LONG, 12 BLUE SKY LAW §§ 3:15, 3:16.1 (June 2004) (explaining that the decision was irrational and that it was quickly the subject of judicial and scholarly criticism).

¹² See *In re Beneficial Assistance*, File No. S-01297, 2003 WL 297791, at *3 (Wisc. Comm’r of Sec. Feb. 5, 2003) (Order of Prohibition and Revocation) (citing over 200 opinions, administrative decisions, and court cases from states across the country finding that viatical settlements are securities).

¹³ See *Griffitts v. Life Partners, Inc.*, No. 10-01-00271-CV, 2004 WL 1178418 (following *Life Partners* and holding that viatical investments were not securities).

¹⁴ *SEC v. Mutual Benefits Corp.*, 408 F.3d 737 (11th Cir. 2005).

not technical – application of the securities laws, the court held that Mutual Benefits' viatical investments "amount[ed] to a classic investment contract."

At the state level, many legislatures added viaticals to their statutory definition of a security to remove any doubt that these investments are subject to securities regulation.¹⁵ Today, over half the states regulate viaticals and life settlements under explicit statutory provisions in their securities laws, and nearly all the remaining states apply the investment contract test.

Regulation of viatical investments as securities is regarded as an effective way to help "alleviate many of the problems inherent in the viatical settlement industry."¹⁶ Promoters must register their securities so that material information about an offering reaches prospective investors before they part with their money. Those who sell securities must submit to testing, licensing, and background checks to help ensure they have the knowledge and fitness to accept investor funds and render investment advice. The securities laws impose stiff civil and criminal penalties as a deterrent against violations of the licensing, registration, and anti-fraud provisions. Finally, the securities laws give regulators the authority to seek important remedial measures, including injunctions, disgorgement, and restitution. All of these provisions play an important role in limiting the harm that viatical settlement investments can inflict upon the investing public.¹⁷

¹⁵ See Brief of NASAA as *Amicus Curiae*, filed in *California v. Innovative Financial Services, Inc.*, No. D045555 (Cal. Ct. App. filed Sept. 6, 2005), at 28-29.

¹⁶ Dave Luxenberg, *Why Viatical Settlements Constitute Investment Contracts Within the Meaning of the 1933 & 1934 Securities Acts*, 34 WILLAMETTE L. REV. 357, 386 (Spring 1998); see also Timothy P. Davis, *Should Viatical Settlements Be Considered "Securities" Under the 1933 Securities Act?*, 6 KAN. J. L. & PUB. POL'Y 75 (Winter 1997).

¹⁷ All of these licensing, registration, and antifraud standards are found in both the federal and state securities laws. See generally the Securities Exchange Act of 1934, the Securities Act of 1933, and the Uniform Securities Act of 1956, which is the predominant model for state securities laws.

Using these regulatory and enforcement tools, state securities regulators and the SEC have significantly reduced the incidence of fraud in the marketing of viaticals and life settlements. Nevertheless, state securities regulators continue to see significant evidence of the “scam artists” that once characterized the entire industry. Our members still file enforcement cases and continue to litigate the legal status of viaticals as securities. For example, in May of 2007, my office in Colorado filed an enforcement action against Life Partners and its affiliates and agents. We alleged that from 2004 to 2007, the defendants sold unregistered viatical settlement investments to at least 110 Colorado investors, netting over \$11 million. We also alleged that the Life Partners sales agents were unregistered and that they marketed the investments using fraudulent misrepresentations and omissions about the risks, costs, and returns associated with viaticals. In December 2008, the court held that the offerings were unregistered securities marketed through unlicensed agents. Life Partners subsequently stipulated to a permanent injunction and agreed to make a rescission offer to all Colorado investors.¹⁸

Earlier this month, my colleague at the Texas State Securities Board issued an Emergency Cease and Desist Order against The Stamford Group and its affiliates and principals, who were selling interests in portfolios of senior life settlement policies. The Texas Board found that the investments were unregistered securities and that the respondents were not properly licensed to sell them. The Board also found that the respondents were making numerous misrepresentations and omissions in the sale of the

¹⁸ See *Joseph v. Life Partners, Inc.*, No. 07CV5218 (Denver D. Ct. Dec. 2, 2008).

investments, including bold claims of guaranteed returns and omissions regarding the principals' complaint history.¹⁹

On March 20th of this year, the Securities Bureau of the Idaho Department of Finance filed a complaint against another group of entities and individuals who bilked 40 Idaho investors out of \$6 million by selling them unregistered securities in the form of a "life settlement purchase" program. The Complaint alleges that the defendants promised returns of 10% per month, but never in fact purchased any insurance policies and instead diverted the investors' funds offshore. Idaho seeks injunctive relief, restitution, and substantial civil penalties.²⁰ Thus, unscrupulous elements in the viaticals industry continue to target our investors, and state securities regulators continue their fight against fraud and abuse.

Emerging Trends

The viatical settlement industry has changed significantly since its early days, and it continues to evolve in terms of the viators, investors, and industry participants involved. For example, the class of viators has been expanded with the advent of so-called "stranger originated life insurance," or "STOLI." This mechanism involves the purchase of life insurance coverage with the intention of settling it, thereby creating investment opportunities for third parties. STOLI raises fundamental issues of insurance law and policy, and it has generated controversy among insurance regulators and insurance companies. It is relevant to NASAA and its members insofar as STOLI

¹⁹ See *In the Matter of the Stamford Group, Inc.*, No. ENF.-09-CDO-1671 (Tex. State Secs. Bd. Apr. 2, 2009).

²⁰ See *State of Idaho, Dept. of Fin., Secs. Bur. v. Potter*, CV OC 0905488 (D. Ct. 4th Jud. Dist. Mar. 20, 2009).

transactions will affect the universe of life insurance policies that are available for securitization—a process overseen by securities regulators.

Another significant trend is the increased role of institutional investors in the life settlement market. Along with this development is a desire among some industry participants to raise standards of conduct, promote sound regulation, and develop a legitimate industry sector untainted by past abuses. Lawmakers and regulators must follow all of these trends, and must be prepared not only to acknowledge improvements in the industry but also to address any new threats to viators and investors. I look forward to the findings of the Committee in this important area of financial services regulation, and I thank you again for the opportunity to share my views.

The CHAIRMAN. Thank you, Mr. Joseph.

I believe that each of you, in your own good way, has demonstrated and testified today that the life settlement industry is a legitimate industry, albeit a new one. That it has a real place in the market under certain circumstances, but that because it is new, and growing as quickly as it is, it is not sufficiently regulated in order to see to it that we protect consumers to the extent that they fully deserve. That's, what we need to do is take a careful look at this industry, and provide the kind of oversight and regulations that will ensure that those people who participate in life settlement situations are fully protected. Is that a fair statement?

[Panelists nod in agreement.]

The CHAIRMAN. Anybody disagree with that in any way?

Mr. JOSEPH. Senator.

The CHAIRMAN. Mr. Joseph.

Mr. JOSEPH. There have been problems in the past, from the securities side of the transaction. At least from the outset there were companies involved some are no longer with us, obviously, that conducted their business in a fraudulent manner; the policies didn't exist, or the returns that they touted were outlandish, and that sort of thing, from the securities side of the transaction. So, I will say that from the outset.

The CHAIRMAN. There's room for outright fraud and dishonesty?

Mr. JOSEPH. Absolutely. Absolutely. In some cases, prison sentences were imposed on the perpetrators.

The CHAIRMAN. Senator Martinez.

Senator MARTINEZ. Well, thank you, Mr. Chairman, and I want to thank all of the witnesses for very thoughtful statements and very enlightening information that you've shared with us.

Let me see if I may have a couple of questions for Mr. Leimberg. I wanted to ask, where do you believe is the greatest opportunity for consumers to be harmed in these kinds of settlement transactions?

Mr. LEIMBERG. I think the single-biggest harm is the taking away of a life insurance policy that is really needed. If there is no holdfold analysis, if there is no analysis of "what do you need?" before you take it away, if you merely give them a set of cookbook statements of, "Here are the possible things that can go wrong," and fold up your tent—if there is no analysis, people will lose life insurance they really need to keep.

Senator MARTINEZ. How would you propose that that hold or fold analysis take place? Would Ms. Senkewicz, in your office, would they—would you do that kind of an analysis? Or would there have to be a certification that that has been explained to the customer, and that you've got like a form that you've filled out, with certain questions asked and answered?

Mr. LEIMBERG. A needs analysis is the first thing a good life insurance agent will do.

Senator MARTINEZ. Yeah, but how can you impose that on the industry, is what I'm saying. I mean, is there a set of regulations you propose, or—?

Mr. LEIMBERG. Well, certainly you can demand that—

Senator MARTINEZ. I mean, that could be a good business practice—

Mr. LEIMBERG [continuing]. State law could require that practice be done, and that they—the documents be kept in the hands of the client, and perhaps in the hands of the broker, as well, and perhaps even the settlement company itself might demand a copy, just to satisfy itself that a needs analysis has been done.

Senator MARTINEZ. Ms. Senkewicz, any comment on that issue?

Ms. SENKEWICZ. Thank you, Senator.

Yes, it would have to be spelled out in Florida statute, because this industry has made it abundantly clear to our office that unless it is spelled out specifically in statute, we enforce the statutes of the State of Florida, we don't make them—it would have to be spelled out, because it's abundantly clear that if we tried to do it without it being spelled out in statute, they'd haul us right into court.

Senator MARTINEZ. Do you believe that there is enough—obviously, the State of Florida has some laws in place, I heard from Mr. Leimberg that there—42 percent of these transactions take place in States with no regulation, whatsoever. We do, in Florida, have a set of statutes that regulate the industry, correct?

Ms. SENKEWICZ. We do have a set of statutes.

Senator MARTINEZ. I'd like to ask all of the panel members, though, do you believe that there is a need for a set of minimal guidelines, regulations, that come at the Federal level, for the industry? I realize that longstanding tradition of insurance being a State issue, and how jealously Insurance Commissioner's Offices guard that, and so forth, but is there—in this instance—some sort of a minimal Federal requirement? I'd like to get an answer from each of you on that.

Mr. Joseph, you go ahead and start—we'll take it from the right to the left.

Mr. JOSEPH. Senator Martinez, thanks.

With regard to the securities side of the transaction, obviously the SEC has a great interest in this area. I believe the Chairman of the SEC responded to Senator Kohl in a letter. Traditionally, we've approached these things using investment contract law to define a viatical investment as a security. However, four years ago, in Colorado, our law—our definition of security actually was amended to include the term "viatical settlement investments."

I believe, if you really want to help the securities side of it, at the Federal level, the law should be amended in the Securities Act of 1933, amend the definition to specifically state that a viatical settlement investment is a security, period. That way, it doesn't have to be argued under investment contract law, and the vagueness therein.

Senator MARTINEZ. Mr. McRaith.

Mr. MCRAITH. Sir, Senator, if I could go back to your initial question very briefly—

Senator MARTINEZ. Sure.

Mr. MCRAITH. I think the biggest potential harm is when a policy is sold or disposed at lower value than what it should be. Because all of those lawful life settlements that might have legitimate benefits for our aging population, there is no guarantee right now that that senior or that individual policy holder is being compensated for that policy at a fair market value.

That's where I think the largest harm is at that point, and I'm not going to quibble with Mr. Leimberg, he's clearly an expert, who I have great respect for.

In terms of whether there should be a—

Senator MARTINEZ. Well, let me go back on that. When you talk about that issue, how does one—in other words, there—I've been told, I understand that typically these settlements would be for a larger amount than what the person could turn the policy back into the company for.

Mr. McRAITH. That's right. The problem is, we don't know the food chain, so to speak. We don't know who's being compensated, and at what rate, in the evolution of that from the gentleman who lives on Maple Street in Tallahassee, FL, as that policy works its way into a bundle of policies that's being disposed of Wall Street.

We don't know—there's something in it for everybody along that food chain, so to speak, Senator, and what we don't know is whether Mr. Jones on Maple Street is getting the best return on that policy that he should, or is the compensation to him being reduced up front, so that the returns to the people—the other participants in that deal—receive enhanced compensation.

There's absolutely no clarity of that—on these transactions—there's no transparency about how these transactions actually work, mechanically, and who's getting paid what. There's no assurance that Mr. Jones on Maple Street is getting the best deal he should—maybe for a policy he's paid for, through premiums, for decades, in some cases.

So, to address your second question about whether there should be a Federal minimum standard, I think the first challenge as both of you well know, is helping people understand what we're talking about. I've worked with our legislature in Springfield, as I alluded to, for 17 months—these are complicated transactions. Insurance, generally speaking, is not something people talk about at cocktail parties.

But then, when we start talking about life settlements, and what that means, eyes will frequently glaze over, and people have, generally, trouble understanding. So, the work of this committee, in raising attention, raising the profile of the importance of this topic, is something that I think is a real important national Federal first step to deal with these issues at a State level.

Senator MARTINEZ. I'll go back to you, Mr. Chair.

The CHAIRMAN. I think so, and that's precisely why, as you're suggesting, that we have this hearing today, and we begin to highlight the industry and the potential pitfalls.

But I think we're all agreeing that it's one thing to highlight the industry, and the kinds of things that can happen to adversely affect people which, while absolutely necessary. From there, to go to proper regulation, is a whole other step, which has to be taken.

Isn't that right, Mr. McRaith?

Mr. McRAITH. I would agree with that, yes. Absolutely, Mr. Chairman.

The CHAIRMAN. Do all of you feel that we're a long way from there? A long, long way?

Mr. LEIMBERG. Absolutely. Absolutely. I think that bad actors will find cracks in State laws, and they will exploit them to their fullest extent.

What we've got right now is a patchwork of State laws, and I don't see anything but a patchwork of State laws. So, without some kind of Federal oversight, we're going to continue that patchwork, and the bad actors will drive a truck right through it.

The CHAIRMAN. Well, let's ask the other panelists about that. You're suggesting that the State laws we have, the patchwork of State laws we've had are not adequate, that we need Federal regulation to begin with, to be followed by adequate State regulation. Is that right?

Ms. SENKEWICZ. Mr. Chairman, if I might address that question. I believe the Senator's question may have also been instigated by something in my testimony where it did—at least on the STOLI level—allude to, perhaps, banning it at the Federal level.

But, I must admit, that statement is borne somewhat of frustration in the difficulty we've had in Florida in passing what we consider, at the Office of Insurance Regulation, inadequate viatical, or life settlement law. The fact is, as I stated in my written testimony, the office introduced a bill to enhance both the reporting, the disclosures, strictly on the viatical, or life settlement side, plus the measures to address STOLI, and the industry came back with, did not support us in that effort, hired lobbyists, and came back, in fact, with an alternative draft that was put forth as being an adequate STOLI bill, but in fact, if you read it very carefully, gutted what we were even doing—that little that we were able to do.

So I would suggest that there has been some difficulty at the State level. So, if the States were aware, and industry aware that Congress—yes, you really are interested in this, and that perhaps a few years down the road, if the States have not been able to adopt the NAIC model, for example, across the board, to adequately protect consumers from some of these issues, then I think that that would be fair warning.

The CHAIRMAN. Mr. McRaith.

Mr. MCRAITH. Yes, Mr. Chairman.

Just to follow up—there will always be bad actors who will always evade any regulation that's in place—we know that. I think the first key to any successful regulation is reporting and accountability so we can track how the industry evolves.

As you well know, this industry has evolved from a \$2 billion industry at the beginning of this decade to over—some estimates are over \$30 billion right now—it's evolving, quickly. The important thing is, do we have the information so we can make informed public policy decisions, going forward.

The CHAIRMAN. Yes, Mr. Joseph?

Mr. JOSEPH. Senator Kohl, if I could just speak briefly, in Colorado—just in Colorado only, when we passed our law, four years ago, it was a dual act, it addressed insurance, primarily, and then at the very end it spoke to the securities part, where it changed the definition of security in our law.

Actually, I believe—and I'd like to offer this to your committee staff to look at it—I believe it's a good roadmap as to, perhaps, what approach should be taken. I'm not willing to, totally say that,

at the State level, that we can't handle it, because I believe—at least in our State—we're dealing with it based on the law that we have in place. So, I'm pleased with the way it works.

The CHAIRMAN. Any other comments from the first panel? Questions?

Senator MARTINEZ. None from me, sir, but I want to thank the panel for insightful information.

Mr. MCRAITH. Thank you.

The CHAIRMAN. You've provided some really important information to us today, and enlightenment, and so we thank you for being here.

Mr. MCRAITH. Thank you very much.

The CHAIRMAN. Thank you so much.

The first witness on this second panel will be James Avery. Mr. Avery is President of Individual Life Insurance at Prudential. In 2007, Mr. Avery became chairman of the Life Insurance Committee of the American Council of Life Insurance, known as ACLI.

He's also a member of the ACLI CEO Taskforce on Secondary Markets. Mr. Avery is a Fellow of the Society of Actuaries, and a member of the American Academy of Actuaries.

Our next witness will be Scott Peden, General Counsel and Secretary of Life Partners Holdings and the President and Chief Operating Officer of its primary operating subsidiary, Life Partners, Inc.

Mr. Peden has worked on legislation and regulation for the protection of all parties in the transaction of life settlements, and he's testified before the National Council of Insurance Legislators, and State insurance committees and regulators.

Finally, we'll be hearing from Michael Freedman, Senior Vice President of Government Affairs for Coventry First, the country's leading purchaser of life settlements.

Prior to joining Coventry, Mr. Freedman served as Vice President of Public Affairs and Public Policy for Global Crossing, Limited. He also previously served as Associate Attorney in New York and received his law degree from the University of Buffalo.

We thank you all for being here. Mr. Avery, we'll take your testimony.

STATEMENT OF JAMES AVERY, JR., PRESIDENT, INDIVIDUAL LIFE FOR PRUDENTIAL FINANCIAL, ON BEHALF OF AMERICAN COUNCIL OF LIFE INSURERS, NEWARK, NJ

Mr. AVERY. Good afternoon, Chairman Kohl, and Ranking Member Martinez and committee staff. I thank you for inviting me here to discuss the exposure of senior citizens to abusive life settlement practices.

As you know, for centuries, life insurance has served as a valuable economic instrument, protecting families and businesses from the potentially devastating financial impact of an untimely death.

Now, my comments here today are going to be limited to just a sub-set of life settlements which are really predatory schemes designed—in our opinion—to subvert the true purpose of life insurance. The schemes are intended solely to enrich both the intermediaries who initiate them, and investors, who are looking for above-market returns.

Called stranger-owned life insurance—as already referenced, or known as, STOLI—they are fraudulent and they are contrary to both public policy and State law, which require life insurance policy owners—or beneficiaries, for that matter—to have an initial insurable interest in the continued life of the insured.

Quite to the contrary, STOLI policy owners and beneficiaries have an interest only in the death of the insured. Quite frankly, the sooner the better.

Vulnerable seniors are lured into these schemes with offers of free insurance for a couple of years, along with promises of cash incentives, free meals, and even vacations. They may be asked to sign applications that grossly misrepresent the current condition of their health, or their income, and even their net worth. The senior may also wind up signing documents, which unknowingly make them responsible for extremely large loans, with high interest rates, to fund the initial premiums on the so-called “free” insurance.

The stranger, or speculator, initiating the transaction is actually attempting to cherry-pick the individuals with the shortest life expectancy, and thereby arbitrage the pricing assumptions that the insurance providers is using.

Now, after a two-year contestability period, when the insurer can no longer rescind the coverage due to fraud or misrepresentation, the senior is usually faced with two options. They can either repay the loan that was used to fund the initial premiums—at a significant cost, usually hundreds of thousands of dollars—or they can sign over the life insurance policy as to the speculator, in full satisfaction of the loan. As you might imagine, the senior really generally only has the latter as their choice.

The policy is then packaged into a death bond and sold to investors. As part of the scheme, the senior must agree to periodic phone calls or visits, to monitor his or her own continued existence. Sadly enough, if life expectancy is less than a year, these grim reaper calls can occur as frequently as monthly.

Now, many of your constituents, in society overall, are in fact harmed by STOLI schemes. First, the victimized senior is usually unintentionally participating in what is a fraud. The senior may be responsible for undisclosed taxes, as was mentioned, on the economic value of the free coverage, the forgiveness of the loan, as well as any other incentives that they’ve accepted as part of the arrangement.

There’s actually no guarantee, in fact, that the speculator will acquire the policy after two years. They can change their mind. It may be that the senior’s health has improved, or that the speculator no longer has the funds to pay the future premiums that will be required. They can walk away, and in some cases, the senior may be responsible for the outstanding loan.

The senior may be ineligible for additional life insurance coverage that they need for their own benefit—either for their beneficiaries, or for their estate planning, or to support other beneficiaries, because the investor is now holding all of the coverage that they may be entitled to buy from the insurance industry.

Yet, the financial markets are maybe once again exposed to another sub-prime-like securitization scheme, which really only benefits the intermediaries, as we've learned.

The life insurance industry strongly supports legislation to stop STOLI, but it has faced stiff opposition, as you've heard earlier, from settlement providers, premium finance companies, and the investors.

The State legislators are continually told that life insurance is not being sold for investors. However, I will tell you—many investigations and court cases have provided evidence to the contrary. In fact, I will share with you one of many examples.

At my own company, Prudential, we uncovered a case last August, after Ohio had passed a very effective law prohibiting all STOLI. It involved a 74-year-old woman who was driven from her home in Cleveland, OH, to Pittsburgh, PA, which has no such law, for a medical exam, and to sign an insurance application.

When she was interviewed by our investigator, she was shocked to learn that the death benefit on the policy that she applied for was \$9 million. She was shocked, because her and her husband's monthly income was \$950 from Social Security and they had a total net worth of \$2,000. Needless to say, once she learned what had been undertaken, she was very concerned for her own personal safety. This is one of many such examples.

Now, as you probably know, insurers design, and they price their policies, using averages to assess the probability of death, surrender, and lapsation of coverage, over the life of a large book of business. While those who are fortunate enough to live long lives may enjoy the peace of mind of knowing that their family or business had been protected financially, they are also the ones that fund the early death benefits to the unfortunate ones who die an early death, that suffer an early death. That's how all insurance works.

This is not the case with STOLI. The investors hope to realize an above-average return by buying policies only on the lives of those selected individuals who they expect—and hope—will die early. History suggests that if they are successful at these transactions, they will be undermining the ability of the life insurance providers to offer legitimate and needed coverage to responsible citizens.

In conclusion, the life insurance industry is working hard to get legislation passed in each and every State, to prohibit all forms of STOLI, and to ensure that life insurance continues to be readily available, on an appropriate, and an affordable basis.

I, again, thank the committee for this opportunity to testify on behalf of the insurance industry, and we are hopeful that this hearing, and the findings that you bring forth, will encourage all State legislators to continue efforts to curb this abusive practice, which is a threat to all of your constituents, and especially the senior citizens.

Thank you.

[The prepared statement of Mr. Avery, Jr. follows:]



STATEMENT OF THE AMERICAN COUNCIL OF LIFE INSURERS
 Testimony of James J. Avery, Jr., FSA
 President, Individual Life Insurance, Prudential Financial
 and
 Chairman of the ACLI Life Insurance Committee
 Before the Senate Special Committee on Aging
 April 29, 2009

The Principles of Insurance: Insurable Interest

Life insurance has for centuries been respected as a financial instrument protecting families and businesses from potential financial devastation caused by untimely death. Responsible members of society, whose death will likely result in economic hardship to their loved ones and dependents, purchase life insurance in order to address that risk.

A respected and fundamental principle of life insurance, established originally in 18th century English law¹, is the requirement that the policy's initial owner, beneficiary, or both have an "insurable interest" in the continued life of the insured. American public policy has reinforced the accepted wisdom that we do not want one citizen to have a direct economic incentive to see or hasten the earthly demise of another citizen.

In determining whether an insurable interest exists, 21 states have requirements substantially similar to Maryland law which states that a person must either: 1) be "related closely by blood or law;" 2) have a "substantial interest engendered by love and affection;" or 3) have "a lawful substantial economic interest in the continuation of the life, health, or bodily safety of the individual." And, almost every state has some kind of requirement that the purchaser of a policy on the life of another have an insurable interest in that person's life. The Courts in virtually every state have reaffirmed that life insurance policies without an insurable interest are wagering, contrary to public policy and voidable or invalid. (*See Appendix 1*)

Everyone's a Winner

Insurance is not wagering or gambling. It is the pooling of like risks to enable individuals to protect themselves and their dependents from financial hardship in the event of a serious economic or physical event. Products are offered and priced by insurers assuming certain personal characteristics and based upon statistics. For example, in the context of homeowners policies, prices are not set assuming that all policies will pay off due to a fire, but rather using observable data about the probability of a claim.

In life insurance, pricing accounts for the probability of death, surrender and lapse. If winning for consumers was defined as getting a "good return" on their life insurance premiums, then dying early would generate the best result. However, few people would call that winning!

¹ Over three centuries ago, the advent of life insurance in England led to the "dead pool" in which gamblers placed bets as to which of several chosen royals would perish first. This in turn led to speculators taking out life insurance policies on these celebrities. Parliament responded in 1774 with the Life Assurance Act, which prohibited the making of any policy on the life of a person without the existence of an insurable interest.

Those fortunate enough to live long lives buy and receive the peace of mind that comes with knowing that they have provided financial protection for their family or business in the event of their own death. The beneficiaries of those who unfortunately die early receive a benefit much larger than the premiums that were paid in. The source of much of that benefit is the premiums paid by those fortunate enough to live. The premiums collected from those who choose to discontinue their coverage or let it lapse before death are also part of the funding of the benefits paid on behalf of those who die while insured. And insurers, whose block of business performs in the expected manner, also benefit.

The Evolution of Life Settlements

During the 1970s and 1980s, AIDS patients were often in need of access to all of their assets, including the value of life insurance policies. Many patients wished to liquidate their life insurance coverage and thus the "Viatical Settlement" industry was born. Although purchasers of these policies were strangers to the insured, there was generally not a public policy concern with a third party having a financial interest in the life of the insured since the insured was already suffering from a terminal illness and death was imminent.

When new drug regimens were introduced that increased life expectancy for AIDS victims, and as insurance companies introduced programs to provide death benefits to terminally ill insureds prior to death, the viaticals shifted to new markets and began offering "life settlements" to longstanding policyowners whose circumstances may have changed and who no longer had the same need for the insurance coverage they purchased earlier. The life insurance industry generally did not react positively or negatively to this new development, other than to support appropriate regulation.

Eventually, a limited inventory of potentially profitable and easily accessible contracts for life settlements led some creative thinkers to the idea of effectuating life insurance contracts solely for the purpose of building an inventory of policies to be settled in order to generate profits for investors. Thus we saw the rise of Stranger Originated Life Insurance or STOLI.

STOLI – There Must Be a Loser for There to Be a Winner

STOLI is the 21st Century equivalent of the wagering abuses prohibited by the British Parliament in the 18th Century. Judicial cases from every decade in between illustrate the innovative persistence of speculators and the persistent vulnerability of consumers to believing valuable things might actually be acquired free. In speculative schemes where the life insurance contract is the asset of desire, however, there must be losers for the speculators to emerge as winners.

Simply put, STOLI schemes are wagering or gambling. They are not genuine insurance transactions because they lack insurable interest -- and "A contract of insurance upon a life in which the insured has no interest is a pure wager that gives the insured a sinister counter interest in having the life come to an end."²

In some schemes, individuals are induced by speculators to acquire insurance in an effort to select against the underlying pricing assumptions by way of arbitrage. In still others, the speculators' "arbitrage" is based upon fraud by misrepresenting to the insurance company a purportedly healthy and affluent insurance applicant, usually a senior citizen, when the facts may be very different.

² Grisby v. Russell, 222 U.S. 154 (1922).

Exactly How Does STOLI Work?

Stranger-originated evasions of insurable interest laws, contestability laws, anti-fraud laws and settlement prohibition laws are various and constantly evolving. Some are pure predatory financing schemes. Others misuse trusts to transfer beneficial interests in trust-owned insurance policies to investors without actual settlement of the policy. But a typical STOLI case involves the sale of a policy to an individual 70 years of age or older. A third party loans or arranges a loan to pay the premiums for the first two or three years. If the insured dies during that time, the benefit is payable to the insured's beneficiaries, although they have an obligation to repay the outstanding loan balance with interest. If the insured lives through that period, -- which usually co-insides with the end of the two-year contestability period of the policy -- it is anticipated, although not guaranteed, that the insured will transfer the policy to a third party settlement company or another investor³. The loan is then treated as paid and the investors take ownership of the policy. In some cases, the insured also receives an upfront cash payment or other incentives, or is promised a small share of the death proceeds for his/her beneficiary. The investors continue ownership of the policy, pay the premiums, and receive the death proceeds upon the death of the insured.

Obviously, these arrangements undercut state laws requiring that life insurance be purchased by those with an interest in the **continued** life of the insured. A STOLI transaction is wagering on human life, and violates long-standing insurable interest laws. Those who profit from STOLI transactions claim that there is nothing wrong with what they are doing. However, litigation and fraud investigations across the country would indicate otherwise:

- In *Stalsberg v. New York Life*, the insurance company sought rescission of a policy purchased with a non-recourse loan arranged by a financing affiliate of a life settlement provider. The loan had a high interest rate and a 26-month maturity date. The insured was an 81-year-old, who testified that he purchased the policy with the intent from the outset to sell it in the secondary market after about 24 months. He also testified that the provider was paying his legal fees in the litigation. The policy was issued to a Utah trust and the Utah Department of Insurance submitted a brief supporting the position that purchasing a policy with intent to sell from the outset violates the insurable interest rule, even if there was not a binding agreement or an up-front inducement to sell. The case was settled and the policy rescinded.
- In *Life Product Clearing (LPC) v. Angel*, the U.S. District Court for the Southern District of New York denied the stranger-plaintiff a judgment on the pleadings. The case involved a 77 year old retired butcher, who was sold a \$10 million life insurance policy, designating a Trust as the sole beneficiary, with premiums for the first year alone of \$572,000, an amount he could not afford. Six days later he sold his interest in the Trust for \$300,000. Five days later he died, and the insurance company paid the Trust. LPC then sued the daughter of the deceased, the personal representative of the estate, contending that it was the rightful beneficiary of the Trust. The Court found that "these policies are lawful only if the insured purchases the policy with the good-faith intent to obtain insurance for the benefit of his family, loved one, or business; they are not lawful if the insured purchases the policy with the intent to resell to a stranger at the earliest possible moment."
- Many STOLI schemes employ fraud, as well as violation of insurable interest laws. In *American General Life Insurance Company v. Schoenthal*, the application for this \$7 million policy, issued

³ The cost to the insured to repay the loan plus other fees and charges at the end of this period is so high that it is economically infeasible for the individual to pay or refinance the loan. Thus, it is almost inevitable that the insured will transfer the policy to the 3rd party investor.

on an 82-year old man, alleged a net worth of \$10.7 million and an annual income of more than \$150,000. Upon investigation after the death of the insured, the insurer learned that Mr. Schoenthal's real net worth was only about \$160,000, with an annual income of about \$7200. The Court granted summary judgment to the insurer, which is currently being appealed.

- After a lengthy investigation, an insurance company reported to the California Insurance Fraud Bureau cases involving 200 applications in which they found that very senior citizens had applied for policies. The applicants did not know the face value of the policies, who was to pay the premiums or who was to be the trustee/beneficiary. The policies all had multi-million dollar face amounts, with some as high as \$15 million. None of the clients had a net worth or assets that could justify policies of those values, and some applicants were found to be on Medicaid. Many had applied after attending a seminar at an Assisted Living Facility.
- After Ohio enacted legislation prohibiting STOLI, a 74 year-old Cleveland resident was transported to Pittsburgh, Pennsylvania on a promise of \$8-15,000, if she applied for life insurance. The application indicated a net worth of \$12,500,000. Due to indicators that this might be a STOLI transaction, a carrier representative met with the applicant - who was shocked to learn that the face amount of the policy was \$9 million. The applicant and her husband receive \$950 combined income per month from social security and have a net worth of \$2,000. The application was rejected, the broker's appointment terminated, and the case reported to Insurance Departments Fraud Units. Understandably and unfortunately, the applicant is now concerned for her personal safety.

Who's the Victim?

Advocates for prohibition of STOLI are frequently asked the question, "Who's the Victim" of a STOLI scheme? Well, there are many "victims":

Seniors may be unwittingly participating in fraud by misrepresenting their health, their financial status and/or the intent of the purchase. If investors lose due to policy application misrepresentation, they may claim damages against the insured or the insured's estate.

The elderly may be exposed to tax consequences from receipt of income from the forgiveness of premium financing loan indebtedness, from two years of "free insurance", and from bonus money or other cash or property incentives (free cars, free cruises, free meals) they receive.

Participants may be ineligible for additional life insurance coverage needed for last expenses, beneficiary support or estate planning because the investors are holding all the coverage capacity for which the senior qualifies.

There may be legal consequences regardless of how things turn out. Since most STOLI transactions involve trusts, the insured's beneficiaries may sue to recover benefits if they feel the transaction transferring the insurance death benefit to investors lacked insurable interest or was not otherwise legally sound.

History demonstrates that when the actual experience of the insured group turns out to differ from expectations, the insurer may suffer unanticipated losses over time. This would be yet another example of where fraud could likely reduce the availability of coverage for a vulnerable market.

If sufficiently aggrieved, the insurer may elect to incur legal costs in the pursuit of contract rescission based on a lack of insurable interest, material misrepresentations in the application, or fraud. As in any business, such costs work their way into higher rates for the classes of risks exhibiting the unpredictable experience.

New underwriting efforts initiated by insurers to detect and deter STOLI applications will result in additional expense to monitor all new business to ensure that only cases with legal insurable interest are effectuated.

And, since STOLI changes anticipated experience, such as mortality and expected lapse rates, life insurance may become less affordable for all Americans. (*See additional commentary in Attachments A and B*).

Where's the Value?

Clearly, life insurance companies that work daily to write as much business as possible would not be trying to stop sales of large amounts of insurance to any market unless they were convinced that STOLI transactions are unacceptable to consumers, to the industry and to society. These transactions:

- Violate the very spirit and purpose of insurance
- Are about investment arbitrage and not insurance protection;
- Generate value only to the transactional intermediaries (via broker commissions, legal costs, trust fees and premium finance costs), as did most sub-prime mortgages. In these cases, both the insurance company and legitimate investors in pension and other funds may be harmed, just like homeowners and legitimate investors were harmed in the sub-prime mortgage fiasco.

Life settlement providers engaged in STOLI claim that they add value for insureds who originally purchased insurance for their own purposes, but who either no longer need the insurance or who have greater current day needs. However, a recent study of 2008 settlements found that 50% of the reported settlements occurred within four years of original policy issuance. Could the reasons for buying insurance in the first place by so many individuals settling their policies really have changed so much, so soon? Even more telling was the finding that over one-third of the settlements were done two to three years after policy origination -- just after the expiration of the insurance policy contestable period⁴. STOLI has to be the reason for the vast majority of this activity.

Regulatory Activity

Prevention of STOLI has been a priority issue for insurance regulators and legislators. The National Association of Insurance Commissioners (NAIC) adopted a Model Act that prohibits the sale of a policy or its benefits for five years after issuance, unless the policy was paid for by the insured or his/her family, or there is a change in family circumstances, such as serious illness or death of a spouse. The National Conference of Insurance Legislators (NCOIL) Model Act took a somewhat different approach and makes entering into any practice or plan which involves STOLI a "Fraudulent Life Settlement Act", subject to civil and criminal penalties. Twelve states enacted meaningful laws in 2008. This session, laws have been adopted in five states, two

⁴ Life Policy Dynamics, LLC - 2009

more await gubernatorial signature, and another eleven states currently have legislation pending.

The state legislative battles have been challenging, with the settlement providers, premium financing companies and investors employing scores of local lobbyists to weaken or defeat the Model bills. The NAIC Model's Five Year Settlement Prohibition is clearly the most effective deterrent to STOLI because it operates as a matter of economics, does not impose new enforcement burdens upon regulators, and is more difficult to game. The claim heard most often in opposition to the NAIC restriction on the sale of a STOLI policy before five years is that any limitation on a sale is an interference with the property rights of policy owners. However, property rights are not absolute. Lawmakers have enacted zoning laws, restrictions on the sale of alcohol to minors, prohibitions on resale of prescription drugs – all motivated by concern for the "public good". And, lawmakers and the Courts continue to affirm that the "public good" requires that there be a legitimate insurable interest when acquiring life insurance. None of the state laws prohibit the sale or transfer of a policy if the premiums are paid with the policyowner's own money, or if there is a significant change in life circumstances, such as the death of the intended beneficiary, divorce or medical expenses. Restrictions on the sale of the policy only apply to STOLI policies. If none of the settlement providers are involved in STOLI policies, why are they working so hard to defeat the legislation?

Bottom Line

The purpose of life insurance is to protect individuals, families and society from the potentially devastating financial consequences of untimely death. The size of the benefits available, as well as the need to make the acquisition process easy and efficient, makes the product vulnerable to fraud and abuse. The industry takes great pains and goes to great expense to protect the integrity of what we believe to be a product that provides considerable value in many ways. We believe that STOLI is an egregious attempt by unscrupulous investors to take unfair advantage of both product providers as well as the elderly for personal profit. It is even worse than the no money down, no principal payment, adjustable rate mortgages that ignited the current economic crisis. There are no gray areas in STOLI and we need strong, clear regulation to prohibit it in every state. We hope that the Senate Special Committee on Aging will advocate that position and the ACLI stands ready to offer its assistance to Congress and the state legislatures.

In closing, let me offer the following. STOLI is not just an issue in the United States. It has spread to civilized countries around the world. A recent story in *The Press* of Christchurch, New Zealand, detailed how to buy and then cash in "the life-insurance policies of rich, elderly and soon-to-die Americans", who are likely to "pop their clogs within a reasonable time frame." The article pondered, "Whatever will the financial world dream of next?" We need to end those dreams to prevent them from becoming one more nightmare for our economy and our society.

Attachment A**STOLI – Who is the Victim?**

There are many participants in a Stranger Originated Life Insurance (STOLI) transaction, some understanding the full ramifications of the “deal” and others woefully uninformed. STOLI is not a victimless crime, and it is important to try to understand what the unforeseen consequence may be to parties involved in STOLI.

The Insured who agrees to buy insurance under a STOLI transaction may not be aware that:

- STOLI is fraud – it is theft by deception of the insurer and violates state insurable interest laws – and they may have wittingly or unwittingly participated in insurance fraud, if the insured helped disguise the nature of the transaction or his true state of health or financial condition from the insurer.
- The payments received from the settlement company or investors, as well as the discharge of indebtedness on any related premium financing, may be taxable as ordinary income.
- They may not be able to buy any additional future life insurance for the benefit of family members or business associates, as the STOLI investors are holding all the coverage for which they qualify.
- The “free” insurance for the first two to three years may be taxed each year on the economic value of the coverage.
- Their personal information, including medical records, may be shared with entities not subject to state and federal privacy laws.
- There is no guarantee that the investors will buy the policy at the end of the premium financing period, and the insured may have to pay huge interest charges.
- They will have no way of knowing who holds the policy on their life because it can be resold many times over, and the insured has absolutely no control over who will be the beneficiary.
- They have agreed to receive calls, as often as once a month, to ascertain if they’re still alive.
- There is no guarantee they will receive the payout promised, as nothing is in writing, nor can it be, because that would be proof of intent to skirt insurance law.
- An estate may be liable to investors if, for some reason, the investors can’t collect for the insurance they expected to receive.

The American Consumer who has never heard or participated in STOLI may:

- Find that life insurance is less available and affordable, as insurers respond to changes in anticipated experience caused by fraudulent STOLI transactions.
- Discover that it is more difficult to purchase life insurance, as agents and brokers abandon traditional sales to engage in the lucrative STOLI business.
- Find that their pension funds have been placed with these questionable “investments”.

The Insurance Company whose policies are caught up in a STOLI scheme may:

- Find the underlying economics of its business and its reputation at risk.
- See its fundamental business assumptions undermined. Insurers pool risks of similar nature and charge a premium based on the law of large numbers and expected experience. Investors deconstruct the averages and fraudulently attempt to arbitrage the insurer’s projections by targeting policies at specific ages (typically 70–80) and ratings to produce a higher return for themselves.

- Be forced to rescind policies and file litigation when state insurable interest laws have been violated and/or where application data was falsified - a costly response that could diminishes the favorable public image of an industry so dependent on customer trust.

The Investors may:

- Find they hold a worthless security, if the policy is rescinded for violation of insurance law or fraud.
- Find that the value of "mortality futures" is less than anticipated, as the insureds live longer than anticipated, thus requiring continued payment of high premiums.
- Be involved in costly litigation, where profits don't match promises - settlement companies have sued life expectancy evaluators, investors are suing settlement providers and investors are suing investors.
- Find their brand damaged due to negative publicity and litigation involving STOLI investments.

The Brokers/Agents may:

- Find that abiding by the law places them at a disadvantage, including requiring that they spend additional time and expense to avoid participating in STOLI transactions.
- Find themselves involved in fraud and conflict of interest challenges, including civil and criminal legal actions and loss of their insurance license.
- Find commissions recaptured if a policy is rescinded.
- Suffer reputational risk if an agency is associated with one or more STOLI claims.
- Find themselves involved in nasty litigation with former beneficiaries, perhaps without E&O coverage.

The Financial Markets may:

- Be exposed to yet another securitization scheme - similar to energy futures and sub-prime mortgages.
- Not have sufficient familiarity with life insurance underwriting and pricing and lack the knowledge and experience to determine credit ratings for these "investments".
- Not be equipped to identify STOLI fraud, as there is no transparency in these schemes and no Regulator when the portfolio is sold to hedge funds or private equity funds.

Attachment B

The Truth about Lapse Rate

At some point in almost every STOLI legislative debate, the settlement providers, investors and financing entities make the accusation that life insurer's benefit from a high lapse rate⁵. The implication is that life insurer's real intent in pursuing anti-STOLI legislation is to destroy the secondary settlement market – since that market supposedly might decrease lapse rates, thus depressing life insurers' profits.

First and foremost - lapse rates are not the issue. Life insurance is priced taking into account the actual experience that an insurer expects in regards to deaths, lapses, surrenders and the like. This is not a lot different from other forms of insurance. For example, when homeowners purchase fire insurance they have every expectation that they will never collect. And, Property and Casualty insurers price those policies, based on past experience, not to have adequate funds to rebuild every customer's home, but to have the resources necessary to rebuild the homes of those very few who have the misfortune of having a fire. If the policies were priced to rebuild every home, no one could afford homeowners insurance.

The same is true for life insurance. Insurers never expect to receive a claim from every policy. Most Life insurance customers buy policies to have peace of mind during those periods of their lives when they have financially dependent family and/or businesses. In fact, one of the most common types of life insurance is Term Life, which serves as a safety net and is designed to expire after the need ends, such as when dependent children are educated and grown. Policyholders purchase Term policies with every hope of never having to file a claim. And, the policies are priced based on actuarial experience validating that very few will collect – making them affordable to young and middle age Americans with growing families.

An individual may maintain a policy for 50 years and then decide that they no longer need the insurance protection or have better uses for the money. In that case, they may let the policy lapse. There is nothing "bad" or "wrong" about letting that happen after deriving the intended protective value of the coverage.

The inference in our opponents' accusation is that insurers have collected premiums to cover the payment of a death benefit on each and every policy and that when a death benefit is not paid, the insurer then pockets that benefit. In truth, of course, the total of premiums collected would never cover a death benefit for all policyholders. Life insurance is affordable because, based on actuarial tables; premiums are calculated to pay benefits for only that percentage of the pool that will eventually file a claim. There is no "bonanza" left for the insurer when policies lapse, since the premiums charged assumed a lapse rate in line with actual experience, thus enabling the insurer to reduce the premiums collected for all policyholders in the pool. If insurers did not include that lapse rate in their prices, they would be challenged for over-charging.

The STOLI market is much different than the market described above. The minimum target age for a STOLI transaction is 65, and probably older. In addition, when investors own the policies, with the sole intent of profiting from the death benefits, they are most reluctant to ever lapse a policy. Consequently, lapse rate assumptions based on past experience are no longer valid. If insurers must now presume that a high percentage of sales to seniors are really to benefit a third party investor, prices will have to be significantly increased for all senior sales, including those intended for legitimate family, business and estate planning purposes. This reality was clearly understood by the Fourth Circuit when it opined:⁶

"The insurer is ... faced with changed economic risks that were not factored into its calculation of premiums. Under the two-party arrangement that preexisted the viatical settlement, the insured was in a class of persons that statistically surrendered a portion of its policies or let a portion of them lapse. Insurance companies rely on these surrender and lapse rates to calculate premiums to charge for life insurance policies. The viatical provider distorts these rates, however, because it will always hold onto the policy until the insured dies in order to protect its investment. Thus, as the initial actuarial risk is distorted with each new viatical settlement, the risk-spreading profile of the insurer becomes less reflective of its initial calculations."

⁵ Lapse rates include: death, expiration, surrender, exchange or non-payment of premium. (When a policy is replaced with a policy issued by another carrier, because data is collected from each insurer rather than industry-wide, the replacement will be recorded as lapse.)

⁶ *Life Partners v. Morrison*, 484 F.3d 284, C.A.4 (Va.); cert. Denied, 128 S.Ct. 708 (December 3, 2007).

Appendix 1

Examples of Court Cases addressing Insurable Interest and Wagering

Alabama: Brewton v. Ala. Farm Bureau Mut. Cas. Ins. Co., 474 So. 2d 1120, 1122 (Ala. 1985); **Alaska:** State Farm Auto. Ins. Co. v. Raymer, 977 P.2d 706, 710 (Alaska 1999) (insurable interest prevents insurance contracts from being used as a means of wagering); **Arkansas:** Corning Bank & Trust Co. v. Foster, 74 S.W.2d 797 800 (Ark. 1934) ("a wagering contract of insurance is contrary to public policy, and void"); **California:** Jimenez v. Protective Life Ins. Co., 8 Cal. App. 4th 528, 536 (1992) (if there is no insurable interest: the policy is a mere wager on the life of the person insured, and...void as against public policy"); **D.C.:** Watson v. Mass. Mut. Life Ins. Co., 140 F.2d 673, 676 (D.C. app. 1943) (purpose of an insurable interest is "to limit [the] speculative business of buying and selling insurance...on the lives of others"); **Delaware:** Baltimore Life Ins. Co. v. Floyd, 91 A. 653, 656 (Del. 1914) ("insurance procured upon a life by one or in favor of one under circumstances of speculation or hazard amounts to a wager contract and is therefore void"); **Florida:** Life Ins. Co. of Georgia v. Lopez, 443 So. 2d 947, 950 (Fla. 1983) (in "the absence of an insurable interest, the law condemns such policies as mere wagering contracts"); **Georgia:** Burton v. John Hancock Mut. Life Ins. Co., 298 S.E.2d 575, 578 (Ga. 1982) ("wager" contracts procured on another by a beneficiary having no "insurable interest"...in the life of the insured are void"); **Illinois:** Colgrove v. Lowe, 175 N.E. 569 (Ill. 1931) ("contract of insurance upon a life in which the [owner] has no interest is a pure wager, that gives the [owner] a sinister counter-interest in having the life come to an end"); **Indiana:** Salem Lodge No. 21, F. & A.M. v. Swails, 197 N.E. 837, 839 (Ind. 1935) (a policy...taken out by one upon the life of another when [there is] no insurable interest in the life [is]...violative of public policy); **Iowa:** Hult v. Home Life Ins. Co., 213 Iowa 890; 240 N.W. 218, 227 (Iowa 1932) (a life insurance contract must be based upon an insurable interest, in the absence of which it becomes a wager contract and void); **Kansas:** Geisler v. Mut. Benefit Health & Accident Ass'n, 163 Kan. 518; 183 P.2d 853, 857 (Kan. 1947) (contracts are against public policy if (a) "they are...wagering in character and (b)...afford an incentive to crime"); **Kentucky:** Ficke v. Prudential Ins. Co., 202 S.W.2d 429, 431 (Ky. 1947) ("the lack of an insurable interest creates...wager policies, which are invalid"); **Louisiana:** Adam Miguez Funeral Home, Inc. v. First Nat'l Life Ins. Co., 234 So. 2d 496, 499 (La. Ct. 3d Cir. 1970) ("the public policy purpose of requiring an insurable interest is to prevent wagering contracts on insurance risks"); **Maine:** Getchell v. Mercantile & Mfrs.' Mut. Fire Ins. Co., 83 A. 801, 802 (Me. 1912) ("Wagering policies are forbidden as against public policy"); **Maryland:** Hopkins v. Hopkins, 614 A.2d 96, 100 (Md. App. 1992) (the "requirement of insurable interest was intended to prevent wagering on human lives"); **Michigan:** Hicks v. Cary, 52 N.W.2d 351, 354 (Mich. 1952) ("a life insurance policy naming as beneficiary one who has no insurable interest in the life of the assured is a wagering contract, void as against public policy"); **Missouri:** Estate of Bean v. Hazel, 972 S.W.2d 290, 292 (Mo. 1998) ("one must have an insurable interest in a person's life in order to take out a valid policy of insurance on that person's life"); **New Hampshire:** Mechanics' Nat'l Bank v. Comins, 55 A. 191, 193 (N.H. 1903) ("insurance procured by one person upon the life of another, the former having no insurable interest in the latter, was void as a wager contract"); **New York:** Scarola v. Ins. Co. of N. Am., 323 N.Y.S.2d 1001 (N.Y. App. Term 1971) (the "vice sought to be avoided by requiring insurable interest is to prevent the insurance policy from becoming a wagering contract"); **North Carolina:** Wharton v. Home Sec. Life Ins. Co., 173 S.E. 338, 339 (N.C. 1934) ("a person cannot take out a...policy of insurance for his own benefit on the life of a person in which he has no insurable interest"); **Ohio:** Westfall v. Am. States Ins. Co., 334 N.E. 2d 523, 525 (Ohio Ct. App. 1974) (a "wager policy" is one in which the insured has interest only in the loss or destruction of the property or thing insured); **Oklahoma:** Delk v. Markel Am. Ins. Co., 81 P.3d 629, 634 (Okla. 2003) (the "insurable interest requirement was to prohibit wagering contracts in the guise of insurance"); **Oregon:** Brett v. Warnick, 75 P. 1061, 1063-64 (Ore. 1904) ("before one can be permitted to take out a policy of insurance upon the life of another for the former's benefit he must have an insurable interest in the life of the latter"); **Pennsylvania:** Van Cure v. Hartford Fire Ins. Co., 253 A.2d 663 (1969) ("insurable interest is founded upon the public policy against wagering"); **South Carolina:** Warren v. Pilgrim Health & Life Ins. Co., 60 S.E.2d 891, 893 (S.C. 1950) ("one cannot obtain valid insurance upon the life of another in whom he has no insurable interest"); **Tennessee:** Duncan v. State Farm Fire & Casualty Co., 587 S.W.2d 375, 375 (Tenn. 1979) (finding an insurable interest "essential" or "the contract amounts to no more than a wager and is void"); **Texas:** Cheeves v. Anders, 28 S.W. 274, 276 (Tex. 1894) (it "is against public policy for one to be interested in the death of another when he has no interest in the continuance of his life"); **Virginia:** Green v. Southwestern Voluntary Ass'n, 20 S.E.2d 694, 696 (1942) ("it has long been held that in the absence of an insurable interest, a policy on the life of another is contrary to public policy and cannot be enforced"); **Washington:** Buckner v. Ridgely Protective Ass'n, 229 P. 313, 316 (1924).

The CHAIRMAN. Thank you, Mr. Avery.
Mr. Peden.

**STATEMENT OF SCOTT PEDEN, PRESIDENT, LIFE PARTNERS,
INCORPORATED, WACO, TX**

Mr. PEDEN. Mr. Chairman, Senator Martinez and members of the committee, I'm honored to testify in front of you today as an industry representative, on behalf of Life Partners, Inc., as this panel examines the life settlement industry. I appreciate the work of this committee in protecting the interests of our parents and our grandparents.

Life Partners is the oldest, and the only publicly traded provider in the life settlement industry. The typical policy that is presented to Life Partners is \$1 million to \$10 million in face, and is owned either by a legal entity—such as an insurance trust—or by financially sophisticated individual.

As is apparent, most senior Americans do not own the type of large-face policies that I'm referring to. The policy owners that Life Partners deals with are financially sophisticated seniors.

The life settlement industry provides a private sector solution to a public sector problem—that is, illiquidity among senior Americans. Prior to the establishment of our industry, policies which are now sold would simply have been abandoned, and the inherent value in those policies given up as windfall profits to life insurance companies.

Now, the liquidity needs of these seniors are being met, privately, discretely, and in a manner that is beneficial to both the purchaser and the seller. We ask nothing more than for insurance companies to fulfill these contracts into which they freely entered.

Unfortunately, the life insurance lobby has promoted State legislation to deter these life settlements, and help them retain their windfall profits. The insurance lobby is extremely well-financed and influential, but it is not looking out for the best interests of American seniors. That is unfair, and extremely detrimental to policy owners.

Now, let me address some of the issues that the committee is specifically investigating. No. 1, the issue of soliciting seniors to purchase policies for a later sale.

We know that there is a concern for senior citizens who might fall victim to arrangements in which they are paid to purchase a policy with a contemporaneous arrangement to sell it, at a future date. This, so called, investor-initiated life insurance, or stranger-initiated life insurance, is a practice which Life Partners has never engaged in. But it is important to note that this is an agent supervision issue—not a live settlement issue.

Insurance agents should assess the true needs of consumers, and should answer all application questions truthfully. But, it is up to the insurance companies to make sure that their agents follows these rules. Then, if the insurance company chooses to issue a policy, they do so with the full knowledge that the United States constitution permits that policy owner to sell the policy at some point in the future.

No. 2, the regulation of live settlement brokers, and their commissions. A live settlement broker offers valuable advice and serv-

ices to their clients, and they deserve to be compensated for it. However, unlike our company, they represent the policy owner. Uniform, Federal regulation may be appropriate in order to protect those who are financially unsophisticated.

No. 3, State versus Federal laws a regulations. Article I, section 8 of the United States Constitution authorizes Congress to regulate commerce among the several State. Most life settlement transactions are interstate in character, sometimes involving a number of different States. The burden of complying with a patchwork of conflicting State laws only raises costs, and lowers the ultimate value paid to policy owners.

Of course, State legislators can certainly regulate intrastate transactions, but the jurisdiction of State legislatures must end at their borders, and States' efforts to extend their jurisdiction beyond their borders, and venture into congressional jurisdiction, must be clearly and completely preempted.

No. 4, clarifying the tax liabilities arising out of a life settlement transaction. We would urge the committee to consider legislation which clearly defines any tax liability for policy owners. We believe that the proceeds from a life settlement should be treated as a capital gain or loss, based on the difference between the total amount of premiums paid for the policy and the amount of proceeds from the sale.

Our overall recommendations to Congress for dealing with the life settlement industry are as follows: First of all, recognize that the secondary market for life insurance is not the business of insurance, and should be regulated differently than our insurance companies.

No. 2, passing 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 seniors who want to sell their policies.

Also, it should recognize that many of the reported abuses or problems with the issuance of policies to unqualified insureds, rests with practices of insurance agents, and insurance companies—not with life settlement companies.

Recognizing that strict regulation may not be appropriate or necessary for accredited or sophisticated insurance consumers, and establishing an appropriate regulatory construct that recognizes a distinction between ordinary insurance consumers, and those who are financially sophisticated.

Mr. Chairman, Senator Martinez, it has been a privilege to offer our company's perspective on the life settlement industry. Life Partners has a firm commitment to protecting unsophisticated policy owners, and preserving the property rights of all senior Americans. We appreciate your consideration, and look forward to your questions.

[The prepared statement of Mr. Peden follows:]

Prepared Testimony of Scott Peden
President and General Counsel
Life Partners, Inc

U.S. Senate Special Committee on Aging
Hearing on "Life Settlement Industry"
April 29, 2009

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.

The CHAIRMAN. Thank you, Mr. Peden.
Mr. Freedman.

STATEMENT OF MICHAEL FREEDMAN, SENIOR VICE PRESIDENT, GOVERNMENT AFFAIRS, COVENTRY, FORT WASHINGTON, PA

Mr. FREEDMAN. Chairman Kohl, Senator Martinez, my name is Michael Freedman, I am the Senior Vice President of Government Affairs for Coventry First. I appreciate the opportunity to testify before the committee, and especially appreciate the committee's interest in the secondary market for life insurance, and life settlements, specifically, and the question, what's at stake for seniors? I'm pleased to share my views on that subject today.

As the market for life settlement develops, a lot is at stake for consumers. One of the most significant of these issues is whether consumers will be able to realize the fair market value for their policies.

Until recently, policy owners had two options for divesting unneeded, underperforming, or unaffordable policies. Stop paying premiums and allow the policy to lapse, or surrender the policy.

According to a leading international actuarial firm, approximately 88 percent of life insurance policies are surrendered or lapse without paying a death benefit.

A policy surrender value is typically a small fraction of its market value, and the value paid by an insurer for a lapsed term policy is zero.

Life settlements provide a valuable alternative to the lapse or surrender of a policy. They pay policy owners fair market value for their policies. These payments typically exceed the surrender value by many multiples. Coventry is a leading participant in that market, and we have paid policy owners approximately \$2 billion in excess of surrender value of their policies.

Coventry purchases policies mostly from sophisticated trusts, corporate entities, and high net-worth individuals who are represented by counsel and financial advisors. We believe that these policy owners' decision to sell a policy should be properly performed.

Coventry requires sellers to establish that they are sophisticated. We disclose to consumers alternatives to life settlements, including borrowing against their policies, cash value, and accelerated death benefits available under the policy.

In addition, we inform prospective sellers that life settlements may have tax consequences, and advise them to seek professional advice before selling their policies.

Of equal importance, Coventry strongly believes that consumers' privacy must be protected. To that end, we had implemented extensive procedural safeguards that protect confidential financial and medical information of policy owners, and insureds.

How do we protect what's at stake for consumers? Coventry believes in a properly regulated life settlement market, with regulations that provide clarity, consistency, transparency, and a level playing field. We proactively support life settlement regulation across the United States.

The American Council of life Insurer's has referred to Coventry as the "principal initiator of life settlement legislation in the States." Today, 31 States regulate life settlements, and States such as California, New York and Illinois are in the process of enacting such laws this year. By the end of 2009, State law regulating life settlements are expected to cover nearly 90 percent of Americans.

Coventry supports measures that prohibit stranger-originated life insurance. We do not condone STOLI transactions, and we have supported the legislation adopted in numerous States since the start of 2008, addressing STOLI.

As we come together today to consider what's at stake for consumers, I feel compelled to report that many insurance companies aggressively take steps to deprive consumers of access to this important market. It has been a common practice for insurers to prohibit their agents from informing policy holders about the option of a life settlement. Insurance companies have terminated agents for helping their customers sell their policies, leaving these consumers with few, if any, option beyond the lapse or surrender or those policies.

Insurers have sought to rescind policies sold in the secondary market, and have imposed contractual restrictions on policy sales. Some have even refused to issue policies when a prospective policy owner indicates an awareness of the policy's market value. Worse still, insurance companies have promoted legislation that has been criticized as anti-consumer and protectionist by State legislators and by consumer advocates. All of these efforts are calculated to protect corporate profits at the expense of consumers.

Coventry supports fair competition in a market regulated to provide transparency for consumers and a fair playing field for business. Such a market is the best way to protect and provide the most value for consumers.

I appreciate the opportunity to appear here today, and I'm available to answer any questions, Chairman Kohl.

[The prepared statement of Mr. Freedman follows:]

**STATEMENT OF MICHAEL FREEDMAN,
SENIOR VICE PRESIDENT OF COVENTRY FIRST LLC**

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As the market for life settlements develops, a lot is at stake for consumers. One of the most significant of these issues is whether consumers will be able to realize the fair market value of their policies. Until recently, policyholders had two options for divesting unneeded, underperforming, or unaffordable policies: Stop paying premiums and allow the policy to lapse, or surrender the policy. According to a leading actuarial firm, approximately 88% of life insurance policies are surrendered or lapse without paying a death benefit. A policy's surrender value is typically a small fraction of its market value, and the value paid by an insurer for a lapsed term policy is zero.

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legislation in the states.” Presently, 31 states regulate life settlements, and states such as California, New York, and Illinois are in the process of enacting such regulations. By the end of this year, state laws regulating life settlements are expected to cover nearly 90 percent of Americans.

Coventry supports measures that prohibit Stranger Originated Life Insurance (“STOLI”). We do not condone STOLI transactions, and we have supported the legislation adopted in numerous states since the start of 2008 addressing STOLI.

As we come together today to consider what’s at stake for consumers, I feel compelled to report that many insurance companies aggressively take steps to deprive consumers of access to this important market. It has been a common practice for insurers to prohibit their agents from informing policy owners about the option of a life settlement. Insurance companies have terminated agents for helping consumers sell their policies, leaving those consumers with few, if any, options beyond the lapse or surrender of those policies. Insurers have sought to rescind policies sold in the secondary market, and have imposed contractual restrictions on policy sales. Some have even refused to issue policies when a prospective policy owner indicates an awareness of the policy’s market value. Worse still, insurance companies have promoted legislation that has been criticized as “anti-consumer” and “protectionist” by state legislators and consumer

advocates. All of these efforts are calculated to protect corporate profits at the expense of consumers.

Coventry supports fair competition in a market regulated to provide transparency for consumers and a fair playing field for businesses. Such a market is the best way to protect and to provide the most value to consumers. Thank you.

The CHAIRMAN. Mr. Freedman, what actions has your firm taken to ensure that your brokers are not engaged in stranger-originated life insurance, known as STOLI?

Mr. FREEDMAN. Mr. Chairman—

The CHAIRMAN. Mr. Freedman, then we'll hear from you, Mr. Avery.

Mr. AVERY. Thank you, thank you.

Mr. FREEDMAN. Mr. Chairman, as I indicated in my testimony, we do not condone STOLI. STOLI is a practice that hurts consumers, it hurts insurance companies, and it hurts the life settlement market.

But, as Mr. Avery characterized it as a sub-set of life settlements, it's not. It's a sub-set of the sale of life insurance. Our companies don't have the authority to write life insurance, but it's the agents of the carriers that do. It is a problem at the inception of a policy, and not the assignment.

As I've indicated, we have supported legislation primarily based on the National Conference of Insurance Legislators that provides targeted measures to attack STOLI where it occurs—at the inception of a policy. Measures to identify the schemes that are being used in premium finance transactions, transactions that are used to hide it in trust arrangements, to attack where it occurs, in the sale of life insurance.

The CHAIRMAN. Mr. Avery, would you like to comment?

Mr. AVERY. I would comment on a few points, here, if I may.

First, at Prudential, which I will comment on, we attempt to understand the need for the insurance and the funding of insurance, and that we really are protecting someone who has an insurance need. If so, regardless of the funding, we will offer that insurance. If we think it is STOLI, we will not.

In regards to one of the comments that I think both of the gentlemen made about windfall profits, and insurance companies trying to hold onto those, I think we all would agree—and I think the gentlemen here are equally smart to understand—is under a fire insurance policy, it is priced to pay claims on only those policies that result in a devastation of the home.

Similar in life insurance—these are not windfall profits. Insurance companies price their policies to take into account those policies that are expected to surrender and those, as they point out, that are expected to lapse. So, there really is no windfall profit issue, here, this is a function of what is taken into account in the pricing of the policy.

The CHAIRMAN. Mr. Peden, you would like to see the patchwork of State regulations replaced by a Federal uniform law. What would such legislation include? Are there any State statutes that we might consider, at the Federal level?

Mr. PEDEN. Well, at the risk of looking chauvinistic, Texas, I think, has a very good law, and certainly would serve as a fine model. I think the important thing is, if it is done on a uniform level—and that's where we have the problem right now—it is patchwork because many of the States' laws are conflicting. What we need is one set of rules that applies to interstate commerce. That is why I've promoted the Federal legislation which would then preempt the States from going off and doing their own things.

What I think is necessary is the recognition that the secondary market for life insurance is regulated in a different way than life insurance is done, and so it doesn't necessarily take away from those States who want to regulate and have traditionally regulated life insurance companies. We're not trying to do that.

But we are trying to do is demystify and uncomplicate transactions, which have become unnecessarily complex because of this patchwork. If we have one set of rules, especially with regard to disclosures, with regard to what must be done, everybody knows the rules, and so we're all singing off the same page. If you're not, that leads to uncertainty, risk evaluation, which we have to price in, and the fact that you may not be able to sell your policy, at all.

If you're in a State which has onerous regulation and not very much business, you won't be licensed in that State. So that deprives individual seniors who are there, who want to sell their policy, of the ability to access a market.

Federal regulation, it seems to me, is the most effective and efficient way of being able to level the playing field, and make sure everybody knows what the rules are.

The CHAIRMAN. Mr. Avery, Mr. Freedman, do you agree with what Mr. Peden—Mr. Freedman?

Mr. FREEDMAN. Mr. Chairman, Senator Martinez, I believe that the story of regulating of life settlements has been a good story, simply because 6 years ago, 10 States had regulation. As we sit here today, 55 percent of Americans are covered by State regulation governing life settlement transactions. As I indicated in my testimony, with the passage, hopefully, of laws expected in California, New York, Illinois and other States, the number of—the percentage of Americans that will be covered by State regulation of life settlements would be close to 90 percent. That's a good story.

I think beyond that is that—the fact that consumers are well-protected in the transaction, from the moment they say, "I think I want to sell my policy," the law requires they deal with a licensed person, that companies like ours be licensed, that the transaction have lots and lots of transparency in that transaction.

It's important, too, that we have been able to reach the kind of consensus on legislation, around this country. Just in the last year and a half the life settlement industry, our company, and the life insurance industry have equally supported legislation in 14 different States.

The most recent State that signed into law was Washington State. Unanimous support for that by all parties, it includes all the kinds of consumer protections I'm talking about, but importantly included also a protection to make sure consumers knew about their option to sell their policy, so that they weren't left in the dark, so they weren't being prevented from hearing about it, that's the kind of legislation that we would support. The ACLI supported it, we supported it, and we think that's a good model for the rest of the nation.

The CHAIRMAN. Yes.

Mr. Avery, would you comment?

Mr. AVERY. Yes, we agree with Mr. Peden that different patchwork legislation is problematic, however we will state that both the NAIC Model Bill, which was then followed by the National Con-

ference of Insurance Legislators Model Bill, are very good bills, and in fact together, we think they solve the issues that we're discussing today.

However, when we go State by State, we do find the settlement industry and the premium finance industry lobbying very hard for changes to those law or model acts that we think really water them down or create loopholes. That is what's creating the patchwork. We do have model laws, that if adopted as designed either by the NAIC or NCOIL, or some combination thereof, we think effectively address the most egregious issues here.

I will state that one of the things, that I think you highlighted in your opening comments, is the need for transparency, which I think all panel members agree. We need not just transparency at the individual transaction level, but we've heard issues earlier today about some of the industry fighting the ability to collect data on transactions undertaken.

The latest transaction data that we've seen, and it's from the settlement industry and it's not total, it's about one-sixth of the transactions, indicate to us, from their own data, that 50 percent or more of the policies that settled in 2008 were only in force between two and four years—or, I'm sorry—in force less than four years. Yet, when we talk about settlements, we think of people owning policies a long time and then not needing them. When you combine that with the comment that these tend to be large policies held by a trust the actual data, if we had it, would tell us, what's the real essence of the transactions going on and are we dealing with people who have held insurance and no longer need it, and therefore have a commercial right to sell it? Or are we dealing with policies that were fabricated for the purpose of stranger-initiated life insurance? That would be very helpful.

The CHAIRMAN. Good.

Mr. Martinez.

Senator MARTINEZ. Thank you, sir, I appreciate it.

I would agree with you, Mr. Avery. I think that is a very healthy way of looking at it and that's the kind of transparency that I think we have been discussing. Because I think we unanimously agree that STOLIs are bad, but yet they continue to exist and grow in numbers. So, I would ask you, and then other panel members, what are we going to do about it? How do we get it to stop?

I think Mr. Freedman makes a good point, they're at the tail end of the transactions—I have a lot of questions about that end of the transaction—but they don't originate the policies in the first place. So, how does it happen? I mean, obviously they don't write policies. You do, or your agents do. How do we improve that part of the equation?

Mr. AVERY. Well, I'll speak for a minute on behalf of Prudential and not the American Council Life Insurers.

Senator MARTINEZ. But, speak on both.

Mr. AVERY. OK, I—at Prudential we do not allow our agents to participate in these transactions and we spend a significant amount of money and resources policing this, which is not helpful, but we do it because we do believe these transactions are bad for the industry and the consumers as a whole, because that's what we do.

I believe at the American Council, I think companies that are as concerned as we are on it are attempting to do the same thing, but it is patchwork and you do run into the legal side of how do you really find fraudulent transactions?

As you might imagine, finding fraudulent transactions and proving them in a timely way is both expensive and is not fail-proof. So that is one of the reasons why we encourage legislation after, say, the NAIC Model Act and NCOIL Model Act, which we think would be effective. In the NCOIL Act, it makes STOLI a fraudulent act, which then can come with criminal and civil penalties, and we think that's appropriate.

Senator MARTINEZ. Mr. Peden, we know that the sellers of these kinds of policies can liable for tax liability, to the extent that they have a gain on the investment that they're making. Does your firm disclose the potential for tax liability?

Mr. PEDEN. We do. We make the similar kinds of disclosures, which agreements—contracts also do, we just suggest that they consult their tax advisor in that regard, because each person's tax consequences may be different, depending on the circumstances.

Senator MARTINEZ. Do you issue them a 1099?

Mr. PEDEN. We do—the escrow agent that we use does issue the 1099 in that regard.

Senator MARTINEZ. Mr. Freedman, I am obviously concerned, as you would imagine, with the issue in Florida. Ms. Senkewicz spoke about that, and we discussed it as well. There seems to be a settlement that was undertaken as a result a number of transactions in the State of Florida.

There was a resolution to this matter back 2007 and a consent order was entered. You agreed to adopt a business practice enhancement plan, is my understanding. You also agreed to pay \$1.5 million in connection with the Office of Insurance Commissioners Investigation and Examination, and agreed to future examinations.

Now, Ms. Senkewicz told us here today that there is now litigation about whether or not they can look at your books and see whether your practices now are more in keeping with good business practices, Florida law, et cetera. It would seem to me that in good faith, your—your company would welcome this oversight. It would be part of what it takes to do business in the State of Florida.

Rather than a motion for preliminary injunction, you should say, "Here are the books, look them over. We want to be in compliance with Florida law, we want to have good business practices. We know we have a sordid record," that you might disagree with what occurred, but you did enter into a settlement.

There are questions that I think are very legitimate about your practices in New York. So, why wouldn't you want to have Florida's Insurance Commissioner looking at your books so that you can then go to Florida consumers and say, "We've got a good house-keeping seal of approval, our books have been opened to the State of Florida," rather than litigate the matter?

Mr. FREEDMAN. Senator Martinez, Coventry does strive to be in compliance with the laws, and particularly the laws in Florida. As you referenced, the Office of Insurance Regulation came to our company following the New York civil matter. They came and in-

vestigated, looked at the company, concluded that investigation, as you indicated, with the consent order. There was a reimbursement for the costs of that investigation. There was no finding of wrongdoing, there was no penalty, there was no fine.

They did come and say, "We want to do a market conduct exam." As you can imagine—

Senator MARTINEZ. You did agree to a business practice enhancement plan?

Mr. FREEDMAN. Yes, sir. What we did in that is we provided—made permanent some voluntary improvements that we had made.

Senator MARTINEZ. Did you not also agree to future examinations?

Mr. FREEDMAN. Yes, sir. As the Department came to ask to do another examination, as you can imagine, our desire to comply—sometimes it runs into conflict with other laws, in that providing information under Florida would cause us to be in violation of laws in other States, particularly with respect to disclosure of transactions that don't involve Florida policyholders, that would expose their sensitive personal medical and financial information from another State into Florida.

We simply have asked—

Senator MARTINEZ. Would you agree to provide the information on Florida policies with Florida policy holders and Florida citizens?

Mr. FREEDMAN. Senator Martinez, yes, we did say that we would and we have provided that information on Florida policyholders already. The issue is a narrow one and it involves policy owners from out of State. We've asked the court to examine the Florida law on this matter.

I think it's important to note that the Office of Insurance Regulation itself can't be entirely sure because they went to the legislature this year asking in a legislation for clarity on this one issue, saying, "We want the State legislature to authorize us to look at out of State information." That legislation was introduced by the OIR to say—because they aren't sure. We aren't sure, that's why we asked the court.

Senator MARTINEZ. Have you taken a position on that legislation?

Mr. FREEDMAN. We have not taken a public position on that legislation. We have legislation in, as well, that would clarify the law that the State of Florida's regulation covers Florida policy owners, such as we've already provided to the OIR.

Senator MARTINEZ. Let me just say, in the State of Florida, we have a very large senior population, as everyone knows. In that population, over the years, Florida has been vulnerable to land schemes, to sub-prime lending, where we are leading the world in more troubled real estate—maybe competing for California for the lead. There's a lot about this that would have, on the surface, the appearance of some of these things, which have really required vigilance, legislation, and we've come a long ways in the State of Florida. I, as a Florida Senator, have to tell you that I am going to be very interested in going forward and how we can make sure the Florida citizens are well protected by this, as well as citizens across our State, I mean across our nation.

Let me just ask one last question, Mr. Chairman, if you would allow me.

The CHAIRMAN. Sure.

Senator MARTINEZ. The business of securitizing, as I was hearing the commentary from the prior panel about the securitizing of this business arrangement. It had an awfully, awfully similar sound and smell to the securitizing of sub-prime lending.

Sub-prime lending got us in a world of trouble. It all sounded great. I remember Fannie and Freddie telling me, "We are bullet-proof, there is no chance that we're going to ever be in trouble, because we are doing everything by the book, everything is great, ever-growing housing market," et cetera, et cetera.

Can any of you address the issue of securitizing and whether, in fact—I mean, I'm concerned about brokers—it's the same thing, you see. There were brokers with very little disclosure with no clear path as to who they were really working for. Were they working for the seller, the buyer, the borrower, or none of the above, themselves, where they were getting a fee? We're talking about middle people that were not clear to anyone in the transactions, of which there was no transparency, banks that were making the loans, brokers that were securing them, passing them off to someone else who would then securitize them, bundle them, sell them into a marketplace that included the world. No one was asking the questions, but at every step of the transaction, everyone was getting a very healthy bite.

So, everything was good, life was good until it wasn't. A result of that, we have had TARP, we have got the rescue of Fannie and Freddie at great cost to the Federal Government. I'm not suggesting that this is the same thing, it just smells and sounds an awful lot like it. I would like for each of you to address that issue.

Mr. AVERY. Thank you, Senator Martinez, I'll go first if I may.

You're right to point out the analogy that there are some common ingredients. First off, the one common ingredient is that most of the intermediaries are paid up front to do the transactions, so the essence is on get the transaction done. If you understand at the end of the day the investor is expecting to get above market return, the only way you can get above market return is someone has to give up value. So in these transactions, for there to be a winner, there must be a loser.

The question is, is it the senior citizens who's giving up value in their policy or is it the insurance company who is being misled with misinformation on the issue of the policy or being arbitrage. So the question long-term will be, who is it that's giving up value and how serious will that be.

To your point, it is very possible that at the end of the day that the investors who are buying up these life insurance contracts once they're pooled, and some of these investments are in fact held in qualified pension plans, which seniors are depending on for their retirement value, could wind up, that if the lives insured live longer than were expected by whoever's evaluating these policies to determine value, that these investments will not be worth what they think they are and that the investors are going to have to continue to pay the premium required on the life insurance to wait for

the ultimate death benefit, or decide that it's a bad investment and have it go under.

So, some of your analogy absolutely applies, and it applies to both the investor, the insurance company, and at times, the senior citizen.

Thank you.

Senator MARTINEZ. Mr. Peden?

Mr. PEDEN. I'm afraid I'm going to have to disagree with Mr. Avery's characterization, primarily because, as he should know, when a policy is issued, it has inherent value. It's a \$5 million policy because it says on the front of it, it's a \$5 million policy. That is completely different than in the sub-prime characteristic where it was a market-related type of deal because of the—the value of houses and that sort of thing.

Senator MARTINEZ. But they had appraisals, there were appraisals on the houses.

Mr. PEDEN. That's true, they had appraisals, but that's still dependent on the appraiser. In this particular instance, you know that the policy itself has a future value of \$5 million, it has inherent value.

Senator MARTINEZ. I'll agree with that.

Mr. PEDEN. It is asset-based instead of market-based kind of investment. We do not actually securitize policies and ship them off like that, however I would say that because of the nature of these policies, because they are secure, these are issued by some of the most well financed and financially solid companies in the United States and in the world, that it is a much better type of investment and would actually be able to shore up some other kinds of asset or funds that are not doing so well. I would much prefer to own this kind of asset because it is asset-based rather than investment-based.

Now, in the case you're referring to, with regard to securitization and that sort of thing, obviously there are areas, of course, securities laws when it referred to that and still apply to that, and I appreciate the opportunity to draw a distinction, which Mr. Joseph neglected to mention, with regard to the settlement of the issue of Life Partners in our State.

Mr. Joseph, apparently, and the State of Colorado did not like the United States Court of Appeals decision, holding that our transaction was not a security, and so they changed the law, going against what Federal law was. One of the things he was—his commission did acknowledge though, was that no investor has alleged or asserted any impropriety against defendants with respect to their investments.

I wanted to make sure that the Committee was aware of that, that there was no allegations of fraud in that regard, just simply a law school question as to the design of the transaction.

Getting back to what we're talking about here, with the securitization, I think that it's important—many of the States law now, with regard to brokers, it's very apparent and it's very clear who the broker is representing. I'm very proud that I actually drafted much of the legislation that was picked up by a lot of the States that says, "There is a fiduciary duty by the broker," irrespective of how he's paid, whether it's by fee or taken out of the

proceeds or however it is, he has a duty as one master, and that is the person who is selling the policy.

We, on the other hand—

Senator MARTINEZ. I would submit to you that his master is who pays him—

Mr. PEDEN. Well—

Senator MARTINEZ [continuing]. At the end of the day.

Mr. PEDEN. Well, the thing I think is important is, the law imposes that fiduciary duty on him, whether—whether it comes out of the—out of the deal—

Senator MARTINEZ. But if it's contrary to financial incentives, I think that's always problematic.

Mr. PEDEN. Well, I would certainly agree and I think that being able to put that into codified legislation is important. Because you are right, it is important to see who the broker is representing. The broker should be representing one party, the person selling the policy.

On the other side of the transaction, are provider companies like Mr. Freedman's and mine, and we are on the buy side of that. We're friendly, we get along with the brokers, but at the end of the day, we represent different parties and so there is a fair transaction in that regard.

Senator MARTINEZ. That makes sense, that makes sense.

Mr. Freedman, just to conclude.

Mr. FREEDMAN. Yes, Senator Martinez, you probably have heard enough on that issue. I simply would address one aspect of it. You alluded to the, with respect to securitization, these policies are moved along in—

Senator MARTINEZ. Right.

Mr. FREEDMAN [continuing]. In the transactions, in the secondary, tertiary markets.

One the things that was stated earlier, but needs correction, is that when a policy holder sells their policy, one of the standard disclosures that's provided and one of the requirements in those, and that we support, is that policy owners and the insureds in those policies know who owns those policies, even beyond the initial sale of the policy by that person, that the insured be notified within a short period of time of any subsequent ownership of the policy.

They're told of that at the—before they enter the contract. If they don't want the policy sold, again, they can say, "We just don't want to do this transaction." They're aware of that, that's an affirmative position that they take, it's a disclosure that they are provided. That also carries with that policy protections, which we've maintained are very important, that their information be protected throughout the stream of commerce.

Senator MARTINEZ. That's a good point for you to make.

Mr. PEDEN. Mr. Martinez, our contracts say the same thing, as well.

Senator MARTINEZ. Thank you all very much.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Martinez.

We have Senator Udall with us today. Thank you for being here, Senator Udall.

Senator UDALL. Thank you, Mr. Chairman. This is an important set of topics. I want to thank you for holding this hearing, and in particular for your focus on shielding consumers and investors from fraud, abuse, and deception. We've learned quite a great deal here today about the potential for that in these instruments.

Senator Martinez, thank you for your questions and I want to associate myself with your remarks in pushing for transparency. I think you have particular expertise and insight given, as you point out, your State and its history and its population.

I want to also thank Commissioner Joseph he served on the first panel. We're proud of the work he's done in Colorado. I'd say to Mr. Peden, he's not perfect, but I think Commissioner Joseph really has operated in his professional life with the interest of consumers up front and center. I know there are times when well meaning and well intentioned people and organizations have a difference of opinion.

If I might, I'd like to direct a question, first to Mr. Freedman. In your written testimony you indicated the extent that Coventry believes in strongly protecting consumer privacy with regard to those transactions. I'd like you to explain in detail, and with examples although you may want to submit some of that for the record, of the safeguards you've taken to protect the financial and medical information of policy owners and insureds.

Additionally, could you share with the Committee what steps, if any, you've taken to ensure that policy holders are not being contacted by third parties to inquire about their health status. We've certainly heard those stories.

Mr. FREEDMAN. Senator Udall, I thank you for the question. Coventry does value the privacy of individuals, both owners and insureds, of their medical information, of their financial information. Our company has sophisticated technology, you know, in software, encrypted in order to maintain that within our own systems, closed systems so that they aren't able to be released. Our company also limits the disclosure of private information to future investors, investors in policies, limiting and retaining the ability to prohibit the use of that information or the release of that information to individual investors, so that only sophisticated investors such as some of the investors in the market, banks, insurance companies, people that know how to handle and are used to handling sensitive personal, medical, and financial information are doing so.

We also support the regulations that are being adopted around the country that require the maintenance of privacy—of that type of information, medical and personal information, both from our transaction throughout the life of the policy.

We also support and maintain that the limitations on contacts, that are found in most State laws, that are limited to contacts with either the insured or the insured's representative, which is usually the case, a designated representative to check on the health status, to maintain that—that contact, limited to—not frequent contacts, but relatively infrequent contacts.

Senator UDALL. I'd like to follow up after the hearing with some additional questions and ask you to generate some examples. I know there have been cases where third parties have called, trying to get a sense of when a life insurance policy might pay off and I

think we all, at least I certainly do, view that situation with some horror and distaste. So, if we could follow up with you, I'd like to do so.

Mr. FREEDMAN. Yes, Senator.

Senator UDALL. If I might, in reading Mr. Avery's testimony, Mr. Freedman's testimony, you both have a strong aversion, it appears to STOLIS. Is there anybody who supports STOLIS and is there any time at which that would be an appropriate insurance instrument?

Mr. AVERY. I think, Senator, when people are asked the question you just posed, whether they support STOLI, I think everyone today says uniformly that they do not. That was not true in the early days of STOLI. However, defining what is STOLI and having a bright line is very difficult and that's why we're pushing for regulation that clarifies that.

For example, there are instances where a consumer will buy a policy, and as long as there's no written agreement, even if they were to sell the policy six months later, when they had the intention to sell it. We would argue that's STOLI, others would argue, no, that's their property right to do so. We think whenever there's an inducement to purchase a life insurance contract with the thought that it will be sold, generally after the contestability period nowadays, that that is STOLI. So it's around the definition of what is STOLI. It's what is.

Senator UDALL. Mr. Peden.

Mr. PEDEN. Thank you, Senator. The problem that Mr. Avery brings up is that you can not adequately or prove, in an empirical fashion, what the intent of someone was. If I buy my house today for, say \$100,000 and tomorrow somebody offers me \$200,000 for it, that sounds like a good deal. I didn't have the intent to sit on it or I may have to live in the house 15 years before it appreciates that much. So it's difficult to say what the intent of the individual was.

There is no question, however, in the law, that if there is a contemporaneous to sell the policy at the time the policy is taken out, that is STOLI and that is something that I don't think anyone here supports. So we would join that as well, of course.

Senator UDALL. Mr. Freedman.

Mr. FREEDMAN. Senator Udall, thank you. As everyone has said, STOLI is bad. As I've testified earlier, it harms the consumers and it harms the insurance companies, it harms our business as well, the secondary market.

As Mr. Peden said, it—first, as Mr. Avery said, there needs to be a bright line and that bright line is clearly established, that the person who is taking out the policy has to have an insurable interest. That bright line is established that there not be fraud in the application or the issuance of the policy. It was also stated, that there not be an inducement. Those are clear, bright line standards.

Where the schemes have come up, the National Conference of Insurance Legislators have said, "We're going to find those schemes, we're going to define those schemes and we're going to attack those schemes." That's the way to do it, and we think that's been successful as States are adopting that model.

Senator UDALL. I know you've all suggested there is some difficulty in defining a STOLI versus an insurance instrument. We all agree a clear definition is necessary and appropriate.

Knowing the Chairman as I do and knowing the ranking member as I do, they're going to continue to work to find that definition, because when this is subject to abuse, it's just not acceptable, it's flat out not acceptable. So, we'll continue, I know, to work with you and also insurance commissioners and other experts draw that bright line in a clear way.

Mr. Peden, if I might, I'd like to come back to the interchange you had with Senator Martinez when you talked about the difference between asset-based and investment-based securities. You said that when \$5 million is on a life insurance policy, that's backed up and that \$5 million will be forthcoming.

I'm still curious, and I think the Senator was—was on an important line of questioning, and I think what he was trying to get at is where is that \$5 million held, where is that \$5 million payout going to come from. Because you still are using leverage, insurance companies still utilize that approach, after all, the money is going to be invested elsewhere to generate a return. I think, Senator Martinez, you were on to something, to ensure that the face value is actually going to be paid out. Could you comment, perhaps the rest of the panel would like to as well.

Mr. PEDEN. Certain and thank you very much for the question. Senator Udall, I think that—it's important to recognize that—I beg your pardon—it's important to recognize that the—the solvency and the solidity of the insurance companies whose policies are purchased in a life settlement is extremely important. We rely not only on the applications, which individuals complete with regard to their financial capacity and other representations they make in that, but also with regard to the oversight which the various States issue on these policies—these companies.

We want to make sure that they maintain their high ratings because—you asked where the \$5 million comes from. It comes from Prudential or Northwestern Mutual or any of the other insurance companies that are out there. These are all extremely large insurance companies. They have to be because only a large insurance company can issue a large-face policy.

Now I can't speak to other companies because we only buy policies from sophisticated individuals who, as I said, the faces are usually \$1 to \$10 million. So, the quality of the insurance company is quite, quite good. What we want to see is a very healthy and remaining healthy insurance industry, but one which does recognize and does not impede the rights of individuals to see their policies when those policies become obsolete. Those are the kinds of situations that we're talking about and that is the niche which life settlements fills.

Senator UDALL. Mr. Avery or Mr. Freedman, you don't have to comment, but if you'd care to.

Mr. AVERY. I'd be glad to, Senator. We certainly agree with Mr. Peden that the large life insurance companies are sound, on a solvent basis, and we appreciate the fact that he wishes we'd remain sound, but you go back to my issue about that if the investor is going to get an above market return, it's coming from somewhere

and someone. If a certain industry undertakes certain actions that cause that to happen, then does question long-term run the solvency of that.

So, in my own case at Prudential, one of the reasons we want to be sure we're not participating in the STOLI transactions, which we think are arbitraging the pricing of policies, we want to make sure that we're not writing those policies because we intend to remain solvent a long time.

Senator UDALL. Mr. Freedman.

Mr. FREEDMAN. Senator Udall, really just taking from the two other gentleman, that there is a value and that value is being paid to consumers. The value may be being paid by carriers as a result of a secondary market transaction to a life settlement company or to an investor, but the value that the policy holder receives is what's really at stake. Are they taking a cash surrender value, are they taking a market value, and are they getting that value through the types of transparent transactions that we support?

I really would just close with, my—at least my response with, I want to refer to the 1886 Wisconsin Supreme Court decision that said that—the court said that they were not able to perceive why the holder of a valid policy should be prevented from realizing the value of the same to him, before his death, by a bona fide sale or assignment thereof. Such a sale or assignment may be, in fact, absolutely necessary in order to get any benefit of his policy. That's what's protected in their ability to sell that, for them to get that value.

So, the attack—the issue of getting that value is in the hands of the consumer, a competitive market gives them value, carriers may choose to give consumers that value or they'll wind up giving it to the secondary market.

Senator UDALL. Thank you, all three of you, for those explanations. I—in reading the testimony, it is fascinating, the case law around insurance products. It's tens of years, decades and longer, and we, of course, have a responsibility to pay attention to the case law, but as these products evolve we also have a responsibility to consider what might be happening.

We know in Washington all too well, that credit default swaps are a form of an insurance product, a very fancy and convoluted and complex insurance product, and they are part and parcel of the reason that we've had some very tough votes and very tough decisions over these last number of months.

So, thank you, Mr. Chairman. Thank you, Ranking Member.

The CHAIRMAN. Thank you very much, Senator Udall.

Any other comments from the panel or Senator Martinez?

You've rendered a real public service in being here today. The life settlements industry needs our attention and it will get it. Thank you so much.

[Whereupon, at 3:40 p.m., the hearing was adjourned.]

APPENDIX

FLORIDA OFFICE OF INSURANCE REGULATION RESPONSE TO SENATOR SPECTER'S QUESTION

Question. I have read a copy of the attached letter, dated May 8, 2009, from Michael Freedman, Senior Vice President, Coventry, to Senate Special Committee on Aging Chairman Kohl and Ranking Member Senator Martinez regarding the testimony of Mary Beth Senkewicz, Deputy Insurance Commissioner, Florida Office of Insurance Regulation, to the Special Committee on April 29, 2009. Ms. Senkewicz testified to the Committee that "Coventry refused to file an Annual Report for the period ending December 31, 2008, as required by Section 626.9913(2), Florida Statutes." But the letter she signed on March 10, 2009 states that Coventry's filing "fulfills Coventry's obligations under Section 626.9913(2), Florida Statutes for calendar year 2008."

I am interested to learn how you can reconcile the apparent conflict between Ms. Senkewicz's testimony to the Committee and her statement in the letter she sent to Coventry on March 10, 2009?

Answer. Please refer to our response to the letter submitted to Chairman Kohl and Ranking Member Martinez by Michael Freedman on May 8, 2009.

ACLI RESPONSE TO SENATOR SPECTER'S QUESTION

Question. I have received a copy of the April 15, 2009 letter from the Life Insurance Settlement Association to Senator Kohl (attached) in which, among other things, the Association states that "[u]fortunately, rather than compete against life settlements, insurers have engaged in a concerted effort to impair and inhibit the ability of American seniors to access the value of their life insurance assets. In this effort, insurers have sought to interfere with consumer rights under the contract of insurance, limit information and, egregiously, provided false and misleading information that has led many seniors to drop their policies without the benefit of knowing about the true market value of their policies." The letter contains both general and specific allegations, including that insurance companies have;

- fired agents for counseling clients about the secondary market;
- made false statements about life settlements and life settlement companies;
- provided misinformation to policy owners;
- pressured competing insurers to boycott premium finance loans;
- sought to rescind policies sold in the secondary market;
- imposed contractual restrictions on policy sales; and
- refused to issue policies when a prospective insured indicates having discussed life settlements with his or her agent."

What are your recommendations on how to protect consumers' in life settlement transactions against efforts that would impair consumers' access to information or assistance about life settlements?

Answer. In addition to the many excellent recommendation offered during the Committee's hearing of April 29, the ACLI recommends that the states faithfully enact the provisions of the NAIC Viatical Settlements Model Act or the NCOIL Life Settlements Model Act that require settlement disclosures to policy owners.¹ These disclosures were adopted by the expert insurance regulators and expert state legislators, respectively, after New York and Florida authorities found pervasive fraud in the business practices of settlement brokers and providers.² The nature of the

¹NAIC Model §8 and NCOIL Model §9.

²See *People of the State of New York v. Coventry* (New York Supreme Court No. 404620/06, filed October 2006; Denial of motion to dismiss and reinstatement of action for common-law

Continued

fraud included systematic breaches of fiduciary duty, conflicts of interest, unconscionable payments to settlement middle-men often in excess of the amounts paid to the consumer for his insurance policy, and questionable use of the consumer's personal information. Faithful adoption of the consumer protection provisions of the model laws will protect consumers' access to information with respect to life settlements, such as:

- There are alternatives to settlements including accelerated death benefits or policy loans offered under the insurance contract;
- A settlement broker represents the consumer exclusively and owes a fiduciary duty to the consumer;
- Some or all of the proceeds of the settlement may be taxable and tax assistance should be sought;
- Proceeds from a settlement could be subject to the claims of the consumer's creditors;
- Receipt of settlement proceeds could affect the consumer's eligibility for Medicaid or other government benefit or entitlements, and advice should be sought from government authorities;
- The consumer has a right to rescind a settlement contract;
- Funds will be sent to the consumer within three days of transfer of the insurance policy or its benefits to an investor;
- A settlement may forfeit or affect other rights or benefits of the insurance policy, such as conversion rights;
- Medical, financial or personal information about the consumer obtained by settlement providers or brokers—including personal identity information—may be disclosed to investors as necessary and often;
- The consumer may be contacted as often as once a month following settlement of his insurance policy to determine the consumer's health status and confirm his address and telephone number;
- Whether there is any affiliation between the settlement provider and the issuer of the insurance policy;
- The contact information of the settlement provider;
- Whether there is any affiliation between the settlement provider and investor purchasing the consumer's policy;
- The possible loss to the consumer of coverage on other lives if the policy is a joint policy or has family riders to the policy;
- The dollar amount of the death benefit, guaranteed insurance benefits, accidental death and dismemberment benefits that might be lost to the consumer by the transfer of the policy;
- Where and with whom the consumer's funds will be escrowed pending completion of the settlement transaction;
- The contact information of the settlement broker;
- All offers and counter-offers made for the consumer's insurance policy;
- Whether there is any affiliation between the settlement broker and any person making an offer to buy the consumer's policy;
- The amount and method of calculating the compensation paid to the broker from the value received for the consumer's policy;
- The total amount of the settlement broker's compensation; and
- The change in ownership of the consumer's policy if the settlement provider transfers it to another stranger or changes the policy beneficiary.³

Enactment of these disclosures will substantially protect consumer's access to information or assistance about life settlements in the settlement transaction.

fraud Ordered by Supreme Court Appellate Division at 2008 N.Y. Slip Op. 05548 (June 17, 2008)). The New York findings were corroborated by similar findings by insurance officials in Florida Office of Insurance Regulation v. Coventry (Order Show Cause No. 88270-06, resolved October 2007) (Order requires Coventry pay Florida \$1.5m plus submit to special compliance audits until 2009 as well as specially report all Florida resident transactions quarterly and more).

³The NAIC Model has additional protections for consumers who are purchasers of settled policies. See NAIC Model §8E, F and G.

**UNITED STATES SENATE
SPECIAL COMMITTEE ON AGING**



LIFE SETTLEMENTS: RISKS TO SENIORS

**SUMMARY OF
COMMITTEE INVESTIGATION**

MAJORITY STAFF

SENATOR HERB KOHL, CHAIRMAN

APRIL 29, 2009

LIFE SETTLEMENTS

Life settlements constitute a multibillion dollar industry.¹ A recent research report estimated that in 2008, the life settlement industry transacted business involving \$12 billion worth of U.S. life insurance policies' face values.² However, some academics and practitioners have questioned the validity of these figures given that life settlement providers are not required to report the volume of policies purchased to a central depository, and estimate that the potential life settlement market could exceed \$160 billion.³ While life settlements may be a valuable way for seniors to derive previously inaccessible economic value from their life insurance policies, recent news reports,⁴ complaints by state law enforcement,⁵ and notices from the Financial Industry Regulatory Authority (FINRA)⁶ have highlighted the dangers that life settlements may pose to seniors. Given these potential dangers and in response to numerous reports of industry misconduct and improper marketing, the U.S. Senate Special Committee on Aging (Committee) recently initiated an investigation into the composition and business practices of life settlement providers

The Committee requested information from select life settlement companies to better understand their business practices and how these providers are educating seniors about potential risks of entering into a life settlement. Specifically, the Committee requested information on these providers' (1) disclosure policies, (2) premium financing activities, (3) tax rewards, and (4) federal and state enforcement or disciplinary-related actions. The providers were selected based on their involvement within the life settlement secondary market, size of the assets under their management, and the extent to which they were involved in a federal or state enforcement action. The information collected is not representative of the entire life settlement industry.

The Committee's preliminary findings indicate:

- (1) life settlements may pose unintended consequences for seniors;
- (2) the Internal Revenue Service (IRS) has not clarified life settlements' tax liabilities;
- (3) most state securities regulators consider life settlement investments to be securities while the Securities and Exchange Commission (SEC) has yet to clarify its position; and
- (4) states are taking action to increase transparency in the life settlements market, but lack consistency.

¹ A life settlement is the sale of a life insurance policy by the insured person—generally 65 or older—to a third party for a cash payment. The third-party purchaser becomes the owner of the policy, pays all future premiums owed on it, and collects the death benefit when the insured person dies.

² Life Policy Dynamics, LLC, *Life Settlement Market Analysis 2008*, (Washington, D.C.: 2009).

³ Deloitte Consulting LLP and the University of Connecticut. *The Life Settlement Market: An Actuarial Perspective on Consumer Economic Value*, 2005. Conning & Co. Research, *Life Settlements: New Challenges to Growth 2008*. (Hartford, Connecticut, 2008).

⁴ Matthew Goldstein, "Death Bonds: Inside Wall Street's most macabre investment scheme yet," *Business Week* (July 30, 2007).

⁵ *People of the State of New York v. Coventry First LLC et al.*, New York Supreme Court, New York County, No. 404620-2006, (10/26/2006). http://www.ong.state.ny.us/media_center/2006/oct/complaint.pdf.

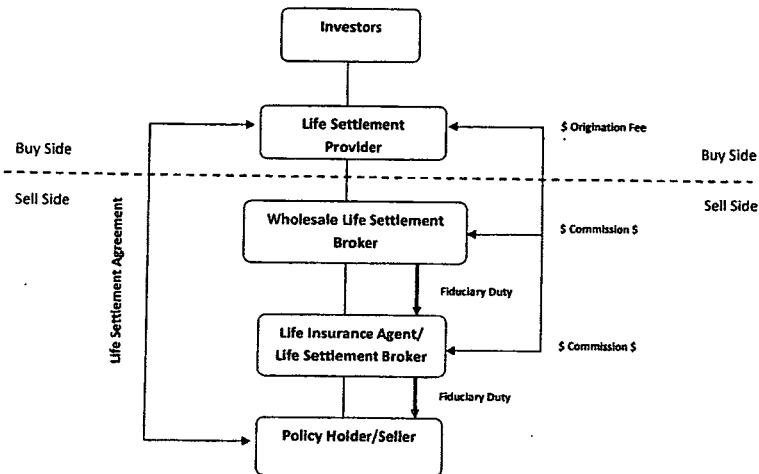
⁶ FINRA, Notice to Members 06-38, August 2006 and Investor Alert, "Seniors Beware: What You Should Know About Life Settlements" February 2007.

BACKGROUND

The life settlement market emerged out of the viatical settlement industry that developed in the 1980s as a source of liquidity for AIDS patients and other terminally ill policyholders with life expectancies of less than two years.⁷ Unlike viaticals, life settlements involve policyholders who are not terminally ill, but generally have a life expectancy of between two and ten years. According to one life settlement research firm, life settlements are a potential source of income for policyholders and are becoming an emerging alternative asset class for investors. Their research indicates that the annual and cumulative U.S. life settlement market grew from an estimated \$2 billion in 2002 to \$12 billion in 2007. The research firm projected in 2007 that growth should remain strong over the next years—growing from 12 billion in 2007 to approximately \$21 billion in 2012.⁸

The life settlement industry involves multiple players, such as life insurance companies, insurance agents, brokers, providers, and investment firms. (See figure 1 for an illustration of the typical life settlement transaction.)

Figure 1: Description of Life Settlement Transactions



Source: Leimberg, Callahan, Casey, Magner, Reed, Rybka, and Siegert, *Life Settlement Planning*, (Tools & Techniques, Cincinnati, Ohio: 2008.)

⁷ Viatical settlements refer to policy holders that have "catastrophic" or "life threatening" illnesses or conditions. Some viatical settlement laws also pertain to policy holders with chronic medical conditions, and others contain no discernible limitation.

⁸ Conning & Co. Research, *Life Settlements: New Challenges to Growth 2008*, (Hartford, Connecticut, 2008).

As shown in Figure 1, one of the key players in the life settlement transaction is the life settlement broker. A life settlement broker negotiates the sale of a life insurance policy between the policy owner and the buyer (the life settlement provider) for a fee or commission.⁹ Some industry experts have raised concerns about the transparency of broker commissions, and believe that there should be full disclosure of brokers' activities, including their fees and compensation—which purportedly may be as high as 35 percent of the policy's purchase price.¹⁰

INVESTIGATION RESULTS

In November 2008, the majority staff of the Special Committee on Aging began an investigation of the growing life settlement industry. The Committee requested information from different players of the life settlement industry, including brokers and life settlement providers.¹¹ Based on information obtained from select life settlement brokers, the Committee determined that these providers purchased policies from individuals with an average age ranging from 65 to 80 years, and that the average age of policies ranged from 6 to 8 years. The Committee also found that between January 2003 and February 2009, the total policies purchased by these companies varied, ranging from 567 to 6,200.

Life Settlements May Pose Unintended Consequences for Seniors

Given that retirees have recently seen their investment portfolios begin to shrink due to the economic downturn, seniors may increasingly turn to selling assets, such as their life insurance policies. While life settlements are a valuable source of liquidity, life settlements may pose unintended consequences, such as unexpected tax liabilities, decreased access to insurance coverage, board release of an individual's private health information, and financial and legal liability if the policy is rescinded due to participation in a stranger-originated life insurance (STOLI),¹² or other fraudulent transaction. In addition, life settlement brokers and other middlemen, who receive large commissions, may be aggressively targeting seniors to sell their life insurance policy on the secondary market. As a result, some regulators have noted that seniors need to be aware of the following:

Unexpected Tax Liability. The lump sum payment that seniors receive in exchange for their life insurance policy can be taxable. In addition, seniors may not be aware that any incentives provided in exchange for a life settlement policy may also be taxable.

⁹ Leimberg, Callahan, Casey, Magner, Reed, Rybka, and Siegert, *Life Settlement Planning*, (Tools & Techniques, Cincinnati, Ohio: 2009.)

¹⁰ Jane Bryant Quinn, *Putting Your Life Policy in Someone Else's Hands*, *The Washington Post*, Sunday, June 22, 2008.

¹¹ The Committee collected information from the following life settlement providers and brokers: Coventry, Life Equity, Lifeline, Life Partners, Peachtree, Advanced Settlements, Mosaic Management Group. The Committee also receive information from industry associations, such as the Life Insurance Settlement Association, the Life Settlement Institute, and the Institutional Life Markets Association, among others.

¹² STOLI involves the creation of a new contract of life insurance where the true "owner" of the policy at inception does not have a valid insurable interest in the life of the insured. It is solely to create an asset for investment purposes.

Committee Finding(s)

-- All of the life settlement providers that submitted information to the Committee acknowledged that they did not provide an opinion on the tax liabilities affecting seniors' and investors' life settlement transactions, but rather advised individuals to consult a tax advisor. Only one provider noted in their response to the Committee that they offer their policy owners with an informational pamphlet on the issue. The provider also noted that they do not take a position or offer any tax advice other than imploring the policy owner to consult their tax advisor with regard to any tax consequences because the area is "exceptionally murky." The company urged the Committee to consider legislation which clearly defines any tax liability for policy owners.

Confidentiality of Personal Information. When an individual engages in a life settlement transaction, they agree to release their medical and other personal information to the provider so that the buyer will be able to determine the worth of the policy. Once that information is obtained, it may be shared with other parties or resold to new investors without the policy holder's knowledge.

Committee Finding(s)

--All of the life settlement providers that submitted information to the Committee noted that they are subject to certain federal and state privacy statutes, such as the Health Insurance Portability and Accountability Act, and do not share information with other parties without the express permission of the insured. However, the Committee was not able to determine the extent to which such information was provided to multiple sources once permission was obtained.

Decreased Insurance Capacity. An individual has a finite amount of "insurance capacity" on his or her life. Once a senior sells his or her life insurance policy, the senior may be unable to obtain more life insurance should a legitimate need for life insurance arise. Scott Berlin, Senior Vice-President at New York Life Insurance Company, testified at a Florida state hearing, "that one of the things that seniors may not understand is that there's a certain amount of insurance an individual can qualify for—that insurance sold to someone else does not free up their capacity for additional insurance coverage."¹³

Committee Finding(s)

--Only two of the five providers that submitted information to the Committee stated that they disclose the possible insurance capacity limitation to the insured.

Financial and Legal Liability if Life Insurance Policy is Rescinded. Seniors may be financially and/or legally liable if a fraudulent scheme is uncovered related to their life settlement transaction. For example, a January 2009 report by the Florida Office of Insurance Regulation noted life insurers in Florida filed three multi-million dollar federal lawsuits in 2008 alleging the true nature of the transactions were allegedly misrepresented.¹⁴ While there was virtually no litigation involving life

¹³ Florida Office of Insurance Regulation. Hearing Transcript: *Stranger Owned Life Insurance (STOLI)*. Public Hearing, August 28, 2008.

¹⁴ Florida Office Of Insurance Regulation. *Stranger-Originated Life Insurance (STOLI) and the Use of Fraudulent Activity to Circumvent the Intent of Florida's Insurable Interest Law*. Report of Commissioner, Kevin M. McCarty. (January 2009).

settlements in 2005, the Committee found that there are currently over 100 cases being litigated nationwide.¹⁵

IRS Has Not Yet Clarified the Tax Liability of Life Settlements

Despite confusion among life settlement providers, the IRS has not clarified the tax implications of life insurance policies sold as a life settlement in the secondary market. Consequently, they advise their clients to seek advice from a professional tax advisor. However, tax professionals may not be able to properly advise their clients on their tax liabilities given the lack of clarification by the IRS about life settlement transactions.

According to the Congressional Research Service (CRS), there are several interpretations of the tax code and regulation for such transactions.¹⁶ CRS noted while there are varying interpretations of the tax consequences of these transactions, that in all cases normal penalties would apply for underreporting of income if the income is not reported.

In December 2007, the Department of the Treasury responded to an inquiry from Congressman Richard E. Neal, Chairman of the Subcommittee on Select Revenue Measures of the Committee on Ways and Means, addressing the tax treatment of life settlement transactions. The letter stated that the Treasury was "working closely with the Internal Revenue Service on how best to address these transactions." However, the Committee found that no action has been taken to date.

Committee Action: On April 6, 2009, Chairman Kohl sent a letter to the Department of the Treasury Secretary, Timothy Geithner, requesting that the Secretary direct the IRS Commissioner to take immediate action to clarify the tax treatment of life settlement transactions for both consumers and investors.

Secretary Geithner responded on April 27, 2009, noting that the Department of the Treasury and the IRS are taking deliberate steps to complete needed guidance, and expects that it will be published in the Internal Revenue Bulletin soon. (See Appendix I for the Department of the Treasury response letter.)

Most State Securities Regulators and the Securities and Exchange Commission Consider Life Settlement Investments to be Securities

Most states have an oversight structure for settlement products resulting from market abuses in the 1980s. Such products are regulated either through their respective insurance departments, securities departments, or some combination of both. While these oversight structures vary across states, as of

¹⁵ Rybka, L., Schick, B. & Teitelbaum (2008). *Hybrid Premium Financing- Is There a Right Way?* Presented at the 2008 LIMRA Conference.

¹⁶ According to CRS, the proceeds received for participating in a life settlement transaction may be considered ordinary income and taxed at the personal income tax rate of as high as 35 percent. An alternative interpretation suggests that a life settlement transaction could be taxed at capital gain tax rates, generally at 15 percent. In the case of stranger-originated life insurance (STOLI), under either interpretation, any forgiven nonrecourse loan amount would be taxable as ordinary income. In addition, insurance premiums not paid by the insured and/or promotional gift received may be treated as ordinary income. (CRS. Memorandum to Special Committee on Aging, Life Settlement/Vitiation of Life Insurance Policies, Including Stranger-Originated Life Insurance (STOLI). April 2, 2009.)

October 2007, 46 states and the District of Columbia had statutes regulating the purchase and investment of viatical or life settlements as securities transactions. Accordingly, several state securities regulators have recently taken action against life settlement providers and brokers operating in their specific states.¹⁷ For instance, in 2008, the Denver District Court ruled in favor of the Colorado Securities Commissioner that Life Partners, a large life settlements provider, violated Colorado securities law by selling unregistered life settlements in Colorado without a proper license.

Most states (46 states and the District of Columbia) and the Financial Industry Regulatory Authority (FINRA)¹⁸ consider life settlements to be securities. In August 2006, FINRA issued guidance on life settlements stating that a variable life insurance policy is a security and the sale of such a product in the secondary market is a securities transaction subject to its rules. While the Securities and Exchange Commission may assert oversight on a case-by-case, it has yet to formulate a formal position on the extent to which life settlement brokers and providers should be registered with the SEC.¹⁹

Committee Action: On April 6, 2009, Chairman Kohl sent a letter to Chairman Mary Schapiro of the Securities and Exchange Commission urging her to evaluate the extent to which life settlement brokers and providers should register and disclose their activities to the Commission.

Chairman Schapiro responded on April 28, 2009, noting that the SEC "will look carefully at the issues surrounding the registration of life settlement providers and brokers and the potential need to regulate more specifically in this area." (See Appendix II for the SEC response letter.)

She also clarified the Commission's jurisdiction stating that "a life settlement arrangement is typically comprised of two types of transactions: a sale by an individual owner of his or her life insurance policy, and a purchase by an investor of an interest in the policy or in a securitized pool of such policies. The sale of a life policy by its owner would involve a securities transaction subject to the Commission's jurisdiction in at least two circumstances. If the policy itself is a security (typically, a variable life insurance policy), that fact alone would bring the transaction under federal securities laws. Second, regardless of whether the policy itself is a security (and many life insurance policies are not), if the owner sold the policy in order to purchase securities with the proceeds, the sale could come under the Commission's jurisdiction.

The second part of the transaction—the purchase of an interest in the life insurance policy or a pool of policies—can be structured in a variety of ways, but in many cases, this transaction will involve the sale of a security and thus be subject to the Commission's jurisdiction."

States are Taking Action to Increase Transparency in the Life Settlements Market, but Actions Lack Consistency

Although most state insurance codes contain provisions that address life settlement transactions, these regulations vary widely. For example, some states only impose licensing requirements for agents/brokers while others may also include reporting and privacy requirements, advertising and marketing regulations, and require certain disclosures be made to policy owners (consumers) or the

¹⁷ State securities regulators taking action against life settlement providers include regulators from Alabama, Colorado, Hawaii, New York, North Carolina, and Wisconsin.

¹⁸ NASD v. Fergus et al., Complaint No. C8A990026 (May 17, 2001) (NASD Enforcement Action).

¹⁹ SEC v. Mutual Benefit Corps., 403F. 3d 737 (11th Cir. 2005).

affected insurer(s). Some states also impose varying penalties for failure to comply with statutory requirements: there may be either civil or criminal monetary penalties, prison sentences, or both; while some state viatical/life settlement statutes consider violations of their viatical/life settlement provisions to be violations of the state's "unfair practices" law, to be punished according to the penalty provisions, if any, of that respective law.

The National Association of Insurance Commissioners (NAIC) and the National Conference of Insurance Legislators (NCOIL) have model legislation addressing life settlements.²⁰ In addition to enhancing licensing regulations and disclosure provisions, the NAIC and NCOIL model acts address the issue of STOLI—the NAIC Model Act establishes a five-year moratorium on the settlement of policies having STOLI characteristics while the NCOIL model instead defines and bans STOLI practices.

Committee Action: The Committee will consider the extent to which significant consumer protection legislation is needed to address the inconsistency in state regulation of life settlements.

²⁰ The NAIC's *Viatical Settlements Model Act* was amended in June of 2007. NCOIL's *Life Insurance Settlements Model Act* was approved by NCOIL in November of 2007.

Appendix I: Response from the Department of the Treasury

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

April 27, 2009

The Honorable Herb Kohl
Chairman
Special Committee on Aging
United States Senate
Washington, DC 20510

Dear Chairman Kohl:

Thank you for your letter regarding the tax consequences to individuals who sell, and investors who buy, life insurance policies in the secondary market. We share your interest in these important issues and have been working on guidance to address them.

Given the importance of these issues, the Department of the Treasury and the Internal Revenue Service are taking deliberate steps to complete needed guidance. At this point, we expect that guidance will be published in the Internal Revenue Bulletin soon. We appreciate your interest in this important matter.

Sincerely,

A handwritten signature in dark ink, appearing to read "Timothy F. Geithner".
Timothy F. Geithner

U.S. Senate Special Committee on Aging
Senator Herb Kohl, Chairman

Appendix II: Response from the Securities and Exchange Commission



THE CHAIRMAN

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

April 28, 2009

The Honorable Herb Kohl
Chairman
Special Committee on Aging
United States Senate
Washington, DC 20510-6400

Dear Chairman Kohl:

Thank you for your letter of April 6, 2009 regarding the secondary market in life insurance policies, the so-called life settlement market. In your letter, you express concern regarding the level of transparency in the market, the regulatory approach to the transactions involved, and potential risks for seniors who sell their policies in the secondary market and for seniors and others who invest in life settlements.

I share your commitment to the protection of seniors and appreciate your concern that seniors be treated fairly in the marketplace and have access to accurate and unbiased information related to their investments. Transparency of the information needed to make informed investment decisions is the cornerstone of the federal securities laws. Life insurance is a crucial asset to many of America's seniors, which can be an important source of funds needed for current living expenses or a means to provide for their family members upon death. A decision to sell a life insurance policy is an important financial decision, and a senior (or any investor) that is involved in any life settlement transaction that constitutes a securities transaction, either as a seller of a life insurance policy or as an investor, is entitled to the full protection of the federal securities laws. These include required disclosures, suitability requirements applicable to broker-dealers, and antifraud protections.

As you know, a life settlement arrangement is typically comprised of two types of transactions: a sale by an individual owner — often a senior citizen — of his or her life insurance policy, and a purchase by an investor of an interest in the policy or in a securitized pool of such policies. The sale of the life policy by its owner would involve a securities transaction subject to the Commission's jurisdiction in at least two circumstances. If the policy itself is a security (typically, a variable life insurance policy), that fact alone would bring the transaction under the federal securities laws. Second, regardless of whether the policy itself is a security (and many life insurance policies are not), if the owner sold the policy in order to purchase securities with the proceeds, the sale could come under the Commission's jurisdiction.

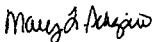
U.S. Senate Special Committee on Aging
Senator Herb Kohl, Chairman

The Honorable Herb Kohl
Page 2

The second part of the transaction - the purchase of an interest in the life insurance policy or a pool of policies - can be structured in a variety of ways, but in many cases this transaction will involve the sale of a security and thus be subject to the Commission's jurisdiction. The federal securities laws apply to "investment contracts," a term which is broadly defined by the courts and the Commission to include an investment of money in a common enterprise with the expectation of profit from the efforts of a promoter or a third party. Typically, the management activities and services provided by the party who arranges the life settlement and sells the interest to an investor will bring the transaction within the definition of an "investment contract." The Commission has brought enforcement actions against persons who sold similarly structured products called "viatical settlements" to investors. In one early Commission case in this area, the court concluded that the viatical settlements at issue were not securities, *SEC v. Life Partners*, 87 F.3d 536 (D.C. Cir. 1996); however, the Commission has continued to bring cases in this area, and the most recent appellate decision on the issue, *SEC v. Mutual Benefits Corp.*, 408 F.3d 737 (11th Cir. 2005), agreed that viatical settlements were securities subject to the federal securities laws. Nonetheless, we will look carefully at the issues surrounding the registration of life settlement providers and brokers and the potential need to regulate more specifically in this area.

I greatly appreciate your interest in this matter, and please don't hesitate to contact me at (202) 551-2100, or have your staff call William Schulz, Director of Legislative and Intergovernmental Affairs, at (202) 551-2010 should you need additional information. I look forward to working with you and the Committee in the coming months on this and other matters towards our common goal of protecting seniors.

Sincerely,



Mary L. Schapiro
Chairman

U.S. Senate Special Committee on Aging
Senator Herb Kohl, Chairman



8 May 2009

Honorable Herbert Kohl
Chairman of the United States
Special Committee on Aging
G31 Dirksen Senate Office Building
Washington, DC 20510

Honorable Mel Martinez
Ranking Member
Special Committee on Aging
G31 Dirksen Senate Office Building
Washington, DC 20510

Re: April 29, 2009 Life Settlements Hearing

Dear Senators Kohl and Martinez:

I write to thank you for the opportunity to testify before the Special Committee on Aging's April 29, 2009 hearing on "what's at stake for seniors" in the life settlement industry. As Senior Vice President of Government Affairs for Coventry First, I believe that what is at stake for seniors is the need for a competitive life settlement market governed by effective regulations that protect consumers in a free and open market. The hallmark of such effective regulation includes the protection of policyowners' property rights to sell their policies and to ensure for these policyowners clarity, consistency, transparency, and a level playing field for each transaction. We have supported, and will continue to support, such regulation, and strive to comply with laws and regulations governing our company and the market.

I am writing also to address an erroneous statement made by Mary Beth Senkewicz, the Florida Office of Insurance Regulation ("FOIR")'s Deputy Commissioner for Life and Health Insurance. Ms. Senkewicz testified that ***"Coventry refused to file an Annual Report for the period ending December 31, 2008, as required by Section 626.9913(2), Florida Statutes."*** To the contrary, Coventry made the complete filing mandated by the statute. Indeed, the FOIR issued a letter to Coventry on March 10, 2009, **signed by Ms. Senkewicz** that stated:

On February 25, 2009, the Office of Insurance Regulation ("Office") received Coventry First, LLC's ("Coventry") audited financial statement, report of life expectancy providers and license fee. ***The Office acknowledges that this fulfils***

***Coventry's obligations under Section 626.9913(2),
 Florida Statutes for calendar year 2008.***

A copy of that letter is attached.

Further, Ms. Senkewicz, in testifying as to why the FOIR did not have an approved annual report form, stated that: "[i]ronically, one of the reasons the current proposed form for the Annual Report has not been approved, is because it has been challenged by the industry causing delays in the administrative process." Well, *ironically*, the FOIR's form was ruled invalid this past week because the FOIR exceeded its authority by proposing a rule that would have required licensees to submit information regarding out-of-state transactions.

A Florida Administrative Law Judge, on May 7, 2009, struck down the FOIR's rule as an "invalid exercise of delegated legislative authority" in holding that the legislature did not grant the FOIR the authority "to collect data regarding transactions not even subject to Florida regulation." The judge stated quite simply that "[t]he problem with the proposed rule is that Respondents [FOIR] have erroneously assumed they have statutory authority to require the annual report to include any information/data that they determine should be collected." A copy of the Order is attached hereto.

While, on occasion, disputes concerning narrow matters of law between regulated entities and regulators do arise, it would be unfair to characterize these as obstacles to compliance or effective regulation. It might be more accurate to characterize these as the appropriate use of established administrative and judicial processes – hallmarks of our system of checks and balances – that ensure sound regulation.

I appreciate the opportunity to share these additional views relating to the Committee's important work concerning life settlements, and thank you in advance for including this letter in the public record.

Sincerely,



Michael Freedman

Attachments



OFFICE OF INSURANCE REGULATION

KEVIN M. MCCARTY
COMMISSIONER

FINANCIAL SERVICES
COMMISSION

CHARLIE CRIST
GOVERNOR

ALEX SINK
CHIEF FINANCIAL OFFICER

BILL MCCOLLUM
ATTORNEY GENERAL

CHARLES BRONSON
COMMISSIONER OF
AGRICULTURE

March 10, 2009

Coventry First, LLC
c/o Frank Santry, Esq.
Post Office Box 16337
Tallahassee, FL 32317-6337

Dear Mr. Santry:

On February 25, 2009, the Office of Insurance Regulation ("Office") received Coventry First LLC's ("Coventry") audited 2008 financial statement, report of life expectancy providers and license fee. The Office acknowledges that this fulfills Coventry's obligations under Section 626.9913(2), Florida Statutes for calendar year 2008.

The Office is currently engaged in rulemaking to adopt a new form for viatical settlement provider annual reports, Proposed OIR Form 1288 (REV 12/08), and is no longer using the previous form OIR Form 1288 (02/98). The Office will not take any action against Coventry First LLC for not filing a Viatical Settlement Provider Annual Report, OIR Form 1288 (02/98), for 2008.

Sincerely,

Mary Beth Senkewicz

MBS/ayh

MARY BETH SENKEWICZ • DEPUTY COMMISSIONER
200 EAST GAINES STREET • TALLAHASSEE, FLORIDA 32399-0326 • (850) 413-5104 • FAX (850) 488-2348
WEBSITE: WWW.FLOR.COM • EMAIL: MARYBETH.SENKEWICZ@FLOR.COM

Affirmative Action / Equal Opportunity Employer

STATE OF FLORIDA
DIVISION OF ADMINISTRATIVE HEARINGS

LIFE INSURANCE SETTLEMENT)	
ASSOCIATION,)	
)	
Petitioner,)	
)	
vs.)	Case No. 09-0386RP
)	
FINANCIAL SERVICE COMMISSION)	
AND OFFICE OF INSURANCE)	
REGULATION,)	
)	
Respondents.)	
)	

SUMMARY FINAL ORDER

This matter came on before the Honorable Suzanne Hood, Administrative Law Judge with the Division of Administrative Hearings, for disposition through summary final proceedings by written submissions.

APPEARANCES

For Petitioner: Wes Strickland, Esquire
 James A. McKee, Esquire
 Foley & Lardner, LLP
 106 E. College Avenue, Suite 900
 Tallahassee, Florida 32301

For Respondents: S. Marc Herskovitz, Esquire
 Office of Insurance Regulation
 Legal Services Office
 612 Larson Building
 200 East Gaines Street
 Tallahassee, Florida 32399-0333

STATEMENT OF THE ISSUES

The issues are whether Petitioner has standing to bring this action, and if so, whether portions of proposed Florida

Administrative Code Rule 690-204.030(1)(a), are an invalid exercise of delegated legislative authority in violation of Sections 120.52(8) and 120.56, Florida Statutes (2008).

PRELIMINARY STATEMENT

On January 23, 2009, Petitioner Life Insurance Settlement Association (Petitioner) filed its Petition for Determination of the Invalidity of a Proposed Rule with the Division of Administrative Hearings. On January 27, 2009, a Notice of Hearing was issued scheduling this matter for hearing on February 20, 2009.

Believing the issues had been sufficiently limited, the parties filed a Joint Motion to Proceed via Written Submissions and a Joint Stipulation on February 18, 2009.

An Order dated February 24, 2009, granted the Joint Motion to Proceed via Written Submissions. The Order required proposed summary final orders from the parties no later than March 31, 2009.

On March 31, 2009, Petitioner and Respondents Office of Insurance Regulation (OIR) and Financial Services Commission (the Commission) (collectively referred to as Respondents) timely filed their proposed orders, together with the following Joint Exhibits: (a) Respondents' file for the proposed rule; (b) Petitioner's Interrogatories and Respondents' responses; (c) Respondents' Interrogatories and Petitioner's responses; (d) Petitioner's Request for Admissions and Respondents'

responses; and (e) Respondents' Request for Admissions and Petitioner's responses.

Petitioner also submitted the following three exhibits that are accepted as evidence over objection: (a) 2008 Legislative Issues Form; (b) OIR's Response to Objections to Rules 690-204.010, .020, .030, .040, and .050 (the Viatical Rule); and (c) OIR's Draft Legislation - January 16, 2009, at 4:00 p.m.

FINDINGS OF FACT

1. OIR is an agency of the State of Florida, created within the Commission in accordance with Section 20.121(3)(a)1., Florida Statutes (2008). OIR is responsible for the administration of laws concerning insurers and other risk-bearing entities, including, but not limited to, viatical settlements.

2. The Insurance Commissioner is head of OIR except for rulemaking purposes. Pursuant to Sections 20.121(1)(c) and 624.308(1), Florida Statutes (2008), the agency head for rulemaking is the Commission.

3. Petitioner is a trade association that represents 12 of the 13 Florida-licensed viatical settlement providers. As an established trade association in the life settlement industry, Petitioner participates in legislative and regulatory matters in all 50 states. Petitioner is comprised of over 160 member companies nationwide.

4. Florida's Viatical Settlement Act, Part X, Chapter 626, Florida Statutes (2008) (the Act), involves the regulation of

viatical settlement providers. The Act regulates both viatical settlements and life settlements. Both types of transactions involve the sale of ownership interest in life insurance policies.

5. A viatical settlement relates to the sale of the ownership interest in a life insurance policy by a person who is expected to live for less than two years. A life settlement involves the sale of the ownership interest in a life insurance policy by a person who is expected to live for longer than two years after the date of sale. Viatical and life settlements are regulated in essentially the same manner. Both are included in the definition of "viatical settlement contract." See § 626.9911(10), Fla. Stat. (2008).

6. In a viatical settlement transaction, the "viatical settlement provider" is the purchaser of the ownership interest in a life insurance policy, including the right to receive the policy proceeds upon the death of the insured. See § 626.9911(12), Fla. Stat. (2008). The "viator" is the owner of an insurance policy who sells the ownership interest in the policy. See § 626.9911(14), Fla. Stat. (2008). The "viatical settlement broker" is the agent of the viator. See § 626.9911(9), Fla. Stat. (2008). The broker owes a fiduciary duty to obtain the best price for the insurance policy and typically, solicits bids from multiple viatical settlement providers on behalf of the viator. Id.

7. This controversy involves a challenge to proposed Florida Administrative Code Rule 690-204.030(1)(a), (the proposed rule) which states as follows:

690-204.030, Forms Incorporated by Reference.

(a) Form OIR-A3-1288, Viatical Settlement Provider Annual Report (REV 11/08).

* * *

Specific Authority 626.9925 FS. Law Implemented 626.9912(2), 626.9912(3), 626.9913(2), 626.9921(3), 626.9921(4) and 626.9928, FS. History-New

8. Petitioner specifically objects to Schedules B and C attached to Form OIR-A3-1288. Schedule B requests the following information on policies purchased for the most recent five years, beginning with the current reporting year: (a) total number of policies purchased (quantity); (b) total gross amount paid for policies purchased (dollars); and (c) total face value of policies purchased (dollars). The information is not limited to policies purchased in Florida.

9. Schedule C requests information relating to a summary of a licensed provider's business in every state, territory or geographical area. The information sought in Schedule C includes the following: (a) whether the provider is licensed/registered in the state; (b) the total number of policies purchased; (c) total gross amount paid for policies purchased; (d) total commissions/compensation paid for policies purchased; and

(e) total face value of policies purchased.

10. Respondent also challenges the portion of Form OIR-A3-1288 (Rev 11/08) that requires providers to annually file supporting documentation demonstrating any change to the provider's "method of operation as described in [the provider's] most recent plan of operations filed with OIR." The form requests this information in Interrogatory 1.(d) attached to the Annual Report.

11. The challenged portions of the Annual Report, incorporated by reference in the proposed rule, require viatical settlement providers to disclose detailed information regarding their nationwide and international business activities. The information, in a publicly available form, involves transactions not subject to Florida regulation.

12. On September 26, 2008, a Notice of Proposed Rulemaking relative to the Viatical Rule was published in Volume 34, Number 39, Florida Administrative Weekly. The notice indicated that a public hearing would be held on October 29, 2008.

13. On October 29, 2008, as indicated in the Notice of Proposed Rulemaking, a public hearing was held. Written comments from the industry were received both prior to and immediately after the public hearing.

14. Based upon comments from the Joint Administrative Procedures Committee (JAPC) dated October 22, 2008, a Notice of Correction was filed in Volume 34, Number 46, Administrative Law

Weekly, on November 14, 2008. The notice reflected that the agency head for rulemaking was the Commission.

15. On December 24, 2008, a Notice of Change was published in Volume 34, Number 52, Florida Administrative Weekly. The notice was based upon comments from JAPC, as well as comments at the October 29, 2008, public hearing.

16. On January 13, 2009, the hearing for final adoption of proposed Florida Administrative Code Rules 690-204.010, .020, .030, .040 and .050, was held before the Commission. Following some discussion, the Commission approved the proposed rules for final adoption.

17. The Commission met all applicable rulemaking publication and notice requirements, as set forth in Chapter 120, Florida Statutes (2008). Petitioner does not challenge the proposed rule pursuant to Section 120.52(8)(a), Florida Statutes (2008).

18. Petitioner does not challenge the proposed rule as imposing excessive regulatory costs, pursuant to Section 120.52(8)(f), Florida Statutes (2008).

19. The proposed rule imposes requirements on Florida licensed viatical settlement providers. Those requirements do not appear significantly different than those required in a number of other states.

20. Florida licensed viatical settlement providers would be subject to administrative penalties if they did not comply with

the proposed rule. See § 626.9913(2), Fla. Stat. (2008).

CONCLUSIONS OF LAW

21. The Division of Administrative Hearings has jurisdiction of the subject matter and the parties to this proceeding pursuant to Sections 120.56(1)(a), 120.569, and 120.57(1), Florida Statutes (2008).

22. In order to be "substantially affected" in accordance with Section 120.56(1), Florida Statutes, an entity must demonstrate that: (1) it will suffer an injury in fact of sufficient immediacy to entitle it to a formal administrative proceeding; and (2) the substantial injury is of a type or nature that the proceeding is designed to protect. Ameristeel v. Clark, 691 So. 2d 473 (Fla. 1997). The first prong of the test deals with the degree of injury, and the second prong with the nature of the injury. Accardi v. Department of Environmental Protection, 824 So.2d 992 (Fla. 4th DCA 2002); Agrico Chemical Company v. Department of Environmental Protection, 406 So. 2d 478 (Fla. 2d DCA 1981).

23. Petitioner has standing to challenge the proposed rule because the proposed rule impacts its members by requiring them to turn over sensitive business information in a public format. Additionally, all of Petitioner's licensed Florida members will be subject to administrative penalties if they do not comply with the proposed rule.

24. Petitioner has the burden of going forward with the

evidence and establishing a basis for the objections raised. As the Court stated in Southwest Florida Water Management District v. Charlotte County, 774 So. 2d 903, 908 (Fla. 2d DCA 2001): "A party challenging a proposed rule has the burden of establishing a factual basis for the objections to the rule, and then the agency has the ultimate burden of persuasion to show that the proposed rule is a valid exercise of delegated legislative authority." See § 120.56(1), Fla. Stat. (2008); Environmental Trust v. State, Department of Environmental Protection, 714 So. 2d 493 (Fla. 1st DCA 1998).

25. Petitioner argues that the proposed rule constitutes an invalid exercise of delegated legislative authority pursuant to Section 120.52(8), Florida Statutes (2008), which states as follows in relevant part:

(8) "Invalid exercise of delegated legislative authority" means action that goes beyond the powers, functions, and duties delegated by the Legislature. A proposed or existing rule is an invalid exercise of delegated legislative authority if any one of the following applies:

* * *

(b) The agency has exceeded its grant of rulemaking authority, citation to which is required by s. 120.54(3)(a)1.;

(c) The rule enlarges, modifies, or contravenes the specific provisions of law implemented, citation to which is required by s. 120.54(3)(a)1.;

(d) The rule is vague, fails to establish adequate standards for agency decision, or vest unbridled discretion in the agency;

(e) The rule is arbitrary or capricious. A rule is arbitrary if it is not supported by logic or the necessary facts; a rule is capricious if it is adopted without thought or reason or is irrational. . . .

* * *

A grant of rulemaking authority is necessary but not sufficient to allow an agency to adopt a rule; a specific law to be implemented is also required. An agency may adopt only rules that implement or interpret the specific powers and duties granted by the enabling statute. No agency shall have authority to adopt a rule only because it is reasonably related to the purpose of the enabling legislation and is not arbitrary and capricious or is within the agency's class of powers and duties, nor shall an agency have the authority to implement statutory provisions setting forth general legislative intent or policy. Statutory language granting rulemaking authority or generally describing the powers and functions of an agency shall be construed to extend no further than implementing or interpreting the specific powers and duties conferred by the enabling statute.

26. Respondents assert that specific authority for the rule is provided by Section 626.9925, Florida Statutes (2008), which states as follows:

The commission may adopt rules to administer this act, including rules establishing standards for evaluating advertising by licensees; rules providing for the collection of data, for disclosures to viators, for the reporting of life expectancies, and for the registration of life expectancy providers; and rules defining terms used in this act and prescribing recordkeeping requirements relating to executed viatical settlement contracts. (Emphasis supplied).

27. The laws identified as being implemented by the proposed rule are Sections 626.9912(3), 626.9913(2), 626.9921(3), 626.9921(4), and 626.9928, Florida Statutes (2008). Sections 626.9921(3) and 626.9921(4), Florida Statutes (2008) relate to proposed Florida Administrative Code Rule 690-204.030(1)(b) and are not at issue here. Section 626.9928, Florida Statutes (2008) was erroneously cited and is not relevant here.

28. Respondents claim that Schedules B and C, as well as the interrogatory in question, implement Sections 626.9912(3) and 626.9913(2), Florida Statutes (2008). Section 626.9912(3), Florida Statutes (2008), states as follows:

(3) In the application, the applicant must provide all of the following:

(a) The applicant's full name, age, residence address, and business address, and all occupations engaged in by the applicant during the 5 years preceding the date of the application.

(b) A copy of the applicant's basic organization documents, if any, including the articles of incorporation, articles of association, partnership agreement, trust agreement, or other similar documents, together with all amendments to such documents.

(c) Copies of all bylaws, rules, regulations or similar documents regulating the conduct of the applicant's internal affairs.

(d) A list showing the name, business and residence addresses, and official position of each individual who is responsible for conduct of the applicant's affairs, including, but not limited to, any member of the applicant's board of directors, board of trustees, executive committee, or other governing board or committee and any other person or entity owning or having the

right to acquire 10 percent or more of the voting securities of the applicant.

(d) With respect to each individual identified under paragraph (d):

1. A sworn biographical statement on forms adopted by the commission and supplied by the office.

2. A set of fingerprints on forms prescribed by the commission, certified by a law enforcement officer, and accompanied by the fingerprinting fee specified in s. 624.501.

3. Authority for release of information relating to the investigation of the individual's background.

(f) All applications, viatical settlement contract forms, escrow forms, and other related forms proposed to be used by the applicant.

(g) A general description of the method the viatical settlement provider will use in determining life expectancies, including a description of the applicant's intended receipt of life expectancies, the applicant's intended use of life expectancy providers, and the written plan or plans of policies and procedures used to determine life expectancies.

(h) Such other information as the commission or office deems necessary to determine that the applicant and the individuals identified under paragraph (d) are competent and trustworthy and can lawfully and successfully act as a viatical settlement provider.

29. Section 626.9913(2), Florida Statutes (2008), provides:

(2) Annually, on or before March 1, the viatical settlement provider licensee shall file a statement containing information the commission requires and shall pay to the office a license fee in the amount of \$500. After December 31, 2007, the annual statement shall include an annual audited financial statement of the viatical settlement provider prepared in accordance with generally accepted accounting principles by an independent certified public accountant

covering a 12-month period ending on a day falling during the last 6 months of the preceding calendar year. If the audited financial statement has not been completed, however, the licensee shall include in its annual statement an unaudited financial statement for the preceding calendar year and an affidavit from an officer of the licensee stating that the audit has not been completed. In this event, the licensee shall submit the audited statement on or before June 1. The annual statement, due on or before March 1 each year, shall also provide the office with a report of all life expectancy providers who have provided life expectancies directly or indirectly to the viatical settlement provider for use in connection with a viatical settlement contract or a viatical settlement investment. A viatical settlement provider shall include in all statements filed with the office all information requested by the office regarding a related provider trust established by the viatical settlement provider. The office may require more frequent reporting. Failure to timely file the annual statement or the audited financial statement or to timely pay the license fee is grounds for immediate suspension of the license. The commission may by rule require all or part of the statements or filings required under this section to be submitted by electronic means in a computer-readable form compatible with the electronic data format specified by the commission.

30. In this instance, Petitioner has established a basis for its objections to the proposed rule on two grounds. First, Petitioner has shown that Respondent Commission has exceeded its grant of rule making authority. See § 120.52(8)(b), Fla. Stat. (2008). Nothing in Section 626.9925, Florida Statutes (2008), provides Respondent with specific authority to require licensed viatical settlement providers to include the information sought

in Schedules B and C or in Interrogatory 1.(d) in their annual reports.

31. Section 626.9925, Florida Statutes (2008), gives Respondents specific authority to adopt "rules for the collection of data." It does not provide specific authority for Respondents to collect data regarding transactions not even subject to Florida regulation.

32. The second reason for upholding Petitioner's objections is that the proposed rule enlarges the specific provisions of law implemented. See § 120.52(8)(c), Fla. Stat. (2008).

33. Under Section 626.9912(3), Florida Statutes (2008), Respondents have the opportunity to request additional information from an applicant. That section is not applicable to licensees who are required to file an annual report containing the information set forth in Section 626.9913(2), Florida Statutes (2008).

34. Section 626.9913(2), Florida Statutes (2008), states that licensees must file annual statements "containing information the commission requires . . ." The statute then proceeds to specify the information that must be included in the annual statements.

35. Without question, Respondents have some discretion in determining the contents of the annual statement. However, Respondents' discretion is limited to such information as is required to implement other requirements of the Act. See Life

Insurance Settlement Association v. Office of Insurance Regulation, Case No. 08-1645RP (DOAH, September 12, 2008).

Respondents' discretion in this case does not extend to the information sought in Schedules B and C and Interrogatory 1.(d).

36. Respondents have a responsibility under Section 626.9914, Florida Statutes (2008), to take action against a viatical settlement provider who, among other things, engages in fraudulent or dishonest practices or is shown to be untrustworthy or incompetent. Examination and investigations are specifically authorized by Section 626.9922, Florida Statutes (2008). These statutes may serve as a vehicle for Respondent to gather the information sought under the proposed rule but they are not cited as laws implemented.

37. As to Section 120.52(8)(d), Florida Statutes (2008), Respondent correctly argues that the proposed rule is not vague. Schedules B and C and Interrogatory 1.(d) require very specific information that is set forth plainly.

38. Likewise, the language of the proposed rule does not fail to establish adequate standards for agency decisions or vest unbridled discretion in the agency. The problem with the proposed rule is that Respondents have erroneously assumed they have statutory authority to require the annual report to include any information/data that they determine should be collected.

39. Finally, Section 120.52(8)(e), Florida Statutes, states that a proposed rule is an invalid exercise of delegated

legislative authority if it is "arbitrary or capricious." An arbitrary decision is one unsupported by facts or logic. A capricious action is one taken irrationally, without thought or reason. See Board of Clinical Laboratory Personnel v. Florida Association of Blood Banks, 721 So. 2d 317 (Fla. 1st DCA 1998). In this instance, it cannot be said that the proposed rule is not supported by facts and logic or the result of irrational thought.

40. The authority for an administrative rule is not a matter of degree. Either the enabling statutes provide authorization for a proposed rule, or they do not. Southwest Florida Water Management District v. Save the Manatee Club, Inc., 773 So. 2d 594 (Fla. 1st DCA 2000): "The question is whether the statute contains a specific grant of legislative authority for the rule, not whether the grant of authority is specific enough." Id. at 599 (emphasis in original). Here, Respondents have not met their ultimate burden of persuasion to show that the proposed rule is a valid exercise of delegated legislative authority.

41. Petitioner has requested an award pursuant to Section 120.595(2), Florida Statutes (2008), which provides as follows:

(2) If the appellate court or administrative law judge declares a rule or portion of a rule invalid pursuant to s. 120.56 (2), a judgment or order shall be rendered against the agency for reasonable costs and reasonable attorney's fees, unless the agency demonstrates that its actions were substantially justified or special circumstances exist which would make the award unjust. An agency's actions are "substantially justified" if there was a

reasonable basis in law and fact at the time the actions were taken by the agency. If the agency prevails in the proceedings, the appellate court or administrative law judge shall award reasonable costs and reasonable attorney's fees against a party if the appellate court or administrative law judge determines that a party participated in the proceedings for an improper purpose as defined by paragraph (1)(e). No award of attorney's fees as provided by this subsection shall exceed \$50,000.

42. The "substantially justified" standard, a standard also found in Section 57.111, Florida Statutes (2008), falls somewhere between the "no justiciable issue" standard found in Section 57.105, Florida Statutes (2008), and an automatic award of costs and fees to the prevailing party such as found in Section 120.56(4), Florida Statutes (2008). Helmy v. Department of Business and Professional Regulation, 707 So. 2d 366 (Fla. 1st DCA 1998).

43. In determining whether Respondent had a reasonable basis in law and fact, Respondents must have a solid though not necessarily correct basis in fact and law for the position it took in proposing the rule. Fish v. Department of Health, Board of Dentistry, 825 So. 2d 421, 423 (Fla. 4th DCA 2002) (quoting McDonald v. Schweiker, 726 F.2d 311, 316 (7th Cir. 1983)).

44. In this case, the specific grant of rule authority found in Section 626.9925, Florida Statutes (2008), provided a reasonable basis in law and fact for the position Respondents took in proposing the rule and defending its validity. Thus,

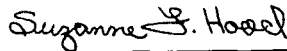
Petitioners' request for attorney's fees and costs pursuant to Section 120.595(2), Florida Statutes, must be denied.

ORDER

Based on the foregoing Findings of Fact and Conclusions of Law, it is

ORDERED that proposed Florida Administrative Code Rule 690-204.030(1)(a) is an invalid exercise of delegated legislative authority to the extent that Form OIR-A3-1288 requires disclosure of information on Schedules B and C and Interrogatory 1.(d).

DONE AND ORDERED this 7th day of May, 2009, in Tallahassee, Leon County, Florida.



SUZANNE F. HOOD
Administrative Law Judge
Division of Administrative Hearings
The DeSoto Building
1230 Apalachee Parkway
Tallahassee, Florida 32399-3060
(850) 488-9675
Fax Filing (850) 921-6847
www.doah.state.fl.us

Filed with the Clerk of the
Division of Administrative Hearings
this 7th day of May, 2009.

COPIES FURNISHED:

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Financial Services Commission
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Honorable Alex Sink
Chief Financial Officer
Department of Financial Services
The Capitol, Plaza Level 11
Tallahassee, Florida 32399-0300

Benjamin Diamond, General Counsel
Department of Financial Services
The Capitol, Plaza Level 11
Tallahassee, Florida 32399-0307

NOTICE OF RIGHT TO JUDICIAL REVIEW

A party who is adversely affected by this Final Order is entitled to judicial review pursuant to Section 120.68, Florida Statutes. Review proceedings are governed by the Florida Rules of Appellate Procedure. Such proceedings are commenced by filing one copy of a Notice of Appeal with the agency clerk of the Division of Administrative Hearings and a second copy, accompanied by filing fees prescribed by law, with the District Court of Appeal, First District, or with the District Court of Appeal in the appellate district where the party resides. The Notice of Appeal must be filed within 30 days of rendition of the order to be reviewed.



OFFICE OF INSURANCE REGULATION

KEVIN M. MCCARTY
COMMISSIONER

FINANCIAL SERVICES
COMMISSION

CHARLIE CRIST
GOVERNOR

ALEX SINK
CHIEF FINANCIAL OFFICER

BILL MCCOLLUM
ATTORNEY GENERAL

CHARLES BRONSON
COMMISSIONER OF
AGRICULTURE

June 4, 2009

The Honorable Herbert Kohl
Chairman, U.S. Senate Special Committee on Aging
G31 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Mel Martinez
Ranking Member, U.S. Senate Special Committee on Aging
G31 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Kohl and Senator Martinez:

I write in response to Mr. Michael Freedman's letter dated May 8, 2009, in which certain statements in my testimony before the Committee on Aging on April 29, 2009, are incorrectly characterized as "erroneous."

Florida Statutes, Section 626.9913(2), (attached as Exhibit A), requires a Florida Viatical Settlement Provider Licensee ("Licensee") to file "a statement containing information the commission requires," pay a license fee and submit other information, by March 1st of each year.

Since 1999, the Florida Office of Insurance Regulation ("Office") and its predecessor, the Department of Insurance, have utilized an "Annual Report" form, (attached as Exhibit B), which is filed by the Licensee using an electronic filing system. After receiving its license to do business in Florida, Coventry First LLC ("Coventry") filed an Annual Report form for each year from 2001 until 2007.

On February 27, 2009, however, Coventry refused to file an Annual Report for 2008, but instead uploaded a file with this statement, "Coventry First LLC will not be submitting Form OIR-A3-1288 (02/98), Viatical Settlement Annual Report, inasmuch as such form has not been adopted by rule." (Relevant portions of Coventry's 2/27/09 submission to the Office are attached as Exhibit C).

MARY BETH SENKEWICZ • DEPUTY COMMISSIONER • OFFICE OF INSURANCE REGULATION
200 EAST GAINES STREET • TALLAHASSEE, FLORIDA 32399-0326 • (850) 413-5104 • FAX (850) 488-2348
website: www.florir.com • MaryBeth.Senkewicz@fldfa.com

Affirmative Action / Equal Opportunity Employer

In December 2008, the Office proposed a new Annual Report form, (attached as Exhibit D), and began the process of adopting the new form through administrative rulemaking. The proposed new Annual Report form was subsequently challenged in administrative court and the case was ongoing at the time of my April 29, 2009 testimony.

Despite the fact that the Office was trying to adopt a new Annual Report form, Coventry filed an administrative challenge to the old version of the Annual Report form, which had been submitted by Florida viatical settlement provider licensees without incident since 1999. In order to resolve the unnecessary administrative litigation, I sent the letter dated March 10, 2009, (attached as Exhibit E), indicating that the Office would take no action against Coventry for failing to file the Annual Report form and provide the information it required. Coventry then withdrew its administrative challenge to the old Annual Report form on March 11, 2009, (see attached Exhibit F).

On May 8, 2009, the Florida Division of Administrative Hearings entered a Summary Final Order finding parts of the proposed Annual Report form to be invalid on the grounds that the Office exceeded its rulemaking authority by requiring information that was not authorized by the laws cited as the basis of the form, (See attached Exhibit G). The Administrative Law Judge noted, however, that "[e]xaminations and investigations are specifically authorized by Section 626.9922, Florida Statutes," and that "[t]hese statutes may serve as a vehicle for [the Office] to gather the information sought under the proposed rule but they are not cited as laws implemented." (Exhibit G, Paragraph 36). The Office is appealing the Summary Final Order.

During the course of the administrative litigation, Coventry was also suing the Office in the U.S. District Court, Northern District of Florida ("District Court") to prevent the Office from conducting a complete examination of its books and records, pursuant to Section 626.9922, Florida Statutes. The District Court dismissed Coventry's complaint, holding that the Office was authorized by the Florida Viatical Settlement Act to conduct the examination. (See attached Exhibit H).

Coventry has appealed the District Court's ruling to the U.S. Court of Appeals, 11th Circuit, which denied Coventry's request for a preliminary injunction to stop the Office from conducting its examination during the appeal. The appeal is ongoing.

I sincerely hope that this clarifies to the Senate Special Committee on Aging any misunderstanding regarding my testimony. Please do not hesitate to contact me if you have any questions.

Most respectfully,

A handwritten signature in dark ink, appearing to read "Mary Beth Senkewicz", with a large, stylized circular flourish at the end.

Mary Beth Senkewicz

Index of Exhibits

Exhibit A – Florida Statutes, Section 626.9913(2)

Exhibit B – Form OIR-A3-1288 (02/98), Viatical Settlement Annual Report

Exhibit C – Excerpts from Coventry's 2/27/09 submissions to the Office.

Exhibit D – Proposed Form OIR-A3-1288 (12/08), Viatical Settlement Annual Report

Exhibit E – March 10, 2009 Letter from OIR to Coventry First, LLC

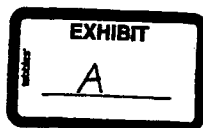
Exhibit F –Coventry First LLC's Voluntary Dismissal, March 11, 2009

Exhibit G - Summary Final Order of the Division of Administrative Hearings

Exhibit H – District Court Order

FL ST § 626.9913

(2) Annually, on or before March 1, the viatical settlement provider licensee shall file a statement containing information the commission requires and shall pay to the office a license fee in the amount of \$500. After December 31, 2007, the annual statement shall include an annual audited financial statement of the viatical settlement provider prepared in accordance with generally accepted accounting principles by an independent certified public accountant covering a 12-month period ending on a day falling during the last 6 months of the preceding calendar year. If the audited financial statement has not been completed, however, the licensee shall include in its annual statement an unaudited financial statement for the preceding calendar year and an affidavit from an officer of the licensee stating that the audit has not been completed. In this event, the licensee shall submit the audited statement on or before June 1. The annual statement, due on or before March 1 each year, shall also provide the office with a report of all life expectancy providers who have provided life expectancies directly or indirectly to the viatical settlement provider for use in connection with a viatical settlement contract or a viatical settlement investment. A viatical settlement provider shall include in all statements filed with the office all information requested by the office regarding a related provider trust established by the viatical settlement provider. The office may require more frequent reporting. Failure to timely file the annual statement or the audited financial statement or to timely pay the license fee is grounds for immediate suspension of the license. The commission may by rule require all or part of the statements or filings required under this section to be submitted by electronic means in a computer-readable form compatible with the electronic data format specified by the commission.





OFFICE OF INSURANCE REGULATION
Bureau of Specialty Insurers

VIATICAL SETTLEMENT PROVIDER
LICENSE NUMBER (VSPN) _____

VIATICAL SETTLEMENT PROVIDER ANNUAL REPORT
OF

(NAME OF VIATICAL SETTLEMENT PROVIDER)

TO THE
THE FLORIDA DEPARTMENT OF FINANCIAL SERVICES,
OFFICE OF INSURANCE REGULATION

FOR THE YEAR ENDED
DECEMBER 31, _____

mail to:
Florida Office of Insurance Regulation
Bureau of Specialty Insurers
200 East Gaines Street
Tallahassee, FL 32399-0331



VSPN

YEAR ENDING
DECEMBER 31, ____**** GENERAL INSTRUCTIONS ****

1. This report and required fees must be received by the Office annually by March 1. The license fee must be mailed under separate cover to the address indicated on the attached invoice.
2. Type or print in ink all responses. Annual reports must be filed on official Office forms or other forms determined by the Office to be substantially identical in all material respects to official Office forms.
3. Respond fully to each item. Reports containing blank lines or unanswered questions may be deemed incomplete. Reply with None, Not Applicable, n/a, or 0, as applicable.
4. Attach and clearly identify and cross reference any supporting documentation or schedules which may be necessary to fully respond to particular report items.
5. Individual violators should not be identified by name in this report.
6. Name of person completing this report:

Telephone Number: _____ Fax Number: _____

IT IS THE RESPONSIBILITY OF EACH LICENSED PROVIDER TO COMPLY WITH APPLICABLE STATUTES AND REGULATIONS AT ALL TIMES. SHOULD ANY QUESTIONS OF COMPLIANCE EXIST, PLEASE CONTACT THE BUREAU OF SPECIALTY INSURERS IN THE FLORIDA OFFICE OF INSURANCE REGULATION.

VSPN

YEAR ENDING
DECEMBER 31, ____**ATTESTATION INSTRUCTIONS****ATTESTATIONS SUBMITTED MUST BE ORIGINALS. COPIES ARE NOT ACCEPTABLE**

1. This report must be attested to by the following, based upon organizational structure of the provider:
 - A. If the provider is an individual, the report must be attested to by that individual.
 - B. If the provider is a corporation, the report must be attested to by both its President and Secretary.
 - C. If the provider is a limited partnership, the report must be attested to by the general partner(s).
 - D. If the provider is a general partnership, the report must be attested to by all of the partners owning a greater than 5% interest.
 - E. If the provider is a trust, the report must be attested to by all trustees and officers.

VSPN

YEAR ENDING
DECEMBER 31, ____**Annual Report**

Name of Viatical Settlement Provider: _____
 Street Address: _____
 City of: _____ County of: _____ State: ____ Zip: ____ - ____
 Phone #: _____ Fax #: _____
 Provider's Federal Employer Identification Number: _____

As an individual responsible for conducting the affairs of the above named viatical settlement provider licensed to transact business in the State of Florida, I am familiar with the laws of Florida relating to viatical settlement providers and do hereby certify under the penalty of perjury pursuant to Section 837.06, F.S., that the information reported herein is a true and correct reporting of the requested information. This report is submitted in compliance with Section 626.9913(2) of the Florida Statutes.

(Typed Name)

(Typed Name)

(Signature)

(Signature)

(Title)

(Title)

Sworn To and Subscribed before Me

Sworn To and Subscribed before Me

This ____ day of _____, 20____

This ____ day of _____, 20____

(Signature of Notary Public)

(Signature of Notary Public)

Personally known to me
Produced IdentificationPersonally known to me
Produced Identification

(Type of Identification produced)

(Type of Identification produced)

(Seal)

(Seal)

VSPN

YEAR ENDING
DECEMBER 31, ____**Interrogatories**

1. Has there been any change in the provider's name, organizational structure or status, Charter, Articles of Incorporation, By Laws, Partnership Agreement, affiliations, officers, directors, members, owners, stockholders or location of books and records since the latter of the date of application or the last Annual Report was filed with this Office? ☐ Yes ☐ No

If there has been a change, has complete documentation been filed with the Office (i.e., amendments, biographical affidavits, character reports, fingerprint cards) ☐ Yes ☐ No ☐ N/A

If there has been a change and complete documentation was not provided to the Office, attach complete documentation.

2. Has any officer, director, member, stockholder, or employee of the provider been the subject of any administrative or judicial proceeding, had any license denied, suspended or revoked, been arrested, indicted, convicted, or pled nolo contendere to any criminal or civil action other than a minor traffic violation, or had a lien, judgment or foreclosure action filed against him or her since the latter of the date of application or the last Annual Report was filed with this Office? ☐ Yes ☐ No

If so, attach a detailed explanation sufficient to disclose all relevant details of the matter, to include its final disposition.

3. Has the Provider been involved in any legal actions, civil suits, criminal proceedings, or had a license denied, suspended or revoked by any government agency or regulatory body since the latter of the date of application or the last Annual Report was filed with this Office? ☐ Yes ☐ No

If so, attach a detailed explanation sufficient to disclose all relevant details of the matter, to include its final disposition.

4. During the reporting year has the provider received any complaints from viators alleging that the escrow agent or third party trustee did not disburse the viatical settlement within three business days of receiving notification that the change in ownership or beneficial interest had been effected? ☐ Yes ☐ No

If yes, attach a list of such complaints, including the viatical settlement number (VSN), policy face amount, settlement amount, contract date, date of insurer notification, and date funds were released to the viator. Describe what actions the provider took to correct the situation and prevent its recurrence. If the settlement funds are yet unpaid, include an explanation for the delay and anticipated payment date.

VSPN

YEAR ENDING
DECEMBER 31, ____**Supporting Documents**

5. Complete and submit the following schedules as of the close of business on December 31:
 - a. Schedule A - a list of all individuals responsible for the conduct of the provider's affairs, including but not limited to officers, directors and owners.
 - b. Schedule B - an aged schedule of all unsettled viatical contracts.
 - c. Schedule C - a summary of viatical settlements paid by year for the last five years.
 - d. Schedule D - a summary of viatical settlement transactions, allocated by State and Territory.
6. Attach a copy of the bank statement which evidences the balance of the escrow account in which viatical settlement funds are escrowed as of December 31, together with a reconciliation to the balance as reflected on the provider's records.
7. Provide a description of the securities currently on deposit with the Office to meet statutory deposit requirements, including the amount, type and maturity dates.
8. If the provider uses a surety bond to meet part of the deposit requirements of § 626.9913, F.S., provide evidence from the surety company that the surety bond will remain in force throughout the year following the report year.
9. If the provider is licensed to operate as a Viatical Settlement Provider or Broker in any state other than Florida, attach a list of those States and the type of license held.

SCHEDULE A - LIST OF OFFICERS/DIRECTORS AND KEY PERSONNEL

List the name, title, percentage of ownership interest, business address and residence address of each individual who is responsible for the conduct of the provider's affairs or has the ability to exercise significant control over the provider, including but not limited to officers, directors, trustees, partners, shareholders holding a 10 percent or greater interest in the provider, and key personnel. Place an asterisk next to the name of any individual not reported on the most recent report or application (whichever occurred last). Attach additional sheets as necessary.

Name	Title	Percentage of ownership (if any)	Business Address	Residence Address

VSPN

YEAR ENDING
DECEMBER 31, ____**SCHEDULE B - AGED SCHEDULE OF UNSETTLED VIATICAL CONTRACTS**

Provide, as of December 31, an aging analysis for all outstanding viatical settlement contracts that have been executed by viators.

DAYS SINCE EXECUTION BY VIATOR	DOLLAR VALUE
Executed less than 30 Days	
Executed 30 to 59 days	
Executed 60 to 89 days	
Executed 90 to 119 days	
Executed 120 to 149 days	
Executed 150 to 179 days	
Executed 180 or more days	
TOTAL	

SCHEDULE C - SETTLEMENTS PAID

(Most recent five years, beginning with this reporting year)

YEAR	TOTAL NUMBER OF POLICIES PURCHASED (Quantity)	TOTAL SETTLEMENTS PAID FOR POLICIES PURCHASED (Dollars)	TOTAL FACE VALUE OF PURCHASED POLICIES (Dollars)
20			
20			
20			
20			
20			

VSPN

YEAR ENDING
DECEMBER 31,**SCHEDULE D - SETTLEMENTS PAID - ALLOCATED BY STATE OR TERRITORY**

VICTOR'S STATE OF RESIDENCE	NUMBER OF VIATICAL SETTLEMENTS	TOTAL SETTLEMENTS PAID (Dollars)	TOTAL FACE VALUE OF POLICIES FOR WHICH A SETTLEMENT WAS PAID
Alabama			
Alaska			
Arizona			
Arkansas			
California			
Colorado			
Connecticut			
Delaware			
District of Columbia			
Florida			
Georgia			
Hawaii			
Idaho			
Illinois			
Indiana			
Iowa			
Kansas			
Kentucky			
Louisiana			
Maine			
Maryland			
Massachusetts			
Michigan			
Minnesota			
Mississippi			
Missouri			
Montana			
Nebraska			
Nevada			
New Hampshire			
New Jersey			
New Mexico			
New York			
North Carolina			
North Dakota			
Ohio			
Oklahoma			
Oregon			
Pennsylvania			
Rhode Island			
South Carolina			
South Dakota			
Tennessee			
Texas			
Utah			
Vermont			
Virginia			
Washington			

OIR-A3-1288 (02/98)

VSPN		YEAR ENDING DECEMBER 31,	
VIATOR'S STATE OF RESIDENCE	NUMBER OF VIATORIAL SETTLEMENTS	TOTAL SETTLEMENTS PAID (Dollars)	TOTAL FACE VALUE OF POLICIES FOR WHICH A SETTLEMENT WAS PAID
West Virginia			
Wisconsin			
Wyoming			
American Samoa			
Guam			
Puerto Rico			
US Virgin Islands			
Canada			
Mexico			
Other Alien (Provide List)			
TOTALS			

VSPN

INVOICE

YEAR ENDING
DECEMBER 31, ____

**Florida Department of Financial Services
Office of Insurance Regulation
Annual License Fee**

Name of Licensed Entity: _____

FEIN: _____

Address: _____

City, State & Zip Code: _____

The original of this form must be returned with the fee payment.

PLEASE NOTE:

1. Make the check payable to the Florida Department of Financial Services.
2. Mail this invoice and a check in the amount indicated below to:
 Florida Department of Financial Services
 Bureau of Financial and Support Services
 P.O. Box 8100
 Tallahassee, FL 32301
3. Send a copy of the check and a copy of this invoice with your Annual Report, to:
 Office of Insurance Regulation
 Bureau of Specialty Insurers
 200 East Gaines Street
 Tallahassee, FL 32399-0331

RECEIPT NUMBER	F/T	AMOUNT	TYPE	CLASS	B/T
	L	\$500.00	12	16	C

Coventry First LLC

Viatical Settlement Provider License No. 69011

Annual Report

Coventry First LLC will not be submitting Form OIR-A3-1288 (02/98), Viatical Settlement Annual Report, inasmuch as such form has not been adopted by rule.





OFFICE OF INSURANCE REGULATION
Specialty Product Administration

FLORIDA COMPANY
 CODE 69 _____

FEDERAL EMPLOYER'S
 IDENTIFICATION NUMBER _____

**ANNUAL REPORT
 OF THE**

 (NAME OF VIATICAL SETTLEMENT PROVIDER)

 (City)

 (State)

TO THE

OFFICE OF INSURANCE REGULATION

OF THE

STATE OF FLORIDA

**SPECIALTY PRODUCT ADMINISTRATION
 200 EAST GAINES STREET
 TALLAHASSEE, FL 32389-0331**

FOR THE CALENDAR YEAR ENDED

DECEMBER 31, 2 _____

DUE ON OR BEFORE

MARCH 1 EACH YEAR



**** GENERAL INSTRUCTIONS ****

1. The report and required fees must be received annually by the Florida Office of Insurance Regulation ("Office") not later than March 1st. The license fee must be mailed under separate cover to the address indicated on the attached invoice.
2. Annual reports must be filed on official Office forms or other forms determined by the Office to be substantially identical in all material respects to official Office forms. Type or print all responses in ink.
3. Respond fully to each item. Reports containing blank lines or unanswered questions may be deemed incomplete. Reply with None, Not Applicable, n/a, or 0, as applicable.
4. Attach, clearly identify and cross reference any supporting documentation or schedules necessary to fully respond to particular report items.
5. Individual violators should not be identified by name in this report.
6. For the purpose of this report, the terms "viatical settlement provider", "viatical settlement contract" and "life expectancy provider" shall have the meaning as specified under Part X, Chapter 628, Florida Statutes.

IT IS THE RESPONSIBILITY OF EACH LICENSED PROVIDER TO COMPLY WITH APPLICABLE STATUTES AND REGULATIONS AT ALL TIMES. SHOULD ANY QUESTIONS OF COMPLIANCE EXIST, PLEASE CONTACT SPECIALTY PRODUCT ADMINISTRATION IN THE FLORIDA OFFICE OF INSURANCE REGULATION.

ATTESTATION INSTRUCTIONS

ATTESTATIONS SUBMITTED MUST BE ORIGINALS. COPIES ARE NOT ACCEPTABLE.

1. This report must be attested to by the following, based upon organizational structure of the Provider:
 - a. If the Provider is an individual, that individual must attest to the report.
 - b. If the Provider is a corporation, both its President and Secretary must attest to the report.
 - c. If the Provider is a limited partnership, the general partner(s) must attest to the report.
 - d. If the Provider is a general partnership, all partners owning greater than 5% interest must attest to the report.
 - e. If the Provider is a trust, all trustees and officers must attest to the report.

YEAR ENDING
DECEMBER 31, _____

Florida Company Code _____

ANNUAL REPORT

Name of Viatical Settlement Provider: _____

Home Office Address: _____
Telephone #: () _____ Fax #: () _____

Main Administrative Office Address: _____
Telephone #: () _____ Fax #: () _____

Mailing Address: _____

Location of Records Address: _____

Principal Florida Office Address: _____
Telephone #: () _____ Fax #: () _____

Provider's Web Site: _____

Official Contact E-Mail Address: _____

Name and Title of person to contact regarding this report: _____
Address: _____
Telephone #: () _____ Fax #: () _____ E-Mail: _____

As an individual responsible for conducting the affairs of the above named viatical settlement provider licensed to transact business in the State of Florida, I am familiar with the laws of Florida relating to viatical settlement providers and do hereby certify, that the information reported herein is a true and correct reporting of the requested information. I understand that Section 837.08, Florida Statutes, makes false official statements with the intent to mislead a public servant in the performance of his or her duty a misdemeanor of the second degree. This report is submitted in compliance with Section 628.9913(2) of the Florida Statutes.

(Typed Name) _____ (Title) _____

(Typed Name) _____ (Title) _____

(Signature) _____ (Date) _____

(Signature) _____ (Date) _____

Florida Company Code

YEAR ENDING
DECEMBER 31, _____**INTERROGATORIES**

1. Since the latter of the date of application or the last annual report filed with the Office has there been any change in the Provider's:

- | | | |
|----|---|--|
| a. | Name | <input type="checkbox"/> Yes <input type="checkbox"/> No |
| b. | Organizational structure or status | <input type="checkbox"/> Yes <input type="checkbox"/> No |
| c. | Charter, articles of Incorporation, bylaws, partnership agreement or other organizational documents | <input type="checkbox"/> Yes <input type="checkbox"/> No |
| d. | Method of operation as described in its most recent plan of operations filed with the Office | <input type="checkbox"/> Yes <input type="checkbox"/> No |

If "Yes" to any of the above, attach supporting documentation.

2. Since the latter of the date of application or the last annual report filed with the Office has there been any change in the Provider's officers, directors, members, partners, owners, stockholders or any other person who controls or has the ability to exercise control of the Provider? ☐ Yes ☐ No

If "Yes", attach a detailed explanation sufficient to disclose all relevant details of the change.

3. Has any officer, director, member, stockholder, owner, partner, or any other person who controls or has the ability to exercise control of the Provider been:

- | | | |
|----|---|--|
| a. | subject to any administrative, regulatory, or disciplinary actions? | <input type="checkbox"/> Yes <input type="checkbox"/> No |
| b. | charged with, arrested, indicted, convicted, or pled guilty or nolo contendere to any criminal offense? | <input type="checkbox"/> Yes <input type="checkbox"/> No |
| c. | a party to any civil action involving dishonesty, breach of trust or a financial dispute or had any lien, judgment or foreclosure action filed against him or her since the latter of the date of application or the last Annual Report was filed with this Office? | <input type="checkbox"/> Yes <input type="checkbox"/> No |

If "Yes" attach a detailed explanation sufficient to disclose all relevant details of the matter, to include its final disposition.

4. Has the Provider been subject to any administrative, regulatory, disciplinary, or judicial actions since the latter of the date of application or the last Annual Report was filed with this Office? ☐ Yes ☐ No

If "Yes", attach a detailed explanation sufficient to disclose all relevant details of the matter, to include its final disposition.

5. For Florida regulated transactions, has the Provider received any complaints from viators alleging that the escrow agent or third party trustee did not disburse the viatical settlement funds within three business days of receiving notification that the change in ownership or beneficial interest had been effected? ☐ Yes ☐ No

If "Yes", attach a list of such complaints, including the policy face amount, settlement amount, contract date, date of insurer notification, and date funds were released to the viator. Describe what actions the Provider took to correct the situation and prevent its recurrence. If the settlement funds are yet unpaid, include an explanation for the delay and anticipated payment date.

Florida Company Code _____

YEAR ENDING
DECEMBER 31, _____**SCHEDULE A – AGED SCHEDULE OF UNSETTLED VIATICAL CONTRACTS**

Provide, as of December 31st of the reporting year, an aging analysis for all outstanding viatical settlement contracts that have been executed by viators. The dollar amounts reported should be the total amounts due to viators.

NUMBER OF DAYS BETWEEN THE DATE THE VIATOR EXECUTED THE VIATICAL SETTLEMENT CONTRACT and DECEMBER 31 st	NUMBER OF VIATICAL SETTLEMENT CONTRACTS – FLORIDA ONLY	DOLLAR AMOUNTS DUE VIATORS – FLORIDA ONLY
less than 60 days		
60 to 119 days		
120 or more days		
TOTAL		

SCHEDULE B – POLICIES PURCHASED

Most recent five years, beginning with this reporting year

YEAR	TOTAL NUMBER OF POLICIES PURCHASED (Quantity)	TOTAL GROSS AMOUNT PAID FOR POLICIES PURCHASED (Dollars)	TOTAL FACE VALUE OF POLICIES PURCHASED (Dollars)
20__			
20__			
20__			
20__			
20__			

SCHEDULE C - SUMMARY OF BUSINESS

Total face value of policies purchased (Dollars)	Total commissions/compensation paid for policies purchased (Dollars)	Total gross amount paid for policies purchased (Dollars)	Total number of policies purchased	Are you licensed/registered in this state? (Y/N)	Policy owner state of residence
					Alabama
					Alaska
					Arkansas
					California
					Colorado
					Connecticut
					Delaware
					Dist. Of Columbia
					Florida
					Georgia
					Hawaii
					Idaho
					Illinois
					Indiana
					Iowa
					Kansas
					Kentucky
					Louisiana
					Maine
					Maryland

SCHEDULE C - SUMMARY OF BUSINESS

Total base value of policies purchased (Dollars)	Total commissions/compensation paid for policies purchased (Dollars)	Total gross amount paid for policies purchased (Dollars)	Total number of policies purchased	Are you licensed/registered in this state? (Y/N)	Policy owner state of residence
					Massachusetts
					Michigan
					Minnesota
					Mississippi
					Missouri
					Montana
					Nebraska
					Nevada
					New Hampshire
					New Jersey
					New Mexico
					New York
					North Carolina
					North Dakota
					Ohio
					Oklahoma
					Oregon
					Pennsylvania
					Rhode Island
					South Carolina
					South Dakota

SCHEDULE C - SUMMARY OF BUSINESS

Total face value of policies purchased (Dollars)	Total commissions/compensation paid for policies purchased (Dollars)	Total gross amount paid for policies purchased (Dollars)	Total number of policies purchased	Are you licensed/registered in this state? (Y/N)	Policy owner state of residence
					Tennessee
					Texas
					Utah
					Vermont
					Virginia
					Washington
					West Virginia
					Wisconsin
					Wyoming
					American Samoa
					Guam
					Puerto Rico
					US Virgin Islands
					Canada
					Other (list)
					TOTALS

Provide the following information for all life expectancy providers who have provided life expectancies directly or indirectly to the Provider for use in connection with a viatical settlement contract or a viatical settlement investment. Place an asterisk next to the name of any life expectancy provider who provided life expectancies directly or indirectly to the Provider that were used by the Provider in connection with a viatical settlement contract or a viatical settlement investment.

[illegible]

SCHEDULE E - LIST OF OFFICERS/DIRECTORS AND KEY PERSONNEL

Provide the following information for each person, as defined by Section 1.01, Florida Statutes, who is responsible for the conduct of the Provider's affairs or has the ability to exercise effective control over the Provider, including but not limited to officers, directors, members, trustees, partners, shareholders or owners holding a 10 percent or greater interest in the Provider. Place an asterisk next to the name of any person that has not been previously reported to the Office.

Individual Social Security Numbers must be entered on the next page as CONFIDENTIAL Information. Make additional copies of the next page as necessary.

[illegible]

(If additional space is needed attach a separate sheet to this Schedule.)

If applicable, provide an organizational chart showing all parent companies and subsidiaries of the Provider, to include, full legal name, FEIN and percentage of ownership.

Florida Company Code _____

YEAR ENDING
DECEMBER 31, _____**CONFIDENTIAL**

Pursuant to Section 119.071(5), Florida Statutes, social security numbers collected by an agency are confidential and exempt from Section 119.07(1), Florida Statutes, and section 24(a), Art. I of the State Constitution. The requirement must be relevant to the purpose for which collected and must be clearly documented.

Below please enter the name and social security number of each individual listed on Schedule G (previous page). If additional space is required, make copies of this page and attach to the report.

Name	Social Security Number		

The requirement for social security numbers is mandatory. Section 119.071(5), Florida Statutes, gives authority for an agency to collect social security numbers if imperative for the performance of that agency's duties and responsibilities as prescribed by law. Limited collection of social security numbers is imperative for the Office of Insurance Regulation. The duties of the Office of Insurance Regulation in background investigation are extensive in order to insure that the owners, management, officers, and directors of any insurer are competent and trustworthy, possess financial standing and business experience, and have not been found guilty of, or not pleaded guilty or nolo contendere to, any felony or crime punishable by imprisonment of one year. In establishing these qualifications and the Office of Insurance Regulation's responsibility to ensure that individuals meet these qualifications, the legislature recognized that owners, officers, and directors of a company are in a position to cause great harm to public should they be untrustworthy or have a criminal background. To meet the legislative intent that these people are qualified to be trusted, having the identifying social security number is essential for the Office of Insurance Regulation to adequately perform the background investigative duty. There are many individuals with the same name, without this identifying number it would be difficult if not impossible to be reasonably sure that the correct individuals are identified and verify they meet the statutorily required conditions.

CONFIDENTIAL

Florida Company Code _____

YEAR ENDING
DECEMBER 31, _____**INVOICE****Office of Insurance Regulation
Volitional Settlement Provider Annual License Fee**

Name of Licensed Entity: _____

FEIN: _____

Address: _____

City, State & Zip Code: _____

The original of this form must be returned with the fee payment.**PLEASE NOTE:**

1. Make the check payable to the Florida Department of Financial Services.
2. Mail this invoice and a check in the amount indicated below to:
Florida Department of Financial Services
Bureau of Financial and Support Services
P.O. Box 6100
Tallahassee, FL 32301
3. Send a copy of the check and a copy of this invoice with your Annual Report, to:
Office of Insurance Regulation
Specialty Product Administration
200 East Gaines Street
Tallahassee, FL 32399-0331

RECEIPT NUMBER	F/T	AMOUNT	TYPE	CLASS	B/T
	L	\$500.00	12	16	C



OFFICE OF INSURANCE REGULATION

KEVIN M. MCCARTY
COMMISSIONER

FINANCIAL SERVICES
COMMISSION

CHARLIE CRIST
GOVERNOR

ALEX SINK
CHIEF FINANCIAL OFFICER

BILL MCCOLLUM
ATTORNEY GENERAL

CHARLES BRONSON
COMMISSIONER OF
AGRICULTURE

March 10, 2009

Coventry First, LLC
c/o Frank Santry, Esq.
Post Office Box 16337
Tallahassee, FL 32317-6337

Dear Mr. Santry:

On February 25, 2009, the Office of Insurance Regulation ("Office") received Coventry First LLC's ("Coventry") audited 2008 financial statement, report of life expectancy providers and license fee. The Office acknowledges that this fulfills Coventry's obligations under Section 626.991(2), Florida Statutes for calendar year 2008.

The Office is currently engaged in rulemaking to adopt a new form for viatical settlement provider annual reports, Proposed OIR Form 1288 (REV 12/08), and is no longer using the previous form OIR Form 1288 (02/98). The Office will not take any action against Coventry First LLC for not filing a Viatical Settlement Provider Annual Report, OIR Form 1288 (02/98), for 2008.

Sincerely,


Mary Beth Senkewicz

MBS/ayh



MARY BETH SENKEWICZ • DEPUTY COMMISSIONER
200 EAST GAINES STREET • TALLAHASSEE, FLORIDA 32399-0326 • (850) 413-5104 • FAX (850) 488-2348
WEBSITE: WWW.FLOR.COM • EMAIL: MARYBETH.SENKEWICZ@FLOR.COM

Affirmative Action / Equal Opportunity Employer

**STATE OF FLORIDA
DIVISION OF ADMINISTRATIVE HEARINGS**

COVENTRY FIRST LLC,
Petitioner


Vs.

DOAH Case No.: 09-001019RU

STATE OF FLORIDA
FINANCIAL SERVICES COMMISSION,
OFFICE OF INSURANCE REGULATION,
Respondent.

PETITIONER'S NOTICE OF VOLUNTARY DISMISSAL

Coventry First LLC, by the undersigned attorneys, hereby voluntarily dismisses this proceeding without prejudice. Each party has agreed to bear its own costs.



Frank J. Santry
Fl. Bar No. 0202231
Frank J. Santry, P.L.
P.O. Box 16337
Tallahassee, FL
32317-6337
Phone: 850.385.3808
santrylaw@comcast.net
Attorneys for Petitioner



Certificate of Service

I certify that a copy of the foregoing was furnished by electronic delivery to Stephen Thomas, Ass't. General Counsel, Financial Services Commission, Office of Insurance Regulation, 200 East Gaines Street, Tallahassee FL, 32399 on March 11, 2009.



EXHIBIT G

See Page 121 through 139 for Exhibit G

State of Florida Division of Administrative Hearings

Life Insurance Settlement Association, Petitioner vs. Financial
Service Commission and Office of Insurance Regulation, Respond-
ents

Case No. 09-0386RP

**IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF FLORIDA
TALLAHASSEE DIVISION**

COVENTRY FIRST LLC,

Plaintiff,

vs.

CASE NO.: 4:08cv387-SPM/WCS

KEVIN M. MCCARTY,
Commissioner of the Florida
Office of Insurance Regulation,

Defendant.

**ORDER DENYING MOTION FOR PRELIMINARY INJUNCTION
AND GRANTING MOTION TO DISMISS**

Pending before the Court is Plaintiff's motion for preliminary injunction (doc. 4) and Defendant's motion to dismiss Plaintiff's complaint and Plaintiff's request for a preliminary injunction. (doc. 12) Plaintiff has filed a response. (doc. 13)

I. BACKGROUND

Plaintiff is a Delaware limited liability company licenced as a "viatical settlement provider" in the state of Florida pursuant to the Florida Viatical Settlement Act (the "Florida Act"). Fla. Stat. § 626.991. As a "viatical settlement provider," Plaintiff provides life insurance policyholders access to a secondary market in which the policyholders can sell their policies in return for a lump sum



cash amount that exceeds the amount that the policyholders would receive if they returned the policy to the life insurance carrier. Defendant is the Commissioner of the Office of Insurance Regulation ("the Office"), which is a division of the Financial Services Commission for the State of Florida. The Office has the statutory duty to enforce the provisions of the Florida Insurance Code, investigate violations of that code and regulate insurance activity within the State of Florida.

According to Section 626.9912 of the Florida Statutes, the Office issues the licenses necessary for a person to perform the functions of a viatical settlement provider. A "viatical settlement provider" is a person who "effectuates a viatical settlement contract." Fla. Stat. § 626.9911(12) (2008). A "viatical settlement contract" is "a written agreement entered into between a viatical settlement provider . . . and a viator [that] includes an agreement to transfer ownership or change the beneficiary designation of a life insurance policy at a later date." Fla. Stat. § 626.9911(10). A "viator" is the owner of the life insurance policy—the policyholder. Fla. Stat. § 626.9911(14).

The Office "may examine the business and affairs of any of its respective licensees" Fla Stat. § 626.9922(1). In doing so, the Office "may order any such licensee or applicant to produce any records, books, files, advertising and solicitation materials, or other information and may take statements under oath to determine whether the licensee or applicant is in violation of the law or is acting

contrary to the public interest." Id. With regard to conflicts with other states, Florida Statute Section 626.9924 states that

A viatical settlement provider who from this state enters into a viatical settlement contract with a viator who is a resident of another state that has enacted statutes or adopted regulations governing viatical settlement contracts shall be governed in the effectuation of that viatical settlement contract by the statutes and regulations of the viator's state of residence. If the state in which the viator is a resident has not enacted statutes or regulations governing viatical settlement agreements, the provider shall give the viator notice that neither Florida nor his or her state regulates the transaction upon which he or she is entering. For transactions in those states, however, the viatical settlement provider is to maintain all records required as if the transactions were executed in Florida.

On April 26, 2001, Plaintiff was granted a license by the Office to act as a viatical settlement provider in the state of Florida. In 2007, the Office examined Plaintiff's viatical settlement agreements for the period covering April 26, 2001 through December 31, 2004. The Office now wants to examine Plaintiff's viatical settlement agreements for the period from January 1, 2005 through December 31, 2007. The Office states that the purpose of this examination is to 1) verify that the Florida transactions reported by Plaintiff occurred in Florida; 2) verify that transactions reported as non-Florida transactions actually occurred outside of Florida; 3) verify that ownership of life insurance policies was not changed with the intent to avoid Florida law; and 4) verify and review Plaintiff's anti-fraud plan.

Plaintiff alleges that with respect to business conducted with out-of-state residents, Plaintiff does not qualify as a "viatical settlement provider" under Florida law. Consequently, Plaintiff filed this instant action to limit the Office's

examination of Plaintiff's non-Florida records. Plaintiff argues that the Office has no authority to review, regulate, examine, or oversee Plaintiff's policies that relate to viators or policyholders who reside outside of Florida. As a result, Plaintiff states that even though it is a licensee in Florida, it does not fall within the Florida statutory definition of a "viatical settlement provider" as it relates to policies outside of Florida. Plaintiff does admit that it is a viatical settlement provider for life insurance policies purchased from policyowners who reside in Florida. Therefore, Plaintiff is willing to allow the Office to review and examine aspects of their business that relate to Florida policyholders and viatical settlement contracts that are effectuated in the State of Florida. But it has filed a Complaint to prevent the Office from examining records for non-Florida policyholders. The legal basis of Plaintiff's claim is that the Dormant Commerce Clause and the Florida Act itself both limit the power of the Office to review, examine, or regulate conduct that occurs exclusively outside of the State of Florida.

Plaintiff has also filed a motion for leave to amend its Complaint. In this amended complaint, Plaintiff adds two additional counts. One count alleges that Defendant's behavior is in violation of Plaintiff's substantive due process because it interferes with Plaintiff's fundamental rights and liberty interests. The second additional count alleges that Defendant's behavior violates the Full Faith and Credit Clause because it infringes upon the sovereignty of other states and disregards the legitimate interests of those states. Plaintiff may amend their

complaint only with leave from this Court. This request to amend will be addressed below.

Defendant filed a motion to dismiss the Complaint. In the motion, Defendant argues that as an initial matter, the Office cannot be sued because it receives Eleventh Amendment immunity from suits of state officials in their official capacity and the Ex Parte Young exception to this immunity bar is inapplicable. Secondly, in the event that they are not protected by the Eleventh Amendment, the Office requests dismissal of this case for failing to state a cause of action for which relief can be granted. Fed. R. Civ. P. 12(b)(6). The Office claims that Florida's Viatical Settlement Act does not violate the Dormant Commerce Clause because the Office does not discriminate against interstate commerce or favor in-state interests over out-of-state interests. Additionally, the Office claims that the Viatical Settlement Act gives the Office permission to examine the business records for any of its licensees, which includes contracts that have taken place wholly outside of the State of Florida. Lastly, the Office claims that Plaintiff's motion for a preliminary injunction should be denied.

II. ANALYSIS

A. Motion for Leave to Amend

Under Federal Civil Procedure Rule 15(a), leave to amend a complaint "shall be freely given when justice so requires." Fed. R. Civ. P. 15(a). Although a decision to grant leave to amend is within the discretion of this Court, there

must be a "justifying reason" for a denial. Foman v. Davis, 371 U.S. 178, 182 (1962). One such reason is if the proposed amendment would be futile. Id. An amendment is futile if the resulting complaint is subject to dismissal because it cannot state a valid claim for relief. Galindo v. ARI Mut. Ins. Co., 203 F.3d 771, 777 n.10 (11th Cir. 2000).

For a claim of a violation of A substantive due process right to succeed, Plaintiff must show that Defendant has violated a fundamental right, a right that has been created by the United States Constitution. Bsse v. Lee County, 2009 U.S. App. LEXIS 5055 (11th Cir. Mar. 5, 2009). "Conduct by a government actor will rise to the level of a substantive due process violation only if the act can be characterized as arbitrary or conscience-shocking in a constitutional sense." Davis v. Carter, 555 F.3d 979, 982 (11th Cir. 2009). "To rise to the conscience-shocking level, conduct most likely must be 'intended to injure in some way unjustifiable by any government interest[.]'" Id. (quoting County of Sacramento v. Lewis, 523 U.S. 833, 849 (1998)). Plaintiff's right to do business in the state fo Florida as a viatical settlement provider is not a fundamental right. Furthermore, the Office's intent to review the business records of its licensee, at the licensee's expense, in accordance with the state law that governs this licensee-licensor relationship hardly rises to the level of arbitrary or conscious-shocking. Nor is it intended to injure Plaintiff. The State's justifiable intent is to protect its citizens from an industry that creates a significant power imbalance

and "potential for harassment of the viator after the sale" of their insurance policy. Life Partners, Inc. v. Morrison, 484 F.3d 284, 288 (4th Cir. 2007).

In its additional allegation of a violation of the Full Faith and Credit Clause, Plaintiff argues that Defendant's intent to examine Plaintiff's out-of-state records does not respect the legitimate interests of other states and such an examination would infringe upon the sovereignty of other states. It is true that the Full Faith and Credit Clause requires states to give "effect to official acts of other States." Nevada v. Hall, 440 U.S. 410, 421 (1979). However, it does not require a state to operate contrary to its own policy objectives in order to preserve the policy objectives of another state. Put another way, there is no authority that "lends support to the view that the full faith and credit clause compels the courts of one state to subordinate the local policy of that state . . . to the statutes of any other state." Williams v. N.C., 317 U.S. 287, 296 (1942). "[I]n the case of statutes 'the full faith and credit clause does not require one state to substitute for its own statute, applicable to persons and events within it, the conflicting statute of another state, even though that statute is of controlling force in the courts of the state of its enactment with respect to the same persons and events.'" Williams, 317 U.S. 287, 296 (1942) (quoting Pac. Employers Ins. Co. v. Indus. Accident Comm'n, 306 U.S. 493, 502 (1939)). Accordingly, Defendant's intent to advance its own legitimate state interests in protecting its citizens does not infringe on the sovereignty of other states. Similarly, Plaintiff is not required to substitute

another state's conflicting statute in place of a statute that advances the policy objectives of the State of Florida. Plaintiff's amendment to its complaint would be futile because neither of the two counts added in the amended complaint state a cause upon which relief can be granted. Accordingly, Plaintiff's motion to amend the complaint to include additional counts will be denied.

B. Standards for Motion to Dismiss and Preliminary Injunction

A complaint is subject to dismissal under Rule 12(b)(6) if it fails to "contain either direct or inferential allegations respecting all the material elements necessary to sustain recovery under some viable legal theory." Roe v. Aware Woman Ctr. for Choice, Inc., 253 F.3d 678, 684 (11th Cir. 2001). To obtain a preliminary injunction, a plaintiff has the burden to demonstrate (1) a substantial likelihood of success on the merits, (2) irreparable injury if the injunction were not granted, (3) that the threatened injury outweighs any harm an injunction may cause the defendant, and (4) that granting the injunction will not be adverse to the public interest. Johnson & Johnson Vision Care, Inc. v. 1-800 Contacts, Inc., 299 F.3d 1242, 1246-47 (11th Cir. 2002). "[A] preliminary injunction is an extraordinary and drastic remedy not to be granted unless the movant clearly establishes the 'burden of persuasion' as to the four requisites." McDonald's Corp. v. Robertson, 147 F.3d 1310, 1306 (11th Cir. 1998). If the Court finds that the movant has failed on any one of the requisites, it is unnecessary to address the others. United States v. Jefferson County, 720 F.2d 1511, 1519 (11th Cir.

1983).

C. Eleventh Amendment Immunity

"The Eleventh Amendment prohibits federal courts from exercising subject matter jurisdiction in suits brought against a state by a citizen of that state."

Schopler v. Bliss, 903 F.2d 1373, 1378 (11th Cir. 1990). The resulting immunity from suit in federal court extends not only to states when named as a party to an action, but also to state agencies acting under the state's control. Id.; P.R. Aqueduct & Sewer Auth. v. Metcalf & Eddy, Inc., 506 U.S. 139, 144 (1993).

There is an exception to this precept. While the Eleventh Amendment bars "suits seeking retrospective relief such as restitution or damages" for actions undertaken by state officers in their "official capacity," Fla. Ass'n of Rehab. Facilities v. Florida Dep't of Health & Rehabilitative Servs., 225 F.3d 1208 (11th Cir. 2000), it does not prevent actions brought against a state officer wherein the plaintiff "seek[s] prospective injunctive relief to end continuing violations of federal law," Id. at 1219. See also Frew v. Hawkins, 540 U.S. 431, 436 (2004) (*citing Ex parte Young*, 209 U.S. 123 (1908)). This is the Ex Parte Young exception to the Eleventh Amendment immunity doctrine. If the exception applies, then the state official may be sued in his or her official capacity.

Defendant argues that because he is a state official being sued in his official capacity, and because the State of Florida has not waived his Eleventh Amendment immunity, nor has Congress abrogated the same, he receives

Eleventh Amendment protection in this suit. Defendant also argues that the Ex Parte Young exception to his immunity does not apply because it is a legal fiction that creates, rather than identifies, a distinction between the state and its officers. Additionally, Defendant claims that the Ex Parte Young exception does not apply because this suit is actually against the state itself, in the form of a state agency, and the suit implicates special sovereignty interests of the state as it relates to the state's insurance regulation.

"Ex parte Young applies only when state officials are sued for prospective relief in their official capacity." Eubank v. Leslie, 210 Fed. Appx. 837, 844 (11th Cir. 2006). Defendant McCarty is a state official and the relief requested from Plaintiff is preliminary and permanent injunctive relief that will enjoin Defendant from behavior the Plaintiff believes is in violation of the United States Constitution. Because Defendant's activities of reviewing wholly out-of-state contracts would constitute an ongoing and continuous violation "where the relief sought is prospective in nature, i.e., designed to prevent injury that will occur in the future," the Ex Parte Young exception may apply. Summit Med. Assocs., P.C. v. Pryor, 180 F.3d 1326, 1338 (11th Cir. 1999). However, in the event that the suit is actually a suit against the state itself or against a state agency, then the Ex Parte Young exception to immunity will not apply "even when the relief is prospective." Eubank, 210 Fed. Appx. at 844. In this case, the named Defendant is the Commissioner of the Office of Insurance Regulation, not the Office of Insurance

Regulation or the State of Florida. And because the authority by which the Commissioner applies the regulations of his office is claimed by Plaintiff to be illegal, the Commissioner is "stripped of his official or representative character and is subjected in his person to the consequences of his individual conduct."

Papasan v. Allain, 478 U.S. 265, 277 (1986). This suit is not against the state itself and the Ex Parte Young exception does apply. Accordingly, the Eleventh Amendment does not bar this Court's jurisdiction and Defendant's request to have this case dismissed on grounds of Eleventh Amendment immunity will be denied.

D. Dormant Commerce Clause

"The Dormant Commerce Clause prohibits 'regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors.'" Island Silver & Spice, Inc. v. Islamorada, 542 F.3d 844, 846 (11th Cir. 2008) (quoting New Energy Co. of Ind. v. Limbach, 486 U.S. 269, 273 (1988)). "[T]he first step in analyzing any law subject to judicial scrutiny under the negative Commerce Clause is to determine whether it regulates evenhandedly with only incidental effects on interstate commerce, or discriminates against interstate commerce." Or. Waste Sys. v. Dep't of Env'tl. Quality, 511 U.S. 93, 99 (1994) (citation and quotation omitted). "If a regulation has only indirect effects on interstate commerce [the court] must examine whether the State's interest is legitimate and whether the burden on interstate commerce clearly exceeds the local benefits." Island Silver & Spice, 542 F.3d at 846.

As the Commerce Clause relates specifically to insurance, the McCarran-Ferguson Act states that no Congressional act "shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, . . . unless such Act specifically relates to the business of insurance." 15 U.S.C. § 1012(b). This statutory language has been interpreted to mean that "Congress removed all Commerce Clause limitations on the authority of the States to regulate and tax the business of insurance when it passed the McCarran-Ferguson Act . . ." W. & S. Life Ins. Co. v. State Bd. of Equalization, 451 U.S. 648, 653 (1981). In other words, a state agency is allowed to regulate the business of insurance even if that regulation would otherwise violate the Commerce Clause.

In order to determine whether the Florida Act is shielded by the McCarran-Ferguson Act, the Court must determine whether the Florida Viatical Settlement Act regulates the insurance aspect of the viatical settlement business or the business aspect of the viatical settlement business. In Nat'l Viatical, Inc. v. Oxendine, the Eleventh Circuit affirmed without opinion the judgment of the District Court dismissing Plaintiff's Commerce Clause challenge to the Georgia Life Settlements Act. 221 Fed. Appx. 899 (11th Cir. 2007). Though the Eleventh Circuit did not specifically agree with all the reasoning offered by the District Court, it appears that the Eleventh Circuit took no issue with the District Court's sound legal conclusion that the Georgia Life Settlement Act regulated the core

aspects of the business of insurance and was therefore insulated from Commerce Clause challenge by the McCarran-Ferguson Act. See In re Perimeter Park Inv. Associates, Ltd., 616 F.2d 150, 151 (5th Cir. 1980) ("This Court is not supposed to affirm without opinion under its local rule unless it determines that "no error of law appears.") (citation omitted). The Florida Act is similar to the Georgia Life Settlement Act in that it regulates the licensing requirements for people who negotiate viatical settlement contracts, the examination of licensees, and the execution of viatical settlement contracts. Accordingly, this Court holds that the Florida Act regulates the business of insurance and is therefore shielded by the McCarran-Ferguson Act from Commerce Clause challenges. Count One of Plaintiff's Complaint will be dismissed for failure to state a claim upon which relief can be granted.

E. Florida Viatical Settlement Act

Plaintiff claims that it is not a viatical settlement provider under the Florida Act as it relates to its conduct with wholly out-of-state viatical contracts. As a result, Plaintiff concludes that Defendant has no jurisdiction to obtain or review information that is unrelated to Plaintiff's activities in the State of Florida. Plaintiff argues that the Commissioner's attempt to examine and regulate Plaintiff's non-Florida transactions goes beyond the authorization given by the Florida Act and if not enjoined by this Court, will cause Plaintiff irreparable harm and economic loss.

Plaintiff's claim that it is not a viatical settlement provider is untenable. Plaintiff is not permitted to maintain the position that it is a viatical settlement provider under the Florida Act only when it is engaged in a viatical settlement contract with a Florida resident. The fact that Plaintiff acts as a viatical settlement provider with a Florida resident, it is a viatical settlement provider under Florida law and is therefore subject to the Florida Act. Furthermore, the granting of a license by a state agency is a privilege. See Council of Ins. Agents + Brokers v. Gallagher, 287 F. Supp. 2d 1302, 1310 (N.D. Fla. 2003). With that privilege comes the responsibility to adhere to the provisions of that act and any evaluations made by the Office regarding the "personal fitness" of licensees. See Brewer v. Ins. Comm'r and Treasurer, 392 So.2d 593, 595 (Fla. Dist. Ct. App. 1981). Especially in such a heavily regulated industry as the insurance industry, licensees are subject not only to express legislation but to a reasonable interpretation of fitness as determined by administrative official in order to insure the safety and welfare of the general public. Id. at 596. Furthermore, the Florida Act specifically states that Defendant may "examine the business and affairs of any licensee." Fla. Stat. § 626.9922(1).

Additionally, the Florida Act provides that the Office of Insurance Regulation, in its discretion, will issue a license to a viatical settlement provider if the applicant for the license is, among other things, "competent and trustworthy and intends to act in good faith" in the viatical settlement business. Fla. Stat.

§626.9912(5)(b). While it is true that the Florida Act only regulates viatical transactions with in-state viators, Am. United Life Ins. Co. v. Martinez, 480 F.3d 1043, 1047 (11th Cir. 2007), there is no basis for concluding that Defendant may not merely *examine* the contracts and business records for those out-of-state contracts. This determination of the character of the settlement provider may be ascertained by evaluating the complete picture of Plaintiff and its business practices as a whole, both inside and outside of the State of Florida. As stated by Defendant, this examination is not the same as imposing penalties on Plaintiff or suspension of Plaintiff's license because Plaintiff's out-of-state contracts may violate Florida law. Defendant acknowledges that the Florida Act does not govern these out-of-state transactions. As a result, Defendant has no intention of applying Florida law to these wholly out-of-state transactions. However, under the Florida Act, Defendant is permitted to review and examine these contracts. So to the extent that an examination of out-of-state contracts serve only to confirm Plaintiff's claim that non-Florida transactions actually occurred outside of Florida and that contracts have not been altered in order to avoid compliance with Florida law, such an examination is in accordance with the provisions of the Florida Act and therefore within the jurisdiction of the Defendant. Accordingly, Count Two of Plaintiff's complaint will be dismissed for failure to state a claim upon which relief can be granted. As referenced throughout this order, Plaintiff has not persuasively argued that the Defendant has violated federal law. As a result,

Plaintiff does not have a likelihood of success on the merits of its underlying case and its motion for a preliminary and permanent injunction will be denied. For all of the foregoing reasons, it is hereby

ORDERED AND ADJUDGED as follows:

1. Plaintiff's motion for leave to file an amended complaint (doc. 19) is ***denied.***
2. Plaintiff's motions for oral arguments (docs. 14, 17, and 18) are ***denied.***
3. Defendant's motion to dismiss Plaintiff's Complaint (doc. 12) is ***granted.***
4. Plaintiff's motion for a preliminary injunction (doc. 4) is hereby ***denied.***
5. Plaintiff's Complaint for Declaratory and Injunctive Relief (doc. 1) is hereby ***dismissed.***

DONE AND ORDERED this thirty-first day of March, 2009.

s/ Stephan P. Mickle

Stephan P. Mickle
United States District Judge



State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Jim Doyle, Governor
Sean Doherty, Commissioner
Wisconsin.gov

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May 12, 2009

Senator Herb Kohl, Chair
Senate Special Committee on Aging
330 Hart Senate Office Building
Washington, D.C. 20510-4903

Senator Kohl,

Please include this letter in the hearing record for the April 29, 2009 hearing, "Betting on Death in the Life Settlement Market."

Given the unstable state of the economy and a general vulnerability for struggling Americans to entertain financial options that promise quick payout, I laud your actions in bringing a national spot light to the life settlement market. As reflected in the attached June 2, 2008 Wall Street Journal article, "Pinched Consumers Scramble for Cash," life settlement agreements can be an attractive option for people as they struggle to make ends meet. While such transactions can be beneficial to individuals who no longer need their life insurance policy, it is critical that individuals understand the potential benefits and ramifications of their decisions.

Recognizing that there is a new interest in life settlement transactions and a greater susceptibility for people to fall victim to Stranger Originated Life Insurance (STOLI) schemes, I am committed to pursuing state legislation that regulates the life settlement market and bans the practice of STOLI in Wisconsin. Late last year I created a life settlement working group comprised of representatives from the life settlement industry, life insurance companies, agents selling life insurance products and consumer advocates. This group is charged with recommending statutory changes that govern life settlement transactions; prohibiting STOLI in Wisconsin and providing penalties for those who solicit STOLI transactions. Both the National Association of Insurance Commissioners (NAIC) and the National Conference of Insurance Legislators have model regulations that serve as strong templates for states' use in crafting legislation. I anticipate the changes I forward to the Legislature will reflect provisions from both models.

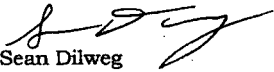
Key issues under consideration are:

- o Defining STOLI and Life Settlement Contract.
- o Prohibiting a person from entering into a life settlement contract at any time prior to the application or issuance of a life insurance policy that is the subject of a life settlement contract.

- Prohibiting a person from entering into a life settlement contract within a certain time period commencing with the date of issuance of the life insurance policy, unless certain exceptions are met.
- Regulation of any "financing" arrangement where an agreement to assign a life insurance policy or benefit is included.
- Outlining prohibited practices, such as prohibiting a person to issue, solicit, market or promote the purchase of a life insurance policy for the primary purpose of settling the policy.
- Requiring disclosures.
- Licensing requirements as well as revocation of a license.
- Annual reporting requirements relating to life settlement transactions.
- Ensuring an opportunity for the owner of a life insurance policy to rescind a life settlement contract.
- Imposing regulations around advertising of life settlement contracts and purchase agreements.
- Imposing penalties for violation of the law as it applies to life settlement transactions.

Thank you for your strong efforts relating to life settlement transactions and STOLI. Correspondence from your staff has been helpful in my pursuit of statutory changes governing life settlement transactions in this state. I look forward to continuing to work with you on consumer protection issues affecting Wisconsin residents.

Sincerely,


 Sean Dilweg
 Commissioner



THE WALL STREET JOURNAL. ONLINE

June 2, 2008

PAGE ONE

TAPPED OUT

Pinched Consumers Scramble for Cash

By ELEANOR LAISE
June 2, 2008; Page A1

After a long binge of borrowing, U.S. consumers face a credit crunch and a sagging economy. To sustain their living standards, many Americans are doing what comes naturally: scrambling to raise more cash.

Sheron Brunner, 63 years old, bought a \$250,000 life-insurance policy in 1997, planning to leave the proceeds to her three children. She faithfully made her \$113 monthly payments. But after retiring in 2002 from her job running a homelessness-prevention program, her finances unraveled. Health problems forced her to siphon her savings. A monthly Social Security check of about \$700, her only source of income, doesn't cover her medical bills and rising everyday expenses. In September, she moved to Wichita, Kan., from San Francisco to cut her cost of living.

It wasn't enough, so this spring she signed what's known as a life-settlement agreement with J.G. Wentworth, a company that buys life-insurance policies and other tough-to-sell assets. The contract transfers ownership of a life-insurance policy to a third party, which then pays future premiums and collects the benefit. Ms. Brunner received about \$45,000 for her \$250,000 term policy.

"It wasn't what I wanted," she says. But "with the economy the way it is, I needed that help now."

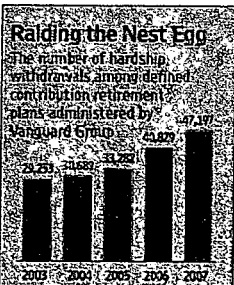
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Sheron Brunner



As consumers max out their credit lines and banks clamp down on lending, many older and middle-class Americans are resorting to pricey, often-risky alternatives to stay afloat. Some are depleting their retirement accounts, tapping 401(k)s for both loans and hardship withdrawals. Some new fast-cash options allow homeowners to squeeze equity from their houses — without the burden of monthly payments. One new product offers a one-time payment. In exchange, the company shares in as much as 50% of any future gain or loss in the property's value, typically collecting proceeds when the house is sold.

Americans are resorting to these more extreme measures due to the

Despite the risks, business in the fast-cash lane has been accelerating. In 2007, 18% of workers had taken a retirement-plan loan within the past year, up from 11% in 2006, says a recent survey by Transamerica Center for Retirement Studies. The number of federally insured reverse mortgages is also ticking up. From January through April of this year, lenders originated 40,068 such loans, compared with 37,020 in the same period last year.

The Financial Industry Regulatory Authority recently issued investor alerts warning consumers about the high costs of reverse mortgages and the opacity of the life-settlement market. More broadly, it also cautioned that some cash-now transactions could hurt consumers' ability to qualify for certain benefits, like Medicaid. A lump-sum payment from a life settlement or reverse mortgage could leave an individual with too much cash to be eligible for such programs.

The costs of reverse mortgages "are all very straightforward and upfront and disclosed," says Peter Bell, president of the National Reverse Mortgage Lenders Association. Doug Head, executive director of the Life Insurance Settlement Association, says the life-settlement industry is "pretty good at disclosures," but notes that regulations pending in a number of states will help improve information for consumers.

Robert Hamzey, a California real-estate agent and financial planner, has been brokering life settlements for years. But last year, as the housing market soured, he started promoting them as a way for his real-estate clients to fund a down payment. "You can't believe how elated these people are when you find an asset that they didn't know existed," he says.

The current environment differs from past downturns. During the last recession, home prices were still rising, many consumers could borrow against their home equity, and credit was more widely available. Now, "real spending is hardly growing, and that's something we haven't seen since the early '90s recession," says Scott Hoyt, senior director of consumer economics for Moody's Economy.com.

Because they often have plenty of equity in their homes, but lack sufficient income for everyday expenses, older Americans are finding products like reverse mortgages especially tempting.

Daniel Petelin, 62, lives in a roughly \$1.8 million house in Redwood City, Calif. His mortgage debt on the place, about \$16,000, is minimal. But the freelance public-relations and event manager, who has an income of about \$47,000, is still feeling pinched. "Eggs a few months ago were 79 cents a dozen. Now they're \$1.79." With gas in his area about \$4 a gallon, he's planning car trips carefully. He has cut back on eating out. And next year, his health-insurance premiums are going up to about \$600 a month.

Single with no children, Mr. Petelin doesn't want to sell the four-bedroom house where his parents lived for nearly 70 years. He's not interested in a home-equity loan, as he doesn't like the idea of making monthly payments. Instead, he's planning to take out a reverse mortgage backed by the equity in his home.

He has shopped around with a few lenders, but has yet to take out the loan because in the midst of the credit crunch, he's found some banks hesitant to lend the amount he's seeking -- roughly \$580,000. Still, he intends to take a loan in the near future because he says he needs the cash.

A Different Strategy

Pinched Consumers Scramble for Cash - WSJ.com

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NCOIL

National Conference of Insurance Legislators

...for the States

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April 28, 2009

The Honorable Herb Kohl
United States Senate
Special Committee on Aging
330 Hart Senate Office Building
Washington, DC 20510-4903

The Honorable Mel Martinez
United States Senate
Special Committee on Aging
330 Hart Senate Office Building
Washington, DC 20510-4903

Dear Chairman Kohl and Ranking Member Martinez:

The National Conference of Insurance Legislators (NCOIL) believes that seniors must be highly protected in their dealings with life settlements. NCOIL—an organization of state legislators devoted to sound insurance public policy—has been actively engaged in this debate for over a decade. We would like to share with the Special Committee on Aging insights gained during our extensive undertaking, which culminated in a 2000 NCOIL *Life Settlements Model Act*, recently amended in response to mounting concerns over stranger-originated life insurance (STOLI) schemes.

NCOIL believes that transparency, disclosure, and accountability are key components in regulating the market. In amending our model to address STOLI, NCOIL legislators—with input from all interested parties—devoted more than 35 hours of debate and deliberation for over 18 months. The result was legislation that strikes a delicate balance between regulating life settlements and protecting policyowners.

By clearly defining STOLI and making these transactions illegal, our model isolates bad actors without impacting legitimate settlement transactions. To enhance accountability, we coupled the definition with stronger penalties and increased insurance department authority. We believe extensive disclosure to state regulators—including information on the total number and aggregate face amounts of policies settled annually—arms them with data to police the market.

Our model also protects a policyowner's right to settle after the standard two-year contestability period, regardless of whether the individual uses liquid assets or premium-financing to pay premiums. Particularly in today's economy, it is important to note that certain individuals—who may have significant assets to protect—may not have the liquid assets to purchase a policy without assistance. Our model protects their interests on an equal basis with those who purchase a policy outright.

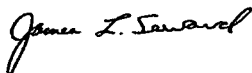
During our deliberations, lawmakers stressed the need to enhance disclosures to policyowners who are considering a life settlement, as well as insurers and settlement companies. Toward that end—and to address some of the most frequent consumer concerns—our model requires written disclosure prior to settlement of the tax consequences of a settlement, and that proceeds could be subject to claims of creditors. It also requires a life settlement provider to inform the policyowner that he/she should seek professional tax advice.

The NCOIL model also requires disclosure that a settlement may negatively affect future access to public assistance and insurance. Specifically, our bill requires policyowner notice that receipt of the settlement proceeds could adversely affect his/her eligibility for public aid, government programs, and entitlements. It also requires a disclosure that—because there is a limit to how much coverage insurers will issue on one life—participation in a settlement could limit the insured's ability to purchase future life insurance.

In order to increase transparency in settlement transactions, our model requires life settlement brokers to disclose, among other things, any compensation received in connection to the life settlement contract. It also requires the broker to disclose a complete and accurate description of all the offers received related to the proposed settlement contract, as well as any affiliations or contractual arrangement between the broker and any person making an offer on the settlement contract.

We appreciate the opportunity to provide written comments in lieu of participating in tomorrow's hearing, and to convey what we know is vital in the protection of seniors. As a result of extensive research, the NCOIL *Life Settlements Model Act* requires important consumer disclosures, demands transparency and accountability, and has provided the framework for most of the state settlement bills enacted since 2007. NCOIL is committed to working with the Committee should Members decide to further investigate the regulation of life settlements.

Sincerely,



Sen. James Seward (NY)
NCOIL President

cc: U.S. Senate Special Committee on Aging
NCOIL Legislators



Wednesday, April 15, 2009

Honorable Herbert Kohl
Chairman of the United States
Special Committee on Aging
G31 Dirksen Senate Office Building
Washington, DC 20510

Dear Senator Kohl:

With this letter, we once again thank and commend the Special Committee on its interest in the secondary market for life insurance as expressed in your letter to David Hartman, our President. As one of the life insurance industry's most consumer-oriented innovations of the past 30 years, the secondary market represents an important development for America's seniors. The Life Insurance Settlement Association is the nation's oldest, largest, and most diverse organization representing participants in the secondary market for life insurance. As we have indicated in earlier correspondence LISA supports laws that protect consumers' property rights in their life insurance policies and protects consumers in life settlements. LISA has supported and worked for the successful passage of most of the 32 states laws that have been adopted to date.

The members of the Special Committee understand that significant market evolutions such as the life settlement industry do not occur in a vacuum. As such, any examination of the secondary market for life insurance would not be complete without full consideration of the conduct and practices of all parties, including life insurers, both leading up to the market's inception and in response to its growth.

As you have noted in your letter, the secondary market for life insurance enables America's seniors "to derive previously inaccessible economic value from unwanted or unneeded life insurance policies." This can occur because of the freedom afforded seniors by the new market to sell life insurance policies that are no longer needed or wanted. Such sales directly benefit policyowners by providing greater financial planning options as well as the opportunity to realize the inherent market value contained in their life insurance assets. With the harsh economic environment of the day inflicting deep financial losses on many seniors, receiving the market value for life insurance that they simply can no longer afford could enable many seniors to maintain their standard of living.

But it must be noted that consumers who exercise their rights and seek the value of their policies represent a cost to insurers – a cost that insurers have demonstrated time-and-again that they are eager to eliminate, even at the risk of violating long-established consumer rights and stifling open and fair competition.

It is sure, and has been publicly recognized, that the secondary market has provided competition for insurers by paying policy owners billions in life settlements over the past five years. Recognition of this is important as lapse and surrender rates for universal life policies remain high. Unfortunately, rather than compete against life settlements, insurers have engaged in a concerted effort to impair and inhibit the ability of American seniors to access the value of their life insurance assets. In this effort, insurers have sought to interfere with consumer rights under the contract of insurance, limit information and, egregiously, provided false and misleading information that has led many seniors to drop their policies without the benefit of knowing about the true market value of their policies. Specifically, insurers have:

- fired agents for counseling clients about the secondary market;
- made false statements about life settlements and life settlement companies;
- provided misinformation to policy owners;
- pressured competing insurers to boycott premium finance loans;
- sought to rescind policies sold in the secondary market;
- imposed contractual restrictions on policy sales; and
- refused to issue policies when a prospective insured indicates having discussed life settlements with his or her agent.

In addition, insurers with the assistance of surrogates in the public policy arena, have promoted legislation that severely curtails policyowners' property rights to sell a policy or borrow against it. Their legislative efforts have included promoting state legislation to prohibit the sale of a policy for a period of 5 years after policy inception – a measure that has been criticized as “anti-consumer” and “protectionist” by state legislators and consumer advocates. The carriers' trade association, the American Council of Life Insurers and its affiliates, have promoted legislation that would impair the lawful ability of policyowners to utilize a policy's market value as collateral for a loan to pay premiums for the policy.

This letter is to call to the Special Committee's full attention the specific – and, in some instances, coordinated – actions insurers have taken to limit American consumers' access to the secondary market for life insurance.

ORIGINS OF THE SECONDARY MARKET

The legal and public policy pillars of the secondary market trace back well over a century to a set of State high court decisions beginning in the mid-1800s and culminating with the unanimous 1911 U.S. Supreme Court decision in which Justice Oliver Wendell Holmes wrote:

[L]ife insurance has become in our days one of the best recognized forms of investment and self-compelled saving. So far as reasonable safety permits, it is desirable to give to life policies the ordinary characteristics of property.... To deny the right to sell except to persons having such an [insurable] interest is to diminish appreciably the value of the contract in the owner's hands.¹

Even though the right to buy and sell life insurance policies has long existed, there was insufficient consumer demand to support a secondary market. This was because most life insurance products sold until the 1980s provided a cash surrender value reasonably equivalent to what the policies were worth. No institutional secondary market was necessary because consumers were receiving fair value.

¹ *Grigsby v. Russell*, 222 U.S. 149 (1911).

All that changed in the 1990s when insurers changed their pricing practices and began offering artificially low premiums in an effort to acquire market share. To support these low premiums, insurers reduced "cash values" or the amount a policyowner receives when the policy is surrendered. This had the effect of creating a windfall for insurers each time a policy was terminated, either by surrender or lapse.

In 2000, Northwestern Mutual chief actuary William Koenig published a prescient article plainly describing this market defect in the context of universal life policies; the resulting consumer harm; and the secondary market's emergence as a competitive alternative.

"What is the main attraction of these plans? It's simple: lower premiums. These policies ... have an Achilles' heel. In order to work at such low premium levels, the policies depend on lapse-supported pricing. Each time a policy lapses, the company's gain is much larger than would reasonably be expected. This pricing method is unfair to consumers.... the vast majority of policyholders who lapse their policies before death are the 'losers.' They receive much less at surrender than what any reasonable person would perceive as acceptable value." (emphasis added)²

Koenig went on to put the growing life settlement market in context as a natural market response to consumer demand for a fair return on their investment.

"The current environment suggests that if an issuing company does not provide fair value, policyholders will proceed directly to a secondary market—presumably, a viatical company—to get a better deal."

And policyowners have done exactly that. To date, the industry estimates that the life settlement market has paid seniors an estimated \$12 billion for their unwanted insurance, some \$9 billion more than they would have received if they had surrendered the policies back to the insurers.

Without life settlements, insurers would enjoy a "monopsony", an economic term that describes "an entity that is the only purchaser of goods or services in a given market."³ As the only purchaser of unwanted life insurance, insurers dictate the terms of how policies may be disposed. (Imagine if the real estate market operated in the same fashion: homeowners would only be able to sell their home back to the original builder, at a price set by the builder.)

The secondary market eliminates the insurer's monopsony – and restores the balance of a competitive market for property owners – by providing multiple buyers and creating a free market for unwanted and unneeded insurance policies. As a result, seniors who choose to settle are paid on average in excess of 300% of cash surrender, according to industry estimates..

² Koenig also pointed out that the unfair return on universal life has been criticized by consumer advocates, writing that: "[t]he major consumer beef about permanent life insurance involves early surrenders. Since the mid-1990s, the Consumer Federation of America and others have decried the "billions of dollars" that consumers waste on cash-value life insurance when they terminate early. The consumerists' point is that someone who surrenders a cash-value policy in the early years receives a cash value... far less than premiums paid."

³ Neil A. Doherty and Hal J. Singer, "Regulating the Secondary Market for Life Insurance Policies," *Journal of Insurance Regulation*. April 2003.

Additionally, prior to the secondary market, lenders only recognized life insurance policies' cash surrender value as collateral. Now, because there is a life settlement market, lenders are able to offer loans to pay premiums that are supported by the fair market value of the policy. This is a particularly valuable opportunity for seniors, who, in consultation with their estate planning professionals, may identify a need for life insurance, qualify for coverage based on health and net worth, but lack liquidity to fund premium payments.⁴ This form of lending, often referred to as "non-recourse" premium financing, may be new to life insurance, but it is not new in most other markets, where the asset that is being acquired is the sole collateral used to secure the loan that will provide funds to acquire that very asset.

In other words, the presence of the life settlement market – establishing a competitive market value for the contract of life insurance benefits consumers by allowing lawful policyowners to access the value of the policy at BOTH the surrender and now at the inception of a policy.

Given the secondary market's considerable benefits for consumers, insurers and their affiliated trade associations have publicly voiced support:

"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." – Frank Keating, CEO American Council of Life Insurers, March 2009.

"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." – Cliff F. Wilson, President of the National Association of Insurance and Financial Advisors⁵

Sadly, the ACLI and life carriers' public stance is directly and systematically contradicted by the insurers' anti-consumer and protectionist market conduct. Consider the following:

INSURERS ARE ISSUING FALSE AND MISLEADING INFORMATION TO SENIORS ABOUT LIFE SETTLEMENTS

For the reasons cited above, we have now seen that insurers have launched aggressive efforts to thwart the secondary market. These efforts involve unfair and deceptive practices, which are anti-competitive, anti-consumer, and directly target seniors. In combination and as continuing practice, these activities amount to an attack on seniors to deprive them of their rights through spin and marketing techniques. Specifically, insurers have engaged in deceptive marketing to limit growth in the secondary market, despite the presence of state laws prohibiting such practices. Here are examples:

- Prudential falsely promises customers that their agents will "provide assistance on a range of financial issues"; "put ... all of [their] experience and skill at your disposal"; and will "provide ongoing service as your needs and

⁴ Insureds over age 65 with life expectancy of less than 20 years are the most likely candidates for a life expectancy review which can translate into a market valuation of a policy. As a result, seniors are the most likely beneficiaries of such loans.

⁵ STOLI Alert, March 2009.

situation change over time" because "planning is not a one-shot deal" and "strategies need to be adjusted periodically." But Prudential's broker contract requires its agents to certify "that no Company Policy shall be sold or used in any manner to or with a viatical or life settlement company or be part of a viatical or life settlement." *The assertion of "ongoing service" is a clear false statement, while the prohibition can clearly result in pecuniary loss to policyowners while benefiting only Prudential.*

- Mass Mutual attempts to scare seniors from life settlements with dire threats about the loss of death benefit coverage—without providing identical warnings in the case of a lapse or surrender. MassMutual has refused to process a change of ownership form (a fundamental right under the contract) to a life settlement provider unless the consumer signs an intimidating form which includes a series of affirmations where the consumer acknowledges the alleged harm wrought by giving up death benefit coverage. These include an extraordinary subjective statement to be affirmed by senior policyowners, that "I am forfeiting a financial asset that probably has a higher rate of return than any other asset in my estate." *Obviously, this same statement pertaining to the loss of death benefit coverage would also apply to lapse and surrender—which, according to a leading international actuarial consulting firm, approaches 90% of these policies. Mass Mutual's surrender forms provide no such statement to seniors about the potential detriment of forgoing coverage.*
- New York Life, in even more dramatic language instills fear in seniors who are considering life settlements: "What if you die suddenly? Without death benefit proceeds, will your loved ones have enough to help settle debts, avoid selling assets to pay bills and taxes, and run the household? They had better because only the life settlement company will gain at your death." *But clearly, upon a surrender, only the insurer benefits. No such warning occurs when a New York Life policy is surrendered. Insurers are thus voluntarily engaging in marketing practices which systematically mislead through incompleteness.*

LIFE INSURERS' ARE THREATENING AGENTS

Nearly uniform national public policy has established that seniors can and should seek the advice and assistance of their trusted life insurance producer when considering a life settlement. The model settlement laws of both the NAIC and NCOIL, and nearly every state in the nation with a settlement law, recognize that life insurance agents are qualified and authorized to advise and assist policyowners in a life settlement transaction. This represents good public policy and common sense, since the insurance agent is often the first person to know or be called by a policyowner or who can no longer afford or no longer needs the policy.

Furthermore, both national models and most state laws expressly establish that the licensed life agent when brokering a life settlement represents only the policyowner (and not the insurer or the settlement provider) and owes a fiduciary duty to the policyowner. This is far stronger consumer protection than exists under state law when any policy or annuity is issued..

Life insurers are overriding this clear and uniform public policy and the related state laws when they prohibit or threaten agents from helping seniors access the market value of their policies, both through a life settlement or when obtaining premium financing. Consider the following:

- New York Life, on its website states: "we have *advised* our agents to avoid [the life settlement] market." Meanwhile, the company's internal instructions to agents explicitly deny consumer access: "all New York Life

agents are *prohibited* from participating in the viatical settlement market"... even as the same memo acknowledges that "the insureds often have legitimate reasons for selling their policies; an insured's estate size may have been reduced, for example, requiring less insurance to pay projected estate taxes."

- New York Life: "You may not obtain forms or papers for the [life settlement] transaction, accompany a client to a meeting with a life settlement broker or provider, evaluate any proposals they receive from a life settlement company."
- Prudential: "No Company Policy shall be sold or used in any manner to or with a viatical or life settlement company."
- Principal: "The Principal's career producers (full-time, part-time, retired), field & management & administrative staff are not allowed to participate in viatical settlement transactions involving policies of The Principal or any other insurer."
- Mass Mutual: "you may not act as a solicitor, placement agent, finder, master broker or in any similar capacity for anyone in the business of buying in-force life insurance policies."⁶

INSURERS' CONFLICTING INFORMATION CAMPAIGNS REGARDING STOLI

Insurers have decried the existence of Stranger Originated Life Insurance (STOLI), (sometimes called Investor Initiated Life Insurance), as justification for attacking consumer access to the value of life insurance through life settlements and lawful premium financing. This coordinated effort among carriers flagrantly seeks to obscure or ignore the facts about STOLI, which are these:

- Life settlements are not STOLI. STOLI exists when a 3rd party investor or "stranger" owns or controls the policy or its benefit from *policy inception*.
- Courts have held that an awareness of the secondary market for life insurance at policy inception does not comprise STOLI, nor does *the intent* to explore opportunities for selling a policy on the secondary market.
- LISA and its member organizations have actively and aggressively sought to eliminate the risk of true STOLI through legislation that focuses on detection, prevention and enforcement.

⁶ Protective, March 13, 2006 ("We also reserve the right to terminate the contract or appointment of any producer or distributor involved with such submissions."); Penn Mutual Bulletin, Feb. 21, 2006 ("please be aware that if you engage in these types of transactions, you will be subject to disciplinary action, up to and including, termination for cause."); Prudential, Aug. 8, 2005 ("the producer may be subject to disciplinary action up to and including termination of the producer's contract"); MetLife, Sept. 23, 2005 ("Evidence of undisclosed producer knowledge of or participation in these arrangements could result in the termination of the producer's contract."); Hartford, Jan. 17, 2006 ("Abuse of the policies and procedures set here may result in disciplinary action."); Transamerica, March 3, 2006 ("we reserve the right to...take appropriate disciplinary action"); MONY, March 1, 2005, ("the financial professional may be subject to disciplinary action up to and including termination.")

Remarkably, as we discovered some time ago, the insurers' agitated claims to public policymakers, including this committee, about the depth and breadth of the problem of STOLI are countered by their own public statements to their shareowners and others. As evidenced by the following avalanche of public statements, many of the largest life insurance carriers have identified that STOLI was being generated by their own agents and that they have been able to control – and even eliminate – STOLI through enforcement of existing laws by employing more due diligence at the time of policy application:

- "We really believe that we avoided the worst of the stranger owned life insurance sales bonanza that went on in this industry. And I think one reason for that is we just never hooked up with the distributors that were leading the way on that. And when we did identify people that we thought were trying to sneak some of the [STOLI] business in during the middle of the night on us, we would deal with it and we still are dealing with it. We never open the door and encourage that kind of business. And I think it really goes back to the quality of the people that sell our products." Johnny Johns, Chairman and Chief Executive Officer, Protective Life (March 11, 2009).
- "I assume you're referring to IOLI/STOLI on universal life. Number one, just to give you some context -- if you look at our business mix today, our in force business mix, less than 5% is in the target range for an age group for a life settlement. So from that perspective we feel very good. In terms of new business we do a number of things. First of all, we do frequent audits to see what's coming in. The second thing is that we're adding a question to our application and we're reviewing our trust agreements because this is usually where you pick it up. And we have also told our distribution partners that we do not want the IOLI/STOLI business. (Genworth Financial EVP at Wachovia Securities CEO Summit, est. June 26, 2007)
- With respect to market conditions and IOLI and SOLI, we did see, in the first quarter, a little more aggressiveness on the part of distribution in trying to move that type of product through. We continued to put up filters, both on the distribution side and the manufacturing side. I think it has backed off quite substantially in the last quarter. I think our success is a combination of factors -- great products, great distribution, great underwriting. (Lincoln National CEO, Q2 2007 Lincoln National Earnings Conference Call published August 1, 2007.)
- "[W]e've put up some great screens, we think we have a good idea of where that business is being produced." (Nationwide Sr. VP at 32nd AIFA conference, March 2007.)
- "[M]any of our competitors are following in our footsteps as evidenced by -- if you look at total life sales for the industry, what you would see is that it really started off with a bang and ended with kind of a whimper.... And so what you can see is that many of our competitors are getting out of this business and we can actually see a time possibly a year from now when there is no more IOLI business. So we see the market is coming back to us over time, and we are going to continue to stick to strong fundamentals of the business and doing the business in the right way." (MetLife Chief Admin. Officer, Q4 2006 earnings call; February 14, 2007.)
- "[W]e greatly strengthened our measures to eliminate the IOLI cases coming through that we all want to prevent from issuing." (John Hancock CEO, Q4 2006 earnings call; February 13, 2007.)
- "As we discussed at our investor day, in the latter half of 2006 you began to see the industry tighten down on the investor-owned life insurance sale. We believe we took a leading position in trying to tighten that down and stem the tide of that. We, like several other companies, did it through a combination of changes in our underwriting process, certifications by both agents and by customers, reviewing trusts, and generally reviewing the entire

process, specifically in the older age marketplace at the higher face amounts where that type of business tended to come in. We stemmed the tide fairly successfully, so much so that we saw a fairly significant drop in our universal life sales at the older ages. In the second half of 2006, we indicated to you, as I believe has come true, that we were going to establish a fairly new baseline from which to grow. We believe that that has occurred and we have indicated that we believe most of the investor-owned life insurance sales have stopped coming through our reported numbers." (American General CEO on Q4 2006 AIG earnings call; March 2, 2007.)

- "In an effort to screen out IOLI sales, the company stopped accepting premiums financed on a non-recourse basis in February 2006, and it has taken proactive steps to improve its surveillance/detection capabilities and its product designs." (Phoenix Life, Fitch report quoted in BestWire, Feb. 27, 2007.)
- "And then U.S. retail life sale, the rebound in the last quarter, a lot of it came actually from the Transamerica Group where there was a period of time there where the IOLI, the industrial life sales and our stance on that slowed things down a bit. But we think that, as a whole, we're back to work there and doing better." (Aegon President and CEO on Final Year Earnings Call; March 8, 2007.)

Despite their own extensive reports of success in addressing STOLI where it occurs, at origination insurers have seized on the image of unscrupulous investors ("strangers") preying on seniors to mount a systematic, coordinated attack on the property right of assignment of life insurance. Specifically related to the assignment of a policy as collateral in a loan, insurers worked together to deny life insurance to applicants who were using non-recourse premium financing (which accepts the policy's market value as collateral for the loan).

United States Senator Arlen Specter was concerned about this apparent coordinated action by the American Council of Life Insurers and the individual life companies, as documented in a letter to the United State Justice Department, which highlighted the following information:⁷:

- ING surveyed twenty of its competitors to determine whether they issue policies financed using non-recourse premium financing. That survey was circulated by ING among its competitors. Shortly after the survey was circulated, the six companies that indicated that they did accept policies funded through non-recourse loans switched their position, indicating they would no longer issue policies in which premiums were financed using non-recourse premium loans.
- Transamerica, in explaining its reversal stated that it was doing so "to support this industry-wide stance."
- An executive at one firm, in circulating the survey, remarked to the recipient that "notice how all these other carriers are jumping on board."

Subsequent to Senator Specter's letter, even more evidence in support of the collusive action was reported. ING's CEO, the company that authored and distributed the survey, stated publicly that "the top 30 life company CEOs that are on the American Council of Life Insurance Board have all agreed that we will not write ... stranger owned⁸ life insurance.... So

⁷ Letter dated December 12, 2006, from U.S. Sen. Arlen Specter to the Honorable Thomas O. Barnett, Assistant Attorney General for Antitrust.

⁸ "Stranger Owned Life Insurance is not Stranger Originated Life Insurance. Life settlements are not STOLI as commonly understood.

the big companies have all agreed to no longer write it."⁹ The statement by the ING CEO specifically referenced the same time period that the survey was circulated, suggesting that the reference to stranger-owned life insurance referred to non-recourse premium financing.

Importantly, the Independent Insurance Agents and Brokers of America ("The Big I"), the largest insurance agent trade association, has decried insurance company business practices that threaten or intimidate insurance producers' ability to assist their clients in obtaining needed life insurance using non-recourse premium financing. In an April 2006 letter to the NAIC, the Big I stated:

[C]ertain marketplace practices ... have recently emerged and are now occurring widely. Many companies have adopted a uniform practice of rejecting all applications where the consumer may potentially use premium financing to access coverage. These insurers are even rejecting applications where the consumer has completed the traditional medical and financial underwriting review process and have demonstrated a need for coverage. Some carriers have even threatened to terminate or seek the criminal prosecution of any producer who submits such an application, and this places agents in an untenable position when their customers ask for an available service that he/she is fearful of discussing or restricted from providing. These practices are troubling.¹⁰

INSURERS ENGAGE IN TRUE ILI/STOLI

The Committee has properly expressed concern investor initiated life insurance (ILI), or stranger originated life insurance (STOLI). Fundamental, long standing, public policy in the insurance business includes prevention of speculative purchase of life insurance by persons or corporations without insurable interest upon insureds where the purchaser does not have a fundamental economic interest in the insured's continued life. Under established law, of course, an insured has an unlimited interest to take out a policy on her own life; whereas persons or corporations other than the insured must have insurable interest to take out a policy on an insured, which can exist in a family member, creditor, or employer.

Employers have a well established insurable interest in key employees. Under traditional insurable interest analysis, as the 10th Circuit explained, the purported rationale for Corporate Owned Life Insurance (COLI) is to "protect the corporation against economic losses which could occur as a result of the untimely death of such an employee."¹¹ For instance, if a CEO or other indispensable employee were to die suddenly, the corporation would suffer an undeniable economic loss from that event. Hence key man insurance is consistent with the insurable interest requirement.

But insurers aggressively promote ILI/STOLI products such as COLI and Bank-Owned Life Insurance ("BOLI") where the vast majority of policies are not sold on key employees whose death would cause a tangible and destructive economic

⁹ ING Group Q4 2006 NV Earnings Conference Call – Final, February 15, 2007.

¹⁰ Independent Insurance Agents and Brokers of America letter to NAIC, April 16, 2006

¹¹ *Tillman ex rel. Estate of Tillman v. Camelot Music, Inc.*, 408 F.3d 1300 (10th Cir. 2005).

loss to the company. These policies are sold on the lives of thousands of employees, and the products are marketed by insurers as a pure investment taken out by, and for the benefit of, a corporation or bank, not the insured.

While COLI/BOLI products can serve legitimate insurance purposes, the vast majority of these programs fall far short of the basic insurable interest test of "protect[ing] the corporation against economic losses which could occur as a result of the untimely death of such an employee." Instead, carriers explicitly promote their product as a way to make a pure investment—providing a steady stream of income to the general assets of the company to fund ongoing operations. Few Americans are really aware that these policies, as a matter of course, stay in force on the life of the employees regardless of whether the employee remains with the company. Indeed, *in excess of 90% of the policy maturities occur after the employee is no longer employed by the company.*

In direct contravention to their self-serving statements about insurable interest in their lobbying against the secondary market (as discussed further below), life insurers emphasize COLI and BOLI's investor initiated life insurance properties in their marketing materials.

- New York life explains that "companies institute COLI programs ... to increase net income," that "COLI can earn a higher after-tax yield than many other investments," and that companies who purchase COLI enjoy "an increase in earnings per share."
- The ACLI's COLI FAQ reads: "Do employees' beneficiaries get death benefit protection from COLI policies? Usually not. COLI is not a direct employee benefit."
- New York Life's brochure flatly states that employees do not "receive any of the cash benefits from COLI."
- In response to the question, "Do the policies actually fund the benefits like a pension plan funds retirement benefits," New York Life's FAQ states: "No. The policies are part of the general assets of the company."
- Similarly, a MassMutual brochure boasts that bank owned life insurance "can be a source of funds that potentially offers annual after-tax returns that are higher than the returns earned on other bank investments," and highlights the fact that the employer "does not usually have a contractual obligation to segregate the BOLI program assets from [its] general assets or contractually designate the BOLI program assets to satisfy employee benefit expenses."

Perhaps the most outrageous issue is that insurers have now misled Congress about COLI and BOLI. These policies are undeniably sold as investments. Insurers have nonetheless sought special treatment in state insurable interest law and federal tax law, and demanded that COLI held on rank and file employees, not just key persons, be regarded as if it were life insurance with traditional insurable interest. This argument has been based on the public policy argument that the proceeds for the policies benefit employees by being dedicated to employee benefit programs.

For instance, when the tax benefit for COLI was under fire in Congress recently, the life insurance industry's self-proclaimed "leading trade associations – the American Council of Life Insurers (ACLI), the Association for Advanced Life Underwriting (AALU), and the National Association of Insurance and Financial Advisors (NAIFA)" asserted when so-called "COLI best practices" were codified that "COLI is an insurance product used by employers both to protect against the financial cost of losing a 'key' employee as well as providing coverage on a wider range of employees to help provide funds for the payment of employee and retiree benefits."

Those assurances to Congress were simply not true: Life insurers' own documents, quoted above, contradict these assertions and demonstrate their intent to use COLI as a pure investment product, substantively indistinguishable from other investments (and not required to be segregated to pay employee benefits)—except for the government-bestowed competitive advantage which flows from the statutory tax benefit for life insurance. *That's really taxpayer subsidized investor initiated life insurance.*

INSURERS' EFFORTS TO UNDERMINE INCONTESTABILITY PROTECTIONS

Rebuffed by the courts in their attempts to impair seniors' property rights, insurers are pressing for a legislative override to protect their monopsony power. Insurers are proposing legislation in the States which extends the prohibition on selling a policy from the traditional two-year contestability period to five years, a time period during which about half of all policies lapse.¹²

Incontestability laws are a fundamental building block of consumer protection in the regulatory scheme for life insurance in the United States. Each state insurance code establishes a two-year contestability period for the insurer to challenge the validity of an insurance policy. After two years, the owner gains complete control over the policy not subject to cloud on marketable title. The United States Supreme Court explained: "The object of the clause is plain and laudable – to create an absolute assurance of the benefit, as free as may be from any dispute of fact except the fact of death, and as soon as it reasonably can be done."¹³

If contestability is extended, insureds would find themselves at a distinct disadvantage should they need to negotiate a claim during the contestability period. The Florida Supreme Court analogized that incontestability "is in the nature of, and serves a similar purpose as, a statute of limitations, the wisdom of which has been universally recognized."¹⁴

By seeking to extend the contestability period to five years, insurers would dramatically undercut this fundamental consumer protection. Indeed, the potential risk of consumer abuse under a five-year contestability period is significant, as insurers would have far greater power to rescind policies, negotiate lower claim amounts and initiate intimidating litigation to force the consumer to accept a reduction in benefits. In short, consumers would no longer have "an absolute assurance of the benefit" for which they have paid, described by the courts.

¹² Texas Department of Insurance fact sheet on life insurance.

¹³ *Northwestern Mutual v. Johnson*, 254 U.S. 96 (1920). See also *American Life Ins. Co. v. Martinez*, 480 F.3d 1043 (11th Cir. 2007) ("[I]ncontestability clauses function much like statutes of limitations. While they recognize fraud and all other defenses, they provide insurance companies with a reasonable time in which to assert such defenses, and disallow them thereafter.").

¹⁴ *Prudential Ins. Co. of America v. Prescott*, 130 Fla. 11 (1937).

DISCLOSURES AND THE IMPORTANCE OF INFORMED CONSUMERS

The Committee's interest in fair and accurate disclosures is the most effective path to proper consumer protection. Such disclosure creates an informed and empowered consumer capable of exercising property rights throughout the unified life insurance marketplace—including both the primary and secondary markets.

Under state life settlement laws, consumers now receive two full sets of disclosures in the settlement transaction which make them aware of all of the established consumer concerns raised by a life settlement. These include, but are not limited to explanations that:

- settlement proceeds may be taxable and affect eligibility for government benefits
- the consumer has a right of rescission up to a full month after signing her contract
- a variety of other choices are available to the consumer in lieu of selling the policy, including keeping the policy in force or seeking an accelerated death benefit or a policy loan.

Statutes supported by secondary market entities also require disclosures to the policyowner which give extraordinary and full detail about the method of calculation and amount of compensation paid to brokers as well as a full disclosure of all bids. Life insurers vehemently oppose equivalent disclosures for the commissions paid to agents, which can exceed 100% of the consumer's first year premium payments.¹⁵

The National Conference of Insurance Legislators (NCOIL) has further established model disclosures and affirmations for potentially improper loans against policies which address all of the established consumer concerns regarding potential consequences of premium finance arrangements. The disclosures include informing the consumer that:

- using a policy as collateral could result in the transferee taking an interest in her life
- could have tax consequences
- could affect a consumer's future insurance capacity and/or insurability.

Mandated certifications require the consumer to affirm:

¹⁵ "The life sale is a very difficult sale. People have to talk about their mortality, about how much money they really need. It's very complicated. If right in the middle of this discussion, you throw in: 'And by the way, there's a 55% commission,'" [Commissions are actually 96% of 1st year premiums with annual renewal commissions of between 2%-5% of annual premium] "...You won't get the sale. You've now created enough of a hurdle to kill that form of distribution, and that's the only form that's proven successful in getting life insurance really out. Plus, you're going to create the potential for rebating, which is against the law in most states. There would be pressure for rebates. And once you do that, then you start affecting the income of these agents. Most of them don't even make it. The industry is lucky to keep 20% after four years. If all of a sudden rebating takes place, and their effective commission is cut back because they're trying to compete on commissions, you get rid of the career agency system...and many fewer people would have life insurance." — Sy Sternberg, CEO of New York Life Insurance Co., *Best's Review*, February 2005.

- that insurable interest is present
- there is no agreement to sell
- there has been no improper inducement to insurance

These sensible and principled requirements further the essential public policy goal of an informed and responsible consumer.

INSURERS' OPPOSITION TO INFORMING POLICYOWNERS ABOUT THE RIGHT OF ASSIGNMENT

Despite their calls for full disclosure of the alternatives to life settlements, insurers vehemently oppose legislation which would make seniors aware of the settlement option when their policies lapse. What could possibly be wrong with such a requirement?

In fact, a life settlement, like a policy surrender, is simply a change of ownership for a consideration. Indeed, every life insurance policy contains a change of owner provision and state laws require settlement providers to disclose the alternatives to settlement. Why shouldn't insurers be held to the same standard of disclosing the lucrative and consumer-oriented alternative of a settlement when the policy lapses?

Instead, the integrity of the information seniors receive from insurers is severely compromised by promises of their agents' full service throughout the life of the policy, only to have those agents terminated for counseling seniors about their property rights in a settlement. Likewise, the insurers continue to make false and misleading disclosures to seniors to dissuade them from life settlements, even though the proffered reason—loss of death benefits—applies equally to surrenders, where no such threatening warnings are issued.

Seniors are best protected in a market which respects and empowers their property rights and fosters competition which yields fair value for their assets. The primary life insurance market is dominated by products which are literally designed to thwart these goals. The secondary market remedies this market defect. Life insurers should not be allowed to mislead policymakers into concluding that non-existent systemic problems in the secondary market are a legitimate pretense to impairing beneficial commerce.

In closing, we would like to reiterate LISA's commitment to America's seniors. The life settlement industry arose out of a desire to restore the fundamental rights of property ownership to life insurance policyowners. We would welcome any opportunity to shed further light on these very important issues.

Sincerely,



David Hartman

President



2008-2009

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April 28, 2009

Senator Herb Kohl
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RE: AALU Testimony for April 29 Hearing of U.S. Senate Special
Committee on Aging on Life Settlements and STOLI

Dear Chairman Kohl:

The Association for Advanced Life Underwriting ("AALU") appreciates the focus of the U.S. Senate Special Committee on Aging ("Committee") on risks to seniors from life settlements and from stranger-originated life insurance ("STOLI") and the opportunity to provide the written testimony contained in this letter in conjunction with the April 29 Committee hearing.

AALU is a nationwide organization representing approximately 2,000 life insurance agents and financial advisors, many of whom are engaged in complex areas of life insurance such as business continuation planning, estate planning, charitable planning, retirement planning, deferred compensation and employee benefit planning.

AALU has been a leader since early 2004 in advocating state laws to prevent various forms of STOLI, which are arrangements through which life insurance is taken out to evade the purpose of state insurable interest laws. In seeking state legislation to prevent STOLI, AALU has consistently worked to protect the ability of those who legitimately take out a policy to sell it in the secondary market.

State insurable interest laws are designed to assure that life insurance is not taken out by or for unrelated third party investors and that life insurance is taken out for its intended purpose of providing protection and benefits for individuals, families, businesses and employees. STOLI is designed to appear to comply with state insurable interest laws, while enabling life insurance to be taken out with funds provided by those with no relationship with the insured for the benefit of such third party investors.

AALU's primary reason for engagement on this issue is to assure that misuse of life insurance through STOLI does not impair the critically important role of life insurance. Life insurance products help 75 million American families by providing protection, savings and other benefits. The role of life insurance products is more important in these times of insecurity and financial crisis than ever before.

The current economic climate also increases the importance of the Committee's focus. On the one hand, STOLI has been chilled by: (1) legislation proposed and enacted in many states; (2) rigorous efforts by life insurance carriers to detect STOLI at the time of application and to pursue litigation to rescind STOLI policies; (3) lack of investor funds due to the financial crisis; and (4) depressed values in the secondary market due to adjustments in mortality assumptions.

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On the other hand, seniors are particularly vulnerable during these hard economic times. In light of the factors above, chances that seniors will actually receive profits that STOLI promoters suggest they may enjoy are lower than ever, while odds of these seniors finding themselves embroiled in litigation from STOLI are greater than ever.

While there are still a variety of circumstances in which seniors who previously took out a policy legitimately may consider selling it in the secondary market, seniors should be aware of risks associated with STOLI. In addition, particularly in light of depressed values, seniors should exercise care in considering whether they should keep the policy or in assuring that they receive the best price.

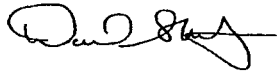
AALU hopes that the Committee's hearing will have two chief impacts: (1) enhance prospects for additional states to enact laws that prevent STOLI while protecting legitimate use of life settlements; and (2) increase understanding among consumers—particularly vulnerable seniors—of risks they may encounter.

AALU applauds this Committee and stands ready to help in any way it can. Thank you.

Sincerely,



Michael P. Corry, CLU
AALU President



David J. Stertz, FLMI
AALU CEO

Statement of



In connection with the hearing of

The Senate Special Committee on Aging

Regarding

"Betting on Death in the Life Settlement Market - What's at Stake for Seniors?"

April 29, 2009

The National Association of Insurance and Financial Advisors (NAIFA) appreciates the opportunity to share with the members of the Senate Special Committee on Aging our views regarding life settlements and in particular our concerns regarding the use of life settlements to facilitate stranger-originated life insurance (STOLI) transactions, which we believe pose significant risks for seniors. We welcome the Committee's interest in this issue, and NAIFA and its members strongly support your efforts to protect and advocate on behalf of America's seniors.

Founded in 1890 as the National Association of Life Underwriters, the National Association of Insurance and Financial Advisors comprises more than 700 state and local associations representing the interests of 200,000 agents and their associates nationwide. Members focus their practices on one or more of the following: life insurance and annuities, health insurance and employee benefits, multiline, and financial advising and investments. NAIFA's mission is to advocate for a positive legislative and regulatory environment, enhance business and professional skills, and promote the ethical conduct of its members.

NAIFA does not oppose all life settlements. Under the appropriate circumstances a life settlement may provide the policy holder with the means to access the maximum value from their policy if they determine that they no longer need the insurance coverage. Each policy holder must evaluate his or her individual circumstances and situation and make the determination of whether and when a life settlement is appropriate under their particular set of circumstances. NAIFA does support rigorous regulation and oversight of life settlements and settlement transactions, and towards this end we support the provisions of the National Association of Insurance Commissioner's Viatical Settlements Model Act. The National Conference of Insurance Legislators (NCOIL) has also adopted

a Life Settlements Model Act, and the NCOIL model also represents a viable option for regulating the life settlement market.

NAIFA does, however, view as problematic and is greatly concerned about life settlement transactions which are used in conjunction with premium financing arrangements to facilitate transactions that are commonly referred to as "stranger-originated life insurance", or "STOLI".¹ STOLI transactions are designed to evade state insurable interest and other laws and allow unrelated investors without an insurable interest in the insured to arrange in advance for their ownership of life insurance policies. The investors then use life insurance to profit from the deaths of people they do not know. In STOLI schemes, investors induce financially well-off seniors to take out life insurance policies on their own lives. The senior policy holder will receive one or more types of financial inducement for entering into this transaction: an upfront payment, a portion of the amount remaining when the policy is sold and the premium loan is paid off, "free insurance" for the two year period the policy is held, or a small continuing interest in the death benefit. It is the intent of all the parties at the time of policy inception that sometime after two years from the time of policy issuance the insured will transfer the policy benefits to those investors, who then profit when the insured dies. The sooner the policyholder dies, the greater the investor's profit.

Life settlements which are used to facilitate STOLI transactions are fundamentally different from legitimate life settlements. In a legitimate life settlement, the insured initially took out the policy for a legitimate, recognized insurance purpose, such as to provide financial protection for family members. The decision to settle the policy is made sometime down the road when the insured's circumstances change and the insured determines the original purpose for the insurance policy no longer exists. In contrast, life settlements which are used in STOLI transactions are initiated solely for the purpose of being sold in the future to investors without any interest in the continued life of the insured.

NAIFA strongly opposes all types of STOLI transactions, and has been at the forefront of efforts to restrict and prohibit STOLI since we first became aware of these transactions in early 2006. Our concern is that these types of arrangements evade the purpose behind state insurable interest laws, because in a STOLI transaction the life insurance policy is taken out by someone who has an intent to sell the policy in a couple of years to an entity

¹ NAIFA does not oppose full recourse or adequately collateralized non-recourse premium financing arrangements where the intent is for the long-term retention of the policy and the motivation is to help the insured finance insurance that he or she needs and expects to keep. In these arrangements the insured typically pledges collateral in addition to the policy to secure the loan and is personally responsible for its payment. This is in contrast to the non-recourse policy loans that are typically used in STOLI transactions, where the lender relies for collateral solely on a guaranty of the policy's secondary market (settlement) "value" as determined by a viatical or life settlement company. Contrary to the way traditional insurance premium financing is typically arranged, in a STOLI transaction the policyholder is not personally liable to pay off the loan or is otherwise assured that the bank will accept the policy in full payment of the debt.

that could not have initially purchased the policy. NAIFA believes that STOLI violates the essential social purpose of life insurance, which is to provide protection. Life insurance protects families and businesses from the unexpected death of a breadwinner or the financial consequences of the death of an owner or key employee.

In contrast, STOLI arrangements involve using life insurance for speculative purposes. Life insurance was not designed to be used in this way. The essential social purpose of life insurance forms the basis for state insurable interest laws and numerous rulings by the United States Supreme Court. STOLI undermines the integrity of life insurance.

STOLI transactions also pose significant risks and dangers to the senior citizens who enter into these arrangements. These risks and dangers include:

- Senior citizens participating in these arrangements may not be aware that the sums they receive (either at policy initiation or upon sale of the policy) as well as the value of any “free insurance” during the time they hold the policy are generally considered to be taxable income and therefore they may receive substantially less compensation than expected.
- The life insurance policies used in the STOLI transaction may be far more valuable to the policyholder as estate protection rather than as a way to make a quick buck.
- People cannot purchase unlimited amounts of life insurance. Seniors participating in STOLI may use up their insurability and be unable to purchase needed life insurance in the future.
- Seniors who enter into STOLI transactions will be giving permission for someone to periodically check on their health and well-being.
- Misstatements or lies on the policy application, including questions completed by an agent that they acknowledge with their signature, could subject the policyholder to legal liability, a risk of litigation or the voiding of the insurance contract.

As stated above, NAIFA has been at the forefront of efforts to put a stop to STOLI before it can harm seniors and other consumers. NAIFA strongly supports the enactment in the states of legislation that will address the abuses occurring in the marketplace today from STOLI. We worked closely with the NAIC and NCOIL to develop amendments to the NAIC’s Viatical Settlements Model Act and to NCOIL’s Life Settlements Model Act that are designed to limit and restrict STOLI while not placing any undue restrictions on legitimate settlement transactions. We believe the best legislative solution is to combine provisions from both the NAIC and NCOIL models into hybrid legislation that contains the strongest elements of each model.

NAIFA, its state associations and their members played a major role in helping to enact anti-STOLI legislation in 12 states in 2008. (This brings to 15 the number of states that have enacted anti-STOLI legislation to date; North Dakota enacted a version of the NAIC model in 2007, and Arkansas and Washington state have had anti-STOLI measures signed into law so far in 2009). Our efforts included providing testimony at hearings,

meeting with key legislators and insurance department staff, and broad-based grass\roots activity to encourage rank and file legislators to support the legislation. State legislative activity for 2009 is well under way, and we are currently involved in legislative activity in over 20 states.

Thank you for your consideration of our views. We appreciate and share your strong interest in protecting the interests of senior citizens, and look forward to working with you as your efforts advance.



Department of
Insurance

Ted Strickland, Governor
Mary Jo Hudson, Director

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**Senate Special Committee on Aging
Testimony of Mary Jo Hudson
Director of the Ohio Department of Insurance
April 29, 2009**

Introduction

Chairman Herb Kohl, Ranking Member Mel Martinez, and members of the Senate Special Committee on Aging, thank you for accepting the written testimony of Mary Jo Hudson, Director of the Ohio Department of Insurance, regarding Ohio's efforts to limit the entry of Stranger Originated Life Insurance transactions into the Ohio insurance market. This testimony will describe viatical settlements, the concept of insurance interest, and also Stranger Originated Life Insurance (STOLI) transactions and why they are problematic for Ohio seniors and the insurance market. This testimony will also provide you with information about Ohio's efforts to amend its viatical sales law.

Viatical settlements have been regulated in Ohio since 2000. A viatical settlement allows a consumer who owns a life insurance policy to sell the policy to a third party/investor, who would then receive the death benefit when the consumer dies. The recent amendments to the Ohio Viatical Settlements Model Act prohibit and help limit the occurrence of Stranger Originated Life Insurance transactions. The Ohio Department of Insurance advocated for adoption of these amendments to protect Ohio consumers, especially seniors, and to assure that Ohio's insurable interest law is not violated by allowing speculation on the lives of others.

Viatical Settlements – How Did We Get Here?

In order to understand why we advocated an amendment to the Ohio Viatical Settlements Model Act, it is important to understand the concept of "insurable interest," as defined in Section 3911.09 of the Ohio Revised Code, and also how viatical settlements moved into the insurance market.

Insurance laws, and the concept of "insurable interest" developed centuries ago, when groups of investors would pool their funds, and agree that the last surviving member of the group could keep the funds. This arrangement, known as a "tontine," was actually used to finance public works and made many rich. However, it was a risky investment, and eventually outlawed, because investors were killing each other to receive the investment pool.

In 1774, England outlawed tontine – the practice of wagering or gambling on the lives of others. Before the Act of 1774, anyone could buy a life insurance policy on the life of another—bets were made on the lives of total strangers to the insured.

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The Act of 1774 required that a person buying life insurance must have an insurable interest. This basic principle of insurance became part of our common law heritage. Ohio's "insurable interest" law defines who can benefit from insurance proceeds. The law provides that family, friends, charities and employers can benefit from an individual's life insurance policy. However, an insurance policy cannot be purchased solely for an investor to profit from the death of the insured - in effect, Ohio's prohibition on "tontines."

Next, it is important to distinguish a tontine from a viatical settlement. Viatical settlements, also known as life settlements, developed in the late 1980s during the AIDS crisis and were first known as "living benefits." Individuals who were diagnosed with AIDS received a virtual death sentence - there was no cure and death was almost guaranteed within a short time after diagnosis. Many of these individuals were young, and they were losing their jobs, housing and health insurance—reaching epidemic numbers in just a few years.

For those AIDS victims who were fortunate enough to hold life insurance policies, a market developed where the policyholder could, in effect, sell their policy to an investor for a fraction of the policy's value. Thus, viatical sales, or life settlements, were born. Under the Health Insurance Portability and Accountability Act of 1996 (HIPAA), terminally ill individuals could receive these accelerated benefits from their life insurance policies tax-free.

As this market developed, two things happened. First, fraud became a common problem—the demand was so heavy for the high rates of promised returns and the number of "real" life insurance policies was so few, individuals began "creating" life insurance for the viatical settlement market. Second, as better treatments for AIDS were developed, the virus did not become as much of a death sentence, and the investors had to pay premiums long after they had been promised their profits.

In order to curb these abuses in the viatical market, the Ohio Viatical Settlements Model Act was enacted. In fact, Ohio was the first state in the nation to enact this law to protect Ohioans and also maintain stability in the Ohio life insurance market.

Today's Viatical Settlement Market Development - Stranger Originated Life Insurance Transactions

So what is Stranger Originated Life Insurance, or a "STOLI," and why is the Ohio Department of Insurance so concerned with STOLI transactions occurring in Ohio? A STOLI arrangement is a transaction where an investor agrees with a consumer to finance the purchase of life insurance, from the first dollar of premium paid on the life insurance policy, in order to benefit the investor. The insured is often paid a fee, up front, in order to participate in the transaction. We have heard of seniors being promised a "referral fee" for providing the names of other seniors who would be willing to help "farm" life insurance policies. The insured is also sometimes promised that his or her beneficiaries may receive a small portion of the policy proceeds.

Alternatively, creative premium financing transactions are used to fund the purchase of high value life insurance policies. Seniors are being offered "free" or low cost premium financing for the first two years of the policy term. Often, the free or low cost financing term coincide with the state holding period for a life insurance policy before it is eligible to be sold in a viatical transaction. At the end of the free or low cost financing period, the senior is offered a chance to pay for the policy. Often, the accumulated premium and finance charges are so high that it is cost-prohibitive for the senior to continue with the transaction. The fine print of the financing documents allows for the finance company to maintain the life insurance policy or sell it to a third party. Thus, a STOLI is born.

A STOLI transaction is, in effect, an arrangement where an investor - a stranger to the insured - owns the right to receive the death proceeds. The only way to recover the investor's money is for the insured to die—the sooner the better. As I discussed earlier, a STOLI transaction is completely contrary to the Ohio "insurable interest" law. It also is a Wall Street version of a tontine.

STOLI Transactions and Ohio Seniors

In addition to our concerns regarding the Ohio "insurable interest" law, the Ohio Department of Insurance is also concerned about the significant, adverse impact that STOLI transactions can have on Ohio seniors. STOLI transactions are generally directed to seniors, over age 65. These transactions are commonly billed as "free" insurance. However, these deals are anything but free for the senior.

STOLI transactions can have adverse consequences for seniors, including unexpected income tax liability, credit score issues, limited future insurability and higher life insurance rates. When a senior enters into a STOLI transaction, the senior often receives an up-front fee. This fee may be the only remuneration that the senior receives in the transaction. Unlike life insurance proceeds, which are exempt from income tax liability, STOLI transaction payments are fully taxable.

Also, a STOLI transaction is a first dollar, premium financed transaction. There is often a loan issued to the insured, or at least in the name of the insured. If the loan is in the insured's name, the debt obligation is reported on the insured's credit history. High debt loads can lower credit scores, and adversely impact future credit applications that the senior might undertake.

Similar to credit history, an individual can only be issued a certain amount of life insurance before the individual would be considered a poor insurance risk. If an individual enters into a STOLI transaction, then needs to apply for life insurance for family or business succession purposes, the insured's application may be denied due to excessive prior insurance coverage.

As noted above, STOLI transactions are counter to Ohio's insurable interest laws. Life insurance rates are established on actuarial principles, assuming the insurer has full knowledge of the risk it is assuming. The premium rates do not consider third parties investing in life insurance proceeds, or the other risks associated with such investments. If STOLI transactions were allowed to continue, unchecked, in Ohio, we anticipated that life insurance for senior applicants would become more expensive, as insurers began to try to protect themselves from these artificial transactions.

Negative Impact on Life Insurance Market

The Ohio Department of Insurance sought to limit STOLI transactions from entering the Ohio insurance market. We determined that even a small influx of STOLI transactions would be harmful to Ohio consumers, because insurers would limit availability of insurance for older Ohioans and also increase premiums in order to address STOLI transactions. We based our analysis on national data that we were accumulating.

In July 2007, *Business Week* noted that the life settlement industry reported virtually no investments in 2001. However, in 2005, the life settlement industry was reporting investments of more than \$10 billion and by 2006, \$15 billion. Experts are predicting that such investments could balloon to \$30 billion in 2007. Goldstein, *Profiting from Mortality*, *Business Week* (7/30/07).

What was the source of this sudden growth, in the absence of a crisis such as AIDS? The *Business Week* article noted that “[m]any life settlement providers... are trying to lure people who don't even hold insurance. In this tail-wagging-the-dog scenario, speculators take out policies on the individuals' behalf, pay them something up front, cover the premiums, and then wait for the people to die so they can collect.” *Id.* The *Business Week* article concluded that many of the transactions that drove these significant investment numbers included STOLI transactions. The Department had observed a similar trend in Ohio and agreed with the *Business Week* analysis.

In addition to this reported sales growth, the Ohio Department of Insurance had seen an increase in the number of applicants to become viatical settlement providers and brokers. The Department was concerned that this alarming rate of growth in life settlements, especially in the absence of a significant health crisis, meant that STOLI transactions were the foundation of the growth.

Regulators across the country are seeing STOLI transactions directed to seniors, usually near the age of 70, causing additional concern for questionable sales tactics being directed to sometimes vulnerable consumers.

Along with growth of the life settlement market driven by these STOLI transactions, the Department also observed signs of an increasingly restrictive environment in the life insurance market for seniors. A major national carrier recently announced increased rates for universal life policies for policyholders over the age of 70. Also, the Department was receiving filings from life insurers that proposed significant restrictions on assignments. These trends did not bode well for the Ohio life insurance market or Ohio consumers.

The Department was concerned that life insurance would become significantly more expensive, and less available, for older Ohioans. As a result, seniors and their families would need to turn to investments other than life insurance. Such investments are riskier, and are subject to additional tax liability. Therefore, we recommended changes to the Ohio Viatical Settlements Model Act, as reflected in Amended Substitute House Bill 404, in order to assure we did not have an unnecessary disruption in our Ohio life insurance market.

Amendments to the Ohio Viatical Settlements Model Act

On June 11, 2008, Ohio Governor Ted Strickland signed Amended Substitute House Bill 404 into law, amending the Ohio Viatical Settlements Model Act to prohibit and prevent the STOLI transactions in Ohio. The amendments were based on the model laws developed by the National Association of Insurance Commissioners ("NAIC") and the National Conference of Insurance Legislators ("NCOIL"), along with Ohio-specific amendments regarding shared responsibility among the insurance industry, the life settlement industry, and insurance regulators. The amendments became effective on September 11, 2008.

Key Provisions of Am. Sub. H.B. 404

The amendments fight STOLI on several fronts. First, the sale and marketing of STOLI is prohibited. Second, restrictions are imposed on the viatical sale of existing life insurance policies on the secondary market (generally referred to as the "settlement" of the policy). Third, insurance companies are required to take affirmative measures at the time of underwriting activities to identify potential STOLI transactions. Finally, if a STOLI transaction is entered into, it can be voided immediately.

Transactional Definition of STOLIs Is More Effective Than Simple Definition

The previous version of the Ohio Viatical Settlements Model Act did not directly address or limit STOLI transactions. Likewise, the Ohio insurance code definition of "insurable interest" did not provide the Department with sufficient enforcement authority necessary to stem the significant tide of STOLI sales that are occurring. The proposed amendments to the Ohio Viatical Settlements Model Act address STOLI transactions, by (1) limiting STOLI through a transactional definition, and (2) by amending the definition of fraudulent viatical settlement to include sales attempting to circumvent STOLI prohibitions.

Some have questioned the amendments supported by the Department because they did not include a simple definition of STOLI. Such questions are unfounded upon careful analysis of the proposed amendments. Since the market is growing so quickly, the Department believed the most prudent approach was a transactional definition. A simple definition would only create a "straw man" that would quickly become obsolete. Also, the Department was concerned with the impact of a simple definition. Defining STOLI in the simple definition required determining the intent of the insurance applicant. A simple definition would not require the life settlement brokers or providers to be accountable for their sales, and thereby would create an untenable situation for consumers. Further, the simple definition also required review of the transaction after the fact.

In order to address the shortcomings of a simple definition, the Department recommended a transactional definition that was narrowly tailored to address STOLI transactions while allowing other life settlements, when appropriate. We recommended a transaction-based approach because of the simple impact of mortality on STOLI transactions. We knew that STOLI transactions were directed to seniors near the age of 70. A STOLI transaction relies on the quick death of the policyholder so that limited premium is expended. A five-year waiting period would likely reduce the investment to interest only. Regulatory experts advised that the perpetrators of STOLI transactions would not benefit enough from a five-year delay before an opportunity to recover on their "investment," and would turn to more legitimate life settlements instead. The transactional definition would be known up-front to all parties to a life settlement, thus requiring less regulatory involvement.

The definition of STOLI was one of the most contentious issues that were debated during the Ohio General Assembly's consideration of the proposed amendments. The life settlement industry advocated for a simple definition of STOLI. Given the dynamic nature of the life settlement market, the transactional definition that was adopted by the Ohio General Assembly provided better protection for consumers.

STOLI Prohibitions

Under the terms of the new Ohio amendments, if, prior to or at the time of purchase of a life insurance policy, there is any contract, arrangement or agreement entered into for the furtherance or aid of a stranger-originated life insurance act, the practice, arrangement or agreement is void and unenforceable, including any policy premium financing arrangement. The definition enacted provides:

"Stranger-originated life insurance or "STOLI," means a practice, arrangement, or agreement initiated at or prior to the issuance of a policy that includes both of the following.

- 1) The purchase or acquisition of a policy primarily benefiting one or more persons who, at the time of issuance of the policy, lack insurable interest in the person insured under the policy;

- 2) The transfer at any time of the legal or beneficial interest of the policy or benefits of the policy or both, in whole or in part, including through an assumption or forgiveness of a loan to fund premiums; and
- 3) The amendments define a “fraudulent viatical settlement act” as (1) issuing, soliciting, marketing or otherwise promoting STOLI; and/or (2) issuing, soliciting, marketing or otherwise promoting the purchase of a life insurance policy for the purpose of or with emphasis on settlement of the policy. (This portion is based on the NCOIL Model, with modifications.)

As a result of these amendments, outright STOLIs, as well as transactions that could result in a STOLI, were all prohibited by the final amendments.

Limitations on the Settlement of Life Insurance

The amendments divide life settlements into three categories that identify when a policy can be settled. These categories have different waiting periods before they can be settled, based on the circumstances of the policyholder. These categories are: (1) settlements allowed at any time; (2) settlements allowed after two years; and (3) settlements allowed after five years.

Settlements Allowed at Any Time:

- **Charities.** Policies owned by qualified charities may be settled any time.
- **Hardship Exceptions.** A life insurance policy may be settled at any time if the policy owner experiences any of a variety of hardship situations occurring after issuance of the policy:
 - Terminal or chronic illness (of owner or insured);
 - Death of spouse;
 - Divorce;
 - Retirement from full-time employment;
 - Physical or mental disability that prevents full-time employment;
 - Bankruptcy or insolvency; or
 - Death of sole beneficiary who is family member.

Most of these hardship categories are based on the NAIC Model Act.

The Ohio legislature added “death of sole beneficiary who is a family member” to assist small businesses using life insurance for recession planning. Some advocated for financial hardship as a hardship; the Department did not agree because we believed the category to be overly broad.

Settlement After Two Years

A policy may be settled two years after it was issued if the policy owner certifies in writing to the Viatical Settlement Provider that he or she meets all four of these requirements are satisfied: (a) funding of the policy; (b) any agreement to settle the policy; (c) presence of a life expectancy evaluation, and (d) disclosure of financing arrangements. *This provision was drafted among all interested parties, but is a variation on the NAIC Model and the NCOIL Model.*

- **Funding of the Policy.** The policy was funded either: (a) with personal assets, or (b) with funds from a financing agreement that was secured by personal assets. If any financing agreement was entered into prior to or within two years after policy issuance, a copy of the financing agreement must have been provided to the insurer within 30 days after execution of the agreement.
- **No Agreement to Settle the Policy.** The owner did not have an agreement or understanding – either prior to issuance of the policy or during the first two years after policy issuance – to settle or transfer the benefits of the policy, including through an assumption or forgiveness of a premium financing loan.
- **Life Expectancy Evaluation Information was Provided to Requesting Insurer.** Any life expectancy evaluation obtained in connection with the application, underwriting, or issuance of the policy was provided to the insurer, if requested.
- **Disclosure of Financial Arrangements, Trusts and other Transactions.** Any financial arrangement, including the existence or expectation of the use of a trust or other device that conceals the ownership of the policy from the insurer, was disclosed to the insurer prior to issuance of the policy.

Settlement After Five Years

All other life insurance policy scenarios may be settled after five years. This section was fought the hardest by opponents of the legislation. We understood that investors in life settlements would not extend their investments for five years. In other words, they did not want to extend potentially “free” financing to an insured for such a long period of time without knowing if the insured would live this long, or would keep the policy. Regulators have found the five-year period to be the best deterrent in the market to avoid STOLIs.

This section is based on the NAIC Model Act.

Effect on Certain Contracts, Agreements and Other Arrangements Used in a STOLI Transaction

Financing agreements, settlement contracts, and other arrangements intended to promote or facilitate STOLI are void and unenforceable. *This section was added by the Ohio Senate.*

Underwriting Requirements

The Legislature added a section to the amendments that required life insurers to include questions in their underwriting process that would identify possible STOLI transactions. The Department was directed to prepare administrative rules regarding these questions. We are in the process of preparing those rules. *This section was added by the Ohio Senate.*

Licensing

The amendments allow for an exception for licensed life insurance agents to obtain a life settlement broker's license. In order to be eligible for the exception, the agent must have been licensed for at least five years, and the agent may only engage in incidental life settlement transactions.

Testimony and Draft Bills

Ohio worked through a lengthy process of nine hearings in the Ohio House and 11 hearings in the Ohio Senate, plus several weeks of interested party meetings, before the amendments were adopted. Interested persons from across the nation appeared before the various committees. The Department worked closely with the Ohio Department of Aging to assure that there were strong provisions in the amendments to protect seniors.

Representatives and companies engaged in the business of viatical and life settlements, industry associations, such as the Life Insurance Settlement Association (LISA), engaged partners from five of the largest, most influential law firms in Ohio to represent their interests at the hearings and at special interest group meetings, each lasting three to four hours that were held over the course of several weeks at the insistence of the chair of the Senate committee on insurance. We estimate that, using even a conservative hourly rate, close to a million dollars was spent by various opponents of the legislation - however, we have no objective proof of that.

- Even before the Ohio Viatical Settlements Model Act was amended, the Department issued a consumer alert regarding STOLI.
<http://www.ohioinsurance.gov/ConsumServ/STOLI.htm>.
- The Department formally testified six times before the Ohio House and Senate. Director Hudson's testimony is available at
<http://www.ohioinsurance.gov/ConsumServ/STOLI.htm>.
- Am.Sub.H.B. 404 went through several amendments. All versions are available at
<http://www.ohioinsurance.gov/ConsumServ/STOLI.htm>.

Recommendations

In Ohio, we are acutely aware of how much damage the viatical and life settlement market can cause to consumers, the viatical and life settlement industry, the life insurance industry and investors when the industry is not regulated. Ohio had been the site of some of the more egregious perpetrators of the viatical fraud that brought the viatical settlement industry to the edge of destruction in the early 2000s.

Since then, the viatical and life settlement industry has been rapidly expanding. The states where there is no viatical or life settlement statutes, or where the state only regulates sales of policies by chronically or terminally ill individuals, have been the site of most life settlements (e.g., New York, 24%; California 18% in 2008). I would posit that there is a reason why 42% of life settlements occur in unregulated states.

On behalf of the Ohio Department of Insurance, I recommend that the Senate Special Committee on Aging consider the following actions to protect consumers against these transactions and strengthen the oversight authority of state regulators.

- Revise the current model by combining the NAIC and NCOIL Models, keeping the NAIC five year holding period in place.
- Consider adding licensure of life expectancy providers. Florida currently requires life expectancy providers to register with its Department of Insurance. This is an area that is wholly without oversight, and seniors are vulnerable.
- Establish an NAIC (A) Committee working group to monitor changes in the life settlement markets, conduct regular trainings with regulators, educate states on how to avoid becoming a shelter or haven for STOLI, and facilitate multi-state enforcement activity, when needed.

Questions?

If you have any questions, please contact Director Mary Jo Hudson at (614) 728-1003 or directors.office@ins.state.oh.us.

STATEMENT OF JOSEPH M. BELTH ON LIFE SETTLEMENTS**FOR THE RECORD OF THE APRIL 29, 2009 HEARING
BEFORE THE U.S. SENATE SPECIAL COMMITTEE ON AGING**

(May 8, 2009)

I am Joseph M. Belth, professor emeritus of insurance in the Kelley School of Business at Indiana University (Bloomington), editor of *The Insurance Forum* (an independent periodical), and author of *Life Insurance: A Consumer's Handbook*. This is an independent statement prepared on my initiative. I am not being compensated for preparing the statement, and the views expressed are mine.

I listened to the hearing and reviewed the prepared statements of the witnesses. I also reviewed other relevant documents, including the report of the investigation by the committee's staff. The purpose of this statement is to provide a few supplemental comments.

Definitions

Life settlements are part of the secondary market for life insurance policies. In the primary market, an insured—or an individual or entity with an insurable interest in the insured's life—buys from a life insurance company a policy on the insured's life.

In contrast, in the secondary market, the insured—or the owner of the policy other than the insured—sells the policy to an individual or entity that does not have an insurable interest in the insured's life. A secondary market transaction creates for the buyer of the policy a strong financial interest in the insured's early death.

History

In the history of life insurance in the U.S., I believe that a secondary market has long existed, but until recently it was confined to a criminal fringe. In 1989, the secondary market emerged from the shadows when a small firm in Albuquerque announced it had assembled capital with which to buy policies on the lives of terminally ill insureds. I spoke with the principals before they bought their first policy. They said they expected to deal primarily with cancer patients, but when they began operations they dealt primarily with HIV/AIDS patients. When I asked where

they had obtained the capital, they declined to disclose the source. I suspected that the money came from gambling interests in Las Vegas.

During the subsequent decade, secondary market promoters formed several other small firms. They focused on terminally ill insureds, and the transactions became known as "viaticals."

During that period, some secondary market firms expanded their operations to include insureds who had serious ailments but were not terminally ill. Those transactions became known as "life settlements." It was difficult to find seriously ill insureds who wanted to dispose of their policies. Consequently the market gravitated toward seniors, and the transactions became known as "senior life settlements."

It was still difficult to find enough policies to meet the demand from speculators in human life. (They are often called "investors," but I call them "speculators.") Consequently some promoters began arranging for the issuance of large policies intended from the outset for sale in the secondary market. I first saw evidence of such an arrangement in 1999. Promoters arrange for financing of all premiums and offer bribes to prospective insureds in the form of cash, "free" insurance for two years, vacations, or other financial benefits in exchange for obtaining large policies intended from the outset for sale in the secondary market. The transactions became known as "stranger originated life insurance" (STOLI) or "speculator initiated life insurance" (spinlife).

Lack of Disclosure

Secondary market transactions are characterized by a lack of disclosure of vital information to market participants. Indeed, secondary market promoters take affirmative steps in an effort to conceal vital information. Insureds who sell their policies, insurance companies that issue the policies, speculators who put up the money to buy the policies, and even some secondary market intermediaries are denied vital information. Listed below are several categories of information generally concealed from market participants.

The policy's economic value: Promoters say the payment to the insured in a secondary market transaction is larger than the policy's cash value, but that is an inappropriate comparison. The proper comparison is to the policy's economic value from the insured's point of view. That figure is apt to be substantially larger than the

payment to the insured. Thus a secondary market transaction may adversely affect the insured's financial condition, and it may be better for the insured to liquidate an asset other than a life insurance policy to meet any current cash needs.

Identities of parties: The identities and roles of some parties in a secondary market transaction usually are concealed from the insured and the insurance company.

The "price on one's head": The insured who sells a policy in the secondary market thereby gives the buyer a strong financial interest in the insured's early death. I recently learned of an insured who sold his \$6 million policy in the secondary market and now fears for his life.

Policy resale: The policy may be resold many times, and there is no way for the insured to know who eventually will own the policy.

Tracking: The insured who sells a policy in the secondary market will be "tracked" for life by those who want to know promptly when the insured dies.

Loss of privacy: The insured who sells a policy in the secondary market will have his or her medical records checked from time to time, such as when the policy is resold.

Loss of insurability: The insured who sells a policy in the secondary market thereby reduces his or her capacity to buy life insurance later.

Life expectancy estimators: The life expectancy estimate is an important factor in pricing a secondary market transaction. It is important, especially for the speculator in the transaction, to know the identity and qualifications of the individual or entity providing the estimate.

Compensation of intermediaries: The total compensation paid to intermediaries in a secondary market transaction may be obscenely large, often substantially exceeding the payment to the insured.

Bidding details: The insured generally is not given bidding details, and the promoter may select the bid that provides the largest compensation for the promoter rather than the bid that is best for the insured.

Tax issues: The Internal Revenue Service did not issue guidance on the taxation of secondary market transactions until recently. The IRS issued two revenue rulings (2009-13 and 2009-14) after an April 6 request from Senator Kohl, the chairman of this committee. One ruling discusses the taxation of the payment to the insured. The other discusses the taxation of the amount paid to the new owner on the insured's death or on resale of the policy. The rulings do not discuss the taxation of the bribe paid to the insured in a spinlife transaction, or the taxation of the forgiveness of loans extended to the insured in the financing of spinlife premiums.

Lack of Data

Reliable data on the magnitude of the secondary market do not exist. The data widely cited are taken from consulting firms' reports that are based on anecdotal information from a few secondary market promoters.

There are virtually no requirements for the filing of detailed, sworn information with regulatory agencies. An exception is Texas, where secondary market firms are required to file detailed annual reports. However, not all secondary market firms are licensed there, and it is difficult to obtain the reports. Based on my experience, the requester invariably encounters legal obstacles to release of the report. A year ago I requested the reports for 2007 filed in Texas by Coventry First and Life Partners, but still have not obtained them.

Secondary market firms should be required by law to file detailed, sworn annual reports in the states where the firms are licensed. It is also important to require that the reports be treated as public documents.

Alternatives to the Secondary Market

Alternatives to the secondary market exist, but they are not yet widely available. First, life insurance companies could develop policy riders that provide benefits larger than policy loans under certain circumstances, such as a serious illness, and thereby reduce the incentive for an insured to sell a policy in the secondary

market. Some companies already offer riders of this type, but they are limited in scope.

Second, life insurance companies could take over the secondary market for their policies through the development of buyout programs, and thereby reduce the incentive for an insured to sell a policy in the secondary market. To my knowledge, no life insurance companies have developed such programs.

Third, life insurance companies could develop programs that provide loans larger than policy loans, and thereby reduce the incentive for an insured to sell a policy in the secondary market. Two such programs already exist—one created by a life insurance company and one developed by an independent firm—but they are limited in scope.

Conclusion

The secondary market for life insurance policies is engaged in the distasteful business of speculating in human life. Strong laws and regulations should be developed to govern the market and impose rigorous disclosure requirements. Also, life insurance companies should pursue alternatives that reduce the incentive for an insured to sell a policy in the secondary market, and that do not involve transferring the ownership of a policy to an individual or entity without an insurable interest in the insured's life.

Thank you for this opportunity to express my views. I will try to answer any questions the committee may have.



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ERIC R. DINALLO
Superintendent

KERMITT J. BROOKS
First Deputy Superintendent

May 8, 2009

Honorable Herb Kohl
United States Senate
Special Committee on Aging
G31 Dirksen Senate Office Building
Washington, DC 20510

Dear Senator Kohl:

Thank you for the opportunity to offer written testimony for inclusion in the record of the Senate Special Committee on Aging's hearing on life settlements.

Enclosed please find written testimony from the New York State Department of Insurance on this important topic. If you or your Committee would like clarification or further information on any aspect of our testimony, please contact me.

Sincerely,

A handwritten signature in black ink, appearing to read "Kermit Brooks", written in a cursive style.

Kermit Brooks



TESTIMONY

TO THE UNITED STATES
SENATE

SPECIAL COMMITTEE ON AGING

HEARING ON
LIFE SETTLEMENTS

BY FIRST DEPUTY SUPERINTENDENT
KERMITT BROOKS

NEW YORK STATE INSURANCE DEPARTMENT

WEDNESDAY APRIL 29, 2009

The New York State Department of Insurance (the "Department") would like to thank Chairman Herb Kohl, Ranking Member Mel Martinez and the members of the Senate Special Committee on Aging for inviting the Department to submit written testimony on New York's regulation of the life settlement industry. In this testimony, I will offer some background on the development of the life settlement market in New York; describe legislation that the Department is currently proposing to provide a comprehensive framework for regulation of life settlements, including viatical settlements; and briefly address stranger-originated life insurance ("STOLI").

I. Background

During the AIDS epidemic of the late 1980s and early 1990s, many seriously ill New Yorkers sold their life insurance policies to pay for medical care, experimental medical treatments and other essential needs. Such transactions, known as "viatical settlements", were unregulated in New York until 1993, when New York enacted Article 78 of the New York Insurance Law. Article 78 provides a statutory framework for the regulation of viatical settlement companies and viatical settlement brokers.

Over the last decade, a new market has developed and evolved in which third parties known as "life settlement providers" purchase existing life insurance policies covering insureds who do not have catastrophic or life-threatening illnesses or conditions. The policy owners are generally senior citizens who may no longer have a need for their life insurance or may no longer be able to afford the coverage. The life settlement transaction provides the policy owner with a monetary benefit greater than the cash surrender value of the life insurance policy, but less than the death benefit. Since the insureds do not have catastrophic or life-threatening illnesses or conditions, these transactions fall outside the scope of the existing Article 78 and are currently unregulated in New York.

The life settlement industry has grown tremendously since its inception. Recent estimates indicate that approximately \$15 to \$20 billion in life insurance policies are sold into the secondary market annually. As the industry has grown and evolved, it has become a much more complex and multi-layered business. Initially, life settlements were structured so that a life settlement provider would purchase a policy from the policy owner and then pay the premiums due to maintain coverage in force until the death of the insured. Today, life settlement providers generally do not retain the policies they purchase. Rather, the policies are typically re-sold to third-party institutional investors who now play a significant role in the marketplace. These policies are then often repackaged into various sophisticated investment vehicles. Institutional investors view life insurance policies as a profitable investment opportunity that is not correlated to other market risks.

The Department's proposed legislation, discussed in Part II of this testimony, addresses the following major concerns with the unregulated life settlement marketplace in New York:

- The non-disclosure of compensation by life settlement providers and brokers in life settlement transactions.

The Department is concerned that policy owners are generally unaware of how the business of life settlements is being conducted. A policy owner who thinks that a life settlement broker is working in his or her best interest when trying to sell his or her policy may be unaware of the significant commissions, fees and bonuses that are being deducted from the life settlement provider's gross offer before the broker even presents the net offer to the policy owner. Policy owners may also be unaware of the intricate bidding processes and the number of interested parties involved when selling their life insurance policies. As a result, the proceeds that policy owners receive for their policies may be significantly less than what the policy owner may have been able to obtain in a fair and transparent marketplace.

- Lack of privacy protection for an insured's or policy owner's personal identifying information or their personal financial and medical information.

New York currently does not have a law that specifically protects the privacy of the personal information of policy owners and insureds in life settlement situations.

- Lack of disclosure regarding the sharing of private information that occurs in the life settlement markets.

Disclosure of the policy owner's or insured's name, home address, personal medical condition and financial information are necessary for a life settlement transaction to take place. Policy owners and insureds should know to whom and under what circumstances this personal information can be disclosed.

- Lack of a statutory fiduciary duty owed by the life settlement broker to the policy owner.

A life settlement broker does not have a statutory duty to act in the best interests of the policy owner, nor is there a requirement that the policy owner be so advised.

- Statutory and regulatory mechanisms do not exist to prevent the types of activities that result in STOLI transactions.

The Department has been contacted by a number of senior citizens who are being solicited to purchase life insurance policies for the purpose of selling them to a third party. These offers entice seniors to enter into arrangements whereby they purchase life insurance policies at no cost through premium financing arrangements in exchange for relinquishing ownership of the policy to a third party, usually after the policy's two-year contestable period. While the specifics

may vary, there is often an upfront cash payment when the person applies for the policy or when the premium finance loan is made, as well as at the time the policy is transferred to the third party. The Department has significant concerns with these arrangements, which may violate the insurable interest requirements of Insurance Law § 3205.

During the last several years, the Department has been drafting life settlement legislation that addresses the concerns discussed above. The Department has also sought to address the concerns of the life settlement industry, the life insurance industry and other interested parties.

In 2008, the Department introduced life settlement legislation in the New York State Legislature. See A.10401/S.7356. Key provisions of this legislation included: a two-year ban on the settlement of new life insurance policies; restrictions with respect to premium finance agreements to deter STOLI; disclosure of all compensation paid to all parties in the settlement of a life insurance policy; the licensure of life settlement providers and life settlement brokers; and the registration of life settlement intermediaries and life settlement investors. However, New York's Legislature did not pass the Department's legislation.

Also in 2008, a bill (A.11679-B) was introduced in New York's Legislature that closely tracked the model bill adopted by the National Conference of Insurance Legislators ("NCOIL"). Although the Department believed that that this bill was good in many respects, the Department was concerned that this "national model" bill did not adequately take into account some of the unique characteristics of New York's statutory and regulatory framework. New York's Legislature also did not pass his bill.

Since the Legislature did not enact life settlement legislation during the 2008 legislative session, the Department sought to elicit further information about the status of the life settlement market in New York. The Department continued to meet with stakeholders, including the life insurance industry, the life settlement industry, agent groups, premium financing entities and the investment community. The Department also conducted public hearings throughout New York State in November 2008 to elicit feedback regarding the experiences of consumers and other interested parties. The Department received testimony on various aspects of the life settlement market, including consumer protection, insurable interest, risk, disclosure of compensation, and privacy. Some individual investors who testified about their experiences described certain abuses that occurred in the life settlement market, while others testified that life settlement transactions give consumers a practical, reasonable way of taking greater advantage of their assets.

After analysis of the public hearing testimony and further discussions with stakeholders and other interested parties, the Department conducted an in-depth review of its 2008 legislation. This year, the Department introduced a modified bill (A.7131/S.36550), a copy of which is attached hereto as Appendix A.

II. 2009 Proposed Life Settlement Legislation

The Department's 2009 legislation establishes a comprehensive statutory framework that regulates both life settlement and viatical settlement transactions. Key elements of the Department's 2009 bill include the following:

- Provides significant privacy protections, with respect to the identity of the insured and the policy owner by limiting the parties to whom, and specifying the circumstances under which, information may be disclosed.

Only a licensed life settlement provider may purchase a life insurance policy from a policy owner. A life settlement provider may sell, assign, or transfer ownership of a settled policy only to another licensed provider, accredited investor, qualified institutional buyer, financing entity, special purpose entity or related provider trust. The bill also provides that any person who obtains or may obtain a settled policy shall comply with the provisions of the Insurance Law and regulations promulgated thereunder, as well as all other applicable laws governing the protection of the insured's or policy owner's identity and privacy. In addition, a provider may transfer a beneficial interest in a settled policy to other persons if the provider continues to administer the settled policy and the policy owner's and insured's personal identifying information is not disclosed to the transferee.

- Provides for a transparent and fair marketplace by requiring disclosure to the policy owner of the dollar amount of the current death benefit payable to the life settlement provider; a description of all offers and counter-offers, including the amount of each life settlement provider's gross offer and the net proceeds to be received by the policy owner; the identity of any person (including the life settlement broker) receiving any compensation with respect to the life settlement contract; and the amount and terms of the compensation.
- Specifies that a life settlement broker shall represent only the policy owner, and that the broker owes a fiduciary duty to the policy owner, including a duty to act according to the policy owner's instructions and in the policy owner's best interests.
- Requires disclosures to the consumer: (1) as to how the life settlement transaction operates; (2) that the life settlement broker owes a fiduciary duty to the policy owner; (3) of the tax consequences that may result from receipt of the life settlement proceeds; (4) of the policy owner's right to rescind the life settlement contract; (5) that the insured's insurable capacity may be adversely affected; (6) as to the extent to which medical, financial or other personal information may be disclosed; and (7) as to the frequency with which the insured may be contacted to determine health status.

Requires licensing of life settlement providers and life settlement brokers, and registration of life settlement intermediaries. (Life settlement intermediaries maintain an electronic or other facility or system for the disclosure of offers and counter-offers to sell or purchase a policy or settled policy. Intermediaries are prohibited from representing, soliciting, negotiating, or acting on behalf of a policy owner, a provider, or a broker and are subject to the privacy requirements of the bill.)

- Prohibits life settlement providers, brokers and their representatives from engaging in any activity at, or prior to, policy issuance to facilitate the issuance of a policy for the intended benefit of a person who, at the time of policy issuance, has no insurable interest in the life of the person insured under the policy.
- Defines “life settlement contract” to include an agreement under which compensation is paid in return for the transfer of “any beneficial interest in a trust or other entity that owns the policy where a primary purpose of the transaction is to acquire the policy.” This language ensures that transactions involving trusts or other entities will be subject to the requirements of the bill.
- Prohibits premium financing arrangements where the policy may be transferred to the lender as repayment of the debt, which are vehicles for STOLI.
- Provides the Department with the authority to enforce compliance, including the imposition of penalties and civil remedies for violations of the New York Insurance Law.
- Establishes standards of conduct and prohibits anticompetitive behavior.

III. STOLI

The Department’s 2009 legislation provides a strong and comprehensive anti-STOLI statutory framework. First, the bill includes a general prohibition against STOLI. Second, the bill prohibits any person from entering into a life settlement contract at any time prior to, or during the first two years after, policy issuance with certain limited exceptions. Third, the bill prohibits premium financing arrangements where the policy may be transferred to the lender as repayment of the debt. Fourth, the definition of “life settlement contract” includes a beneficial interest in a trust or other entity that owns the policy where a primary purpose of the transaction is to acquire the policy.

Another important aspect of the anti-STOLI statutory framework is currently set forth in Insurance Law § 3205, which requires the beneficiary to have an insurable interest in the life of the person insured when a person purchases a life insurance policy. An “insurable interest” is a substantial interest in the continued life of the person insured rather than an interest that would arise only by a financial interest in the death of the person insured. The purpose of the insurable interest requirement is to prevent the moral

hazards that arise with speculation on human life. Any violation of Insurance Law § 3205 raises significant public policy concerns.

IV. CONCLUSION

The New York Department believes that, in addition to addressing STOLI, our proposed life settlement legislation will ensure a competitive and transparent marketplace, and will provide strong consumer protections, including privacy of personal information, disclosure of compensation, other important consumer disclosures and the requirement that the life settlement broker owe a fiduciary duty to the policy owner.

APPENDIX A

Legislative Bill Drafting Commission
07184-02-9

DEPARTMENTAL BILL # 139

S.

Senate

IN SENATE--Introduced by Sen

--read twice and ordered printed,
and when printed to be committed
to the Committee on

----- A.
Assembly

IN ASSEMBLY--Introduced by M. of A.

with M. of A. as co-sponsors

--read once and referred to the
Committee on

INSURLA *New York State Insurance
Department 3 R-1*
(Relates to the licensure of life
settlement brokers; creates certain
crimes relating to life settlement
fraud; relates to premium finance
agreements; repealer)

Ins. life settlement brokers

AN ACT

to amend the insurance law, in
relation to the licensure of life
settlement brokers; to amend the
penal law, in relation to life
settlement fraud; to amend the bank-
ing law, in relation to premium
finance agreements; and to repeal
article 78 of the insurance law
relating to viatical settlements

IN SENATE

Senate introducer's signature

The Senators whose names are circled below wish to join me in the sponsorship
of this proposal

628 Adams	695 Foley	624 Lanza	612 Murrate	608 Skelos
615 Addabbo	606 Pischillo	679 Larkin	677 Upmeholmer	616 Smith
619 Alcant	623 Wilson	601 LaValle	611 Padavan	625 Squadron
648 Ambrosino	647 Giffie	648 LaBella	621 Parker	638 Stachnowski
642 Bonacic	606 Hanson	612 Libano	630 Paskine	616 Stavisky
618 Braglin	636 Hensell	645 Little	661 Rovershofer	636 Stewart
616 D'Amico	Thompson	695 Marcellino	616 Roback	Cousins
611 Dias	610 Montley	643 Mathers	611 Saland	640 Thompson
617 Dineen	627 Johnson, C.	643 McDonald	619 Simpson	609 Valenty
619 Duane	604 Johnson, D.	613 Monasterre	623 Savino	619 Volkes
613 Egan	616 Klein	616 Montgomery	611 Silverman	613 Wiener
614 Foley	626 Krueger	616 Morahan	620 Sorrento	617 Young
607 Flanagan	627 Krueger	616 Muscatello	611 Toward	

IN ASSEMBLY

Assembly introducer's signature

The Members of the Assembly whose names are circled below wish to join me in the
multi-sponsorship of this proposal:

644 Albano	647 Altman	691 Amodeo	627 Meyerbaum	676 Rivera, F.
606 Alessi	610 Cotto	615 Anselmi	619 McDonough	616 Robinson
602 Alfano	632 Cook	644 Hayes	614 McElroy	607 Rosenthal
645 Amodeo	617 Corbin	607 Bonacic	617 Novick	610 Ruessell
604 Arroyo	617 Cronin	602 Bonet	602 Napp	612 Salandino
615 Baber	643 Cusick	649 Cusick	613 Miller	615 Sayward
610 Buccellio	641 Cymbrowitz	610 Ronger	602 Hillman	629 Scarborough
609 Bull	618 DeLuca	644 Hoyt	603 Milione	616 Schindler
616 Barclay	611 DeLuca	606 Myer-Spencer	612 Marullo	610 Schindler
614 Barra	616 DeLuca	602 Jacobs	607 Nolan	615 Schneider
608 Barrow	605 Diaz	619 Jaffe	619 Ocho	612 Sconosciuto
607 Benedetto	601 Diamante	607 Jettison	607 O'Donnell	618 Sconosciuto
609 Benjamen	610 Dugan	611 John	612 O'Hara	606 Silver
603 Biny	603 Edgerton	619 Jordan	611 Ortiz	610 Scharfman
605 Boyland	604 Hughes	676 Krasnow	614 Parnot	607 Spoor
608 Boyle	629 Ariga	605 Ralmer	608 Puzio	613 Stiles
609 Bradley	602 Bepko	619 Rob	611 Puzio	611 Sweeney
604 Brennan	601 Carroll	619 Ross	619 Puzio	619 Tullio
609 Brodsky	605 Pardo	609 Sandom	616 Perry	603 Thiele
604 Brook-Rosen	612 Finch	601 Lattimer	601 Pfeiffer	601 Titone
617 Buckley	607 Fitzpatrick	612 Levier	608 Powell	601 Titone
617 Butler	611 Galt	605 Lunt	607 Puzio	603 Tonnino
610 Canale	616 Galt	616 Lunt	614 Usher	614 Tonnino
605 Calabrese	617 Galt	617 Lopez, F.	607 Rabbitt	615 Townsend
603 Canale	601 Galt	617 Lopez, V.	609 Rade	611 Walker
604 Canastota	614 Cipriani	616 Lunt	601 Rade	611 Weinstein
606 Carrozza	604 Dick	611 Mason	614 Ralmer	610 Weissberg
605 Cassin	609 DeLeon	629 Mervin	619 Reilly	616 Reilly
614 Christensen	615 DeLeon	619 Reilly	619 Reilly	616 Reilly
617 Clark	607 DeLeon	619 Reilly	619 Reilly	616 Reilly

1) Single House Bill introduced and printed separately in either or both
houses. Bill 1111 introduced simultaneously in both houses and printed as one
bill. Senate and Assembly introduce sign the same copy of the bill.

2) Circled names of co-sponsors and return to introduction clerk with 2 signed
copies of bill and 4 copies of memorandum in support (single house), or 4 signed
copies of bill and 8 copies of memorandum in support (both bills).

LMD 62/11/79

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The People of the State of New
York, represented in Senate and
Assembly, do enact as follows:

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1 Section 1. Subsection (a) of section 308 of the insurance law, as
2 amended by chapter 11 of the laws of 2008, is amended to read as
3 follows:

4 (a) (1) The superintendent may also address to any health maintenance
5 organization, life settlement provider, life settlement intermediary or
6 its officers, or any authorized insurer or rate service organization, or
7 officers thereof, any inquiry in relation to its transactions or condi-
8 tion or any matter connected therewith. Every corporation or person so
9 addressed shall reply in writing to such inquiry promptly and truthful-
10 ly, and such reply shall be, if required by the superintendent,
11 subscribed by such individual, or by such officer or officers of a
12 corporation, as [he] the superintendent shall designate, and affirmed by
13 them as true under the penalties of perjury.

14 (2) In the event any corporation or person does not provide a good
15 faith response to an inquiry from the superintendent pursuant to this
16 section relating to accident insurance, health insurance, accident and
17 health insurance or health maintenance organization coverage or with
18 respect to life settlements, within a time period specified by the
19 superintendent of not less than fifteen business days, the superinten-
20 dent is authorized to levy a civil penalty, after notice and hearing,
21 against such corporation or person not to exceed five hundred dollars
22 per day for each day beyond the date specified by the superintendent for
23 response, but in no event shall such penalty exceed seven thousand five
24 hundred dollars.

25 § 2. Section 2101 of the insurance law is amended by adding a new
26 subsection (v) to read as follows:

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1 (v) In this article, "life settlement broker" shall have the meaning
2 contained in subsection (i) of section seven thousand eight hundred two
3 of this chapter.

4 § 3. Paragraph 1 of subsection (a) of section 2102 of the insurance
5 law, as amended by chapter 687 of the laws of 2003, is amended to read
6 as follows:

7 (1) No person, firm, association or corporation shall act as an insur-
8 ance producer [or], insurance adjuster or life settlement broker in this
9 state without having authority to do so by virtue of a license issued
10 and in force pursuant to the provisions of this chapter.

11 § 4. The section heading and subsections (a) and (b) of section 2110
12 of the insurance law, as amended by chapter 687 of the laws of 2003, are
13 amended to read as follows:

14 Revocation or suspension of license of insurance producer, insurance
15 consultant [or], adjuster or life settlement broker. (a) The superinten-
16 dent may refuse to renew, revoke, or may suspend for a period the super-
17 intendent determines the license of any insurance producer, insurance
18 consultant [or], adjuster or life settlement broker, if, after notice
19 and hearing, the superintendent determines that the licensee or any
20 sub-licensee has:

21 (1) violated any insurance laws, or violated any regulation, subpoena
22 or order of the superintendent [of insurance] or of another state's
23 insurance commissioner, or has violated any law in the course of his or
24 her dealings in such capacity;

25 (2) provided materially incorrect, materially misleading, materially
26 incomplete or materially untrue information in the license application;

27 (3) obtained or attempted to obtain a license through misrepresen-
28 tation or fraud;

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- 1 (4)(A) used fraudulent, coercive or dishonest practices;
- 2 (B) demonstrated incompetence;
- 3 (C) demonstrated untrustworthiness; or
- 4 (D) demonstrated financial irresponsibility in the conduct of business
- 5 in this state or elsewhere;
- 6 (5) improperly withheld, misappropriated or converted any monies or
- 7 properties received in the course of business in this state or else-
- 8 where;
- 9 (6) intentionally misrepresented the terms of an actual or proposed
- 10 insurance contract [or], application for insurance or life settlement
- 11 contract;
- 12 (7) has been convicted of a felony;
- 13 (8) admitted or been found to have committed any insurance unfair
- 14 trade practice or fraud;
- 15 (9) had an insurance producer license, a life settlement broker
- 16 license, or its equivalent, denied, suspended or revoked in any other
- 17 state, province, district or territory;
- 18 (10) forged another's name to an application for insurance or life
- 19 settlement contract or to any document related to an insurance or life
- 20 settlement transaction;
- 21 (11) improperly used notes or any other reference material to complete
- 22 an examination for an insurance license or life settlement broker
- 23 license;
- 24 (12) knowingly accepted insurance business from an individual who is
- 25 not licensed;
- 26 (13) failed to comply with an administrative or court order imposing a
- 27 child support obligation; [or]

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1 (14) failed to pay state income tax or comply with any administrative
2 or court order directing payment of state income tax[.]; or

3 (15) ceased to meet the requirements for licensure under this chapter.

4 (b) Before revoking or suspending the license of any insurance produc-
5 er, life settlement broker or other licensee pursuant to the provisions
6 of this article, the superintendent shall, except when proceeding pursu-
7 ant to subsection (f) of this section, give notice to the licensee and
8 to every sub-licensee and shall hold, or cause to be held, a hearing not
9 less than ten days after the giving of such notice.

10 § 5. The section heading of section 2119 of the insurance law is
11 amended and a new subsection (e) is added to read as follows:

12 Insurance agents, brokers, consultants, and life settlement brokers;
13 written contract for compensation; excess charges prohibited.

14 (e)(1) No person licensed as a life settlement broker may receive any
15 compensation for examining, appraising, reviewing or evaluating any life
16 settlement contract or for making recommendations or giving advice with
17 regard to such contract; or receive any compensation from any owner or
18 proposed owner for or on account of the solicitation or negotiation of,
19 or other services in connection with, any life settlement contract
20 subject to this chapter or for any other services on account of such
21 contract; unless such compensation is based upon a written memorandum
22 signed by the party to be charged and specifying or clearly defining the
23 amount or extent of such compensation. A copy of every such memorandum
24 shall be retained by the licensee for not less than three years after
25 such services have been fully performed.

26 (2) No person licensed as a life settlement broker may receive any
27 compensation, direct or indirect, for or on account of the solicitation
28 or negotiation of, or other services in connection with a life settle-

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1 ment contract subject to this chapter from any person for whom any such
2 licensee has performed any related consulting service for which the
3 licensee has received a fee or contracted to receive a fee within the
4 preceding twelve months unless such compensation is provided for in the
5 written memorandum required pursuant to paragraph one of this
6 subsection.

7 {3} No person licensed as a life settlement broker may receive any
8 compensation, direct or indirect, from a life settlement provider or any
9 other person with respect to any life settlement contract if the life
10 settlement broker has already received or will receive compensation,
11 direct or indirect from, or on behalf of, the owner with respect to that
12 life settlement contract.

13 § 6. Subsections (a) and (b) of section 2132 of the insurance law, as
14 added by chapter 656 of the laws of 1992, are amended to read as
15 follows:

16 (a) This section shall apply to resident and non-resident persons
17 licensed pursuant to this article with respect to [the following types
18 of insurance]:

19 (1) life insurance, annuity contracts, variable annuity contracts and
20 variable life insurance;

21 (2) sickness, accident and health insurance; [and]

22 (3) all lines of property and casualty insurance; and

23 (4) life settlements.

24 (b) This section shall not apply to:

25 (1) those persons holding licenses for which an examination is not
26 required by the laws of this state; [or]

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1 (2) any limited licensees or any other licensees as the superintendent
2 may exempt subject to any continuing education requirements deemed
3 appropriate by the superintendent(.); or

4 (3) for purposes of the continuing education requirements for life
5 settlements, an insurance producer with a life line of authority who is
6 acting as a life settlement broker pursuant to section two thousand one
7 hundred thirty-seven of this article.

8 § 7. The insurance law is amended by adding a new section 2137 to
9 read as follows:

10 § 2137. Life settlement brokers; licensing. (a) The superintendent
11 may issue a license to any individual, firm, association or corporation
12 who or that has complied with the requirements of this chapter, author-
13 izing the licensee to act as a life settlement broker.

14 (b) Any such license issued to a firm or association shall authorize
15 only the members thereof, named in such license as sub-licensees, to act
16 individually as life settlement brokers thereunder, and any such license
17 issued to a corporation shall authorize only the officers and directors
18 thereof, who are named in such license as sub-licensees, to act individ-
19 ually as life settlement brokers thereunder. Every sub-licensee, acting
20 as a life settlement broker pursuant to such a license shall be author-
21 ized so to act only in the name of the licensee.

22 (c) Every individual applicant for a license under this section and
23 every proposed sub-licensee shall be eighteen years of age or over at
24 the time of the issuance of such license.

25 (d)(i) Before any original life settlement broker's license is issued,
26 there shall be on file in the office of the superintendent an applica-
27 tion by the proposed licensee in such form or forms, and supplements
28 thereto, and containing information the superintendent prescribes. For

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1 each business entity, the sub-licensee or sub-licensees named in the
2 application shall be designated responsible for the business entity's
3 compliance with this chapter and regulations promulgated thereunder. The
4 applicant shall fully disclose the identity of all stockholders (except
5 stockholders owning fewer than ten percent of the voting shares of a
6 life settlement broker whose shares are publicly traded), partners,
7 officers, members, directors and persons with a controlling interest and
8 the superintendent may, in the exercise of the superintendent's
9 discretion, refuse to issue a license in the name of a legal entity if
10 not satisfied that any employee, stockholder, partner, officer, member,
11 director or person with a controlling interest thereof who may mate-
12 rially influence the applicant's conduct meets the standards of this
13 article and article seventy-eight of this chapter. Thereafter, the
14 applicant and, if a license has been issued, the licensee, shall provide
15 to the superintendent new or revised information about stockholders
16 (except stockholders owning fewer than ten percent of the voting shares
17 of a life settlement broker whose shares are publicly traded), partners,
18 officers, members, directors and persons with a controlling interest
19 within thirty days of the change. For purposes of this section,
20 "controlling interest" means a person who directly or indirectly, has
21 the power to cause to be directed the management, control or activities
22 of such licensee.

23 (2) Each individual signing such application shall, unless licensed as
24 an insurance producer with a life line of authority, with such applica-
25 tion, submit to the superintendent fingerprints of his or her two hands
26 recorded in such manner as may be specified by the superintendent. Such
27 fingerprints shall be submitted to the division of criminal justice
28 services for a state criminal history record check, as defined in subdi-

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1 vision one of section three thousand thirty-five of the education law,
2 and may be submitted to the Federal Bureau of Investigation for a
3 national criminal history record check.

4 (e) The superintendent shall, in order to determine the competency of
5 every individual applicant and of every proposed sub-licensee for the
6 life settlement broker license, require such individual to submit to a
7 personal written examination and to pass the same to the satisfaction of
8 the superintendent. The examination shall be held at such times and
9 places as the superintendent shall from time to time determine. Every
10 individual applying to take any written examination shall, at the time
11 of applying therefor, pay to the superintendent or, at the discretion of
12 the superintendent, directly to any organization that is under contract
13 to provide examination services, an examination fee of an amount that is
14 the actual documented administrative cost of conducting said qualifying
15 examination as certified by the superintendent from time to time. An
16 examination fee represents an administrative expense and is not refunda-
17 ble. The superintendent may accept, in lieu of any such examination, the
18 result of any previous written examination, given by the superintendent,
19 which in the superintendent's judgment, is equivalent to the examination
20 for which it is substituted. No individual shall be deemed qualified to
21 take the examination unless he or she shall have successfully completed
22 a course or courses, approved by the superintendent.

23 (f)(1) No such written examination or prelicensing education shall be
24 required:

25 (A) of any insurance producer with a life line of authority licensed
26 in this state for at least one year;

27 (B) in the discretion of the superintendent, of any individual whose
28 license has been revoked or suspended;

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1 (C) of any applicant who has passed the written examination given by
2 the superintendent for a life settlement broker's license and was
3 licensed as such, or of an applicant who was licensed as a life settle-
4 ment broker but did not pass such an examination; provided the applicant
5 applies within two years following the date of termination of the appli-
6 cant's license;

7 (D) in the discretion of the superintendent, as to all or any part of
8 the written examination or the prerequisite course specified in
9 subsection (e) of this section, of any individual seeking to be named a
10 licensee or sub-licensee, upon whom has been conferred the Chartered
11 Life Underwriter (C.L.U.) or Chartered Life Underwriter Associate desig-
12 nation by The American College; or

13 (E) any individual seeking to be named a licensee or sub-licensee, who
14 is a nonresident and a life settlement broker, provided, however, that
15 the individual's home state grants nonresident licenses to residents of
16 this state on the same basis.

17 (2) No prelicensing education shall be required of any individual
18 regularly employed by a life settlement provider, life insurance compa-
19 ny, life settlement broker, or an insurance producer with a life line of
20 authority, for a period or periods aggregating not less than one year,
21 during the three years next preceding the date of entrance into the
22 service of the armed forces of the United States or immediately follow-
23 ing his or her discharge therefrom, in responsible duties relating to
24 the use of life insurance and annuity contracts in the design and admin-
25 istration of plans for estate conservation and distribution, employee
26 benefits and business continuation, and settlements of life insurance
27 and annuity contracts; provided the application for such license is
28 filed within one year following the date of discharge, and the applicant

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1 submits with the application a statement subscribed and affirmed as true
2 under the penalties of perjury by such employer or employers stating
3 facts which show compliance with this requirement.

4 (g) The superintendent may refuse to issue any life settlement
5 broker's license if, in the superintendent's judgment, the proposed
6 licensee or any sub-licensee: is not trustworthy and competent to act
7 as a life settlement broker; has given cause for license revocation or
8 suspension; or has failed to comply with any prerequisite for the issu-
9 ance of such license.

10 (h)(1) Every license issued to a business entity pursuant to
11 subsection (a) of this section shall expire on June thirtieth of odd-
12 numbered years.

13 (2) Every license issued pursuant to this section to an individual who
14 was born in an odd-numbered year shall expire on the individual's birth-
15 day in each odd-numbered year. Every license issued pursuant to this
16 section to an individual who was born in an even-numbered year shall
17 expire on the individual's birthday in each even-numbered year. Every
18 such license may be renewed for the ensuing period of twenty-four months
19 upon the filing of an application in conformity with this subsection.

20 (3) The license may be issued for all of such two-year terms, or upon
21 application made during any such term, for the balance thereof.

22 (4) Any license shall be considered in good standing within the
23 license term unless:

24 (A) revoked or suspended by the superintendent pursuant to this arti-
25 cle; or

26 (B) if at the expiration date of the license term, the licensee fails
27 to file a renewal application, provided the license was in good standing
28 during the term.

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1 (5) Before the renewal of any life settlement broker's license shall
2 be issued, the licensee shall have:

3 (A) filed a completed renewal application in such form or forms, and
4 supplements thereto, and containing such information as the superinten-
5 dent may prescribe; and

6 (B) paid such fees as are prescribed by the superintendent.

7 (6) If an application for a renewal license shall have been filed with
8 the superintendent before the expiration of such license, then the
9 license sought to be renewed shall continue in full force and effect
10 either until the issuance by the superintendent of the renewal license
11 applied for or until five days after the superintendent shall have
12 refused to issue such renewal license and shall have given notice of
13 such refusal to the applicant and to each proposed sub-licensee. Before
14 refusing to renew any such license, except on the ground of failure to
15 pass a written examination, the superintendent shall notify the appli-
16 cant of the superintendent's intention to do so and shall give the
17 applicant a hearing.

18 (7)(A) The superintendent may, in issuing a renewal license, dispense
19 with the requirements of a verified application by any individual licen-
20 see or sub-licensee who, by reason of being engaged in any military
21 service for the United States, is unable to make personal application
22 for the renewal license, upon the filing of an application on behalf of
23 such individual, in such form as the superintendent shall prescribe, by
24 a person who, in the person's judgment, has knowledge of the facts and
25 who makes affidavit showing such military service and the inability of
26 the life settlement broker to make personal application.

27 (B) An individual licensee or sub-licensee who is unable to comply
28 with license renewal procedures due to other extenuating circumstances,

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1 such as a long-term medical disability, may request a waiver of such
2 procedures, in such form as the superintendent shall prescribe. The
3 licensee or sub-licensee may also request a waiver of any examination
4 requirement or any other fine or sanction imposed for failure to comply
5 with renewal procedures.

6 (8) In addition to any examination fee required by subsection (e) of
7 this section, there shall be paid to the superintendent for each indi-
8 vidual license applicant and each proposed sub-licensee a licensing or
9 renewal fee to be determined by the superintendent.

10 (9) An application for the renewal of a license shall be filed with
11 the superintendent not less than sixty days prior to the date the
12 license expires or the applicant shall be subject to a further fee of
13 ten dollars for late filing.

14 (10) No license fee shall be required of any person who served as a
15 member of the armed forces of the United States at any time and who
16 shall have been discharged therefrom, under conditions other than
17 dishonorable, in a current licensing period, for the duration of such
18 period.

19 (11) Except where a corporation, association or firm licensed as a
20 life settlement broker is applying to add a sub-licensee, there shall be
21 no fee required for the issuance of an amended license.

22 (12) The license shall contain the licensee's name, address, personal
23 identification number, the date of issuance, and any other information
24 the superintendent deems necessary. The superintendent may issue the
25 life settlement broker's license in conjunction with any other license,
26 or its renewal, held by the applicant.

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1 (i) If the superintendent deems it necessary, then the superintendent
2 may require any licensed life settlement broker to submit a new applica-
3 tion at any time.

4 (j) The superintendent may issue a replacement for a currently
5 in-force license that has been lost or destroyed. Before such replace-
6 ment license shall be issued, there shall be on file in the office of
7 the superintendent a written application for such replacement license,
8 affirming under penalty of perjury that the original license has been
9 lost or destroyed, together with a fee of fifteen dollars.

10 § 8. Section 2401 of the insurance law is amended to read as follows:

11 § 2401. Purpose. The purpose of this article is to regulate trade
12 practices in the business of insurance, including the business of life
13 settlements, in accordance with the intent of congress as expressed in
14 Public Law 15, 79th Congress, by defining, or providing for the determi-
15 nation of, all such practices in this state [which] that constitute
16 unfair methods of competition or unfair or deceptive acts or practices
17 and by prohibiting the trade practices so defined or determined.

18 § 9. Subsections (a) and (b) of section 2402 of the insurance law,
19 subsection (b) as amended by chapter 631 of the laws of 2007, are
20 amended to read as follows:

21 (a) "Person" means any individual and any legal entity subject to any
22 provision of this chapter, engaged in the business of insurance in this
23 state, including any reciprocal exchange or Lloyds insurer, or in the
24 business of life settlements.

25 (b) "Defined violation" means the commission by a person of an act
26 prohibited by: section one thousand two hundred fourteen, one thousand
27 two hundred seventeen, one thousand two hundred twenty, one thousand
28 three hundred thirteen, subparagraph (B) of paragraph two of subsection

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1 (i) of section one thousand three hundred twenty-two, subparagraph (B)
2 of paragraph two of subsection (i) of section one thousand three hundred
3 twenty-four, two thousand one hundred twenty-two, two thousand one
4 hundred twenty-three, subsection (p) of section two thousand three
5 hundred thirteen, section two thousand three hundred twenty-four, two
6 thousand five hundred two, two thousand five hundred three, two thousand
7 five hundred four, two thousand six hundred one, two thousand six
8 hundred two, two thousand six hundred three, two thousand six hundred
9 four, two thousand six hundred six, two thousand seven hundred three,
10 three thousand one hundred nine, three thousand two hundred
11 twenty-four-a, three thousand four hundred twenty-nine, three thousand
12 four hundred thirty-three, paragraph seven of subsection (e) of section
13 three thousand four hundred twenty-six, four thousand two hundred twen-
14 ty-four, four thousand two hundred twenty-five [or], four thousand two
15 hundred twenty-six, seven thousand eight hundred nine, seven thousand
16 eight hundred ten, seven thousand eight hundred eleven, seven thousand
17 eight hundred thirteen, seven thousand eight hundred fourteen and seven
18 thousand eight hundred fifteen of this chapter; or section 135.60,
19 135.65, 175.05, 175.45, or 190.20, or article one hundred five of the
20 penal law.

21 § 10. Subsection (c) of section 3220 of the insurance law is amended
22 to read as follows:

23 (c) (1) Notwithstanding any provision of law, a person whose life is
24 insured under any policy of group life insurance, whether or not such
25 policy is otherwise subject to this section, is permitted to make an
26 assignment of all or any part of his incidents of ownership in such
27 insurance, including, without limitation, any right to designate a bene-
28 ficiary or beneficiaries thereunder and any right to have an individual

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1 policy issued upon termination either of employment or of said policy of
2 group life insurance, provided that the insurer and the group policy-
3 holder may prohibit or restrict such assignment by appropriate policy
4 provisions except as otherwise provided in paragraph three of this
5 subsection.

6. (2) [This] Paragraph one of this subsection shall be construed as
7 declaring the law as it existed prior to its enactment and not as modi-
8 fying it.

9 (3) A group policy that permits assignment of an insured person's
10 rights by gift shall also allow assignment for value to the same extent
11 that it allows assignment by gift.

12 § 11. Article 78 of the insurance law is REPEALED and a new article 78
13 is added to read as follows:

14 ARTICLE 78

15 LIFE SETTLEMENTS

16 Section 7801. Short title.

17 7802. Definitions.

18 7803. License requirements for life settlement providers.

19 7804. Registration requirements for life settlement interme-
20 diaries.

21 7805. License and registration revocation.

22 7806. Life settlement contract forms.

23 7807. Reporting requirements.

24 7808. Examinations or investigations.

25 7809. Advertising.

26 7810. Privacy.

27 7811. Disclosures to owners and insureds.

28 7812. Life insurance applications.

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1 7813. General rules.

2 7814. Prohibited practices.

3 7815. Stranger-originated life insurance.

4 7816. Penalties and civil remedies.

5 7817. Authority to promulgate regulations.

6 7818. Nonconforming contracts.

7 7819. Applicability.

8 7820. Severability.

9 § 7801. Short title. This article shall be known and may be cited as
10 the "life settlements act".

11 § 7802. Definitions. In this article:

12 (a) "Accredited investors shall be as defined in regulation D, rule
13 501 of the Federal Securities Act of 1933, as amended.

14 (b) "Advertisement" means any written, electronic or printed communi-
15 cation or any communication by means of recorded telephone messages or
16 transmitted on radio, television, the Internet or similar communications
17 media, including film strips, motion pictures and videos, published,
18 disseminated, circulated or placed before the public, directly or indi-
19 rectly, for the purpose of creating an interest in or inducing a person
20 to purchase, sell, assign, devise, bequest or transfer the death benefit
21 or ownership of, a life insurance policy or an interest in a life insur-
22 ance policy pursuant to a life settlement contract.

23 (c)(1) "Business of life settlements" means an activity involving, but
24 not limited to, offering to enter into, soliciting, negotiating, procur-
25 ing, effectuating, monitoring, or tracking life settlement contracts.

26 (2) For purposes of this article, "business of life settlements" shall
27 include:

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1 (A) such acts or transactions effectuated in this state by mail or
2 otherwise from outside this state; and

3 (B) doing or proposing to do any business in substance equivalent to
4 the business of life settlements in a manner designed to evade the
5 provisions of this chapter.

6 (d) "Compensation" means anything of value, including money, credits,
7 loans, interest on premium, forgiveness of principal or interest,
8 vacations, prizes, gifts or the payment of employee salaries or
9 expenses, whether paid as commission or otherwise.

10 (e) "Financing entity" means an accredited investor:

11 (1) whose principal activity in connection with the transaction is
12 providing funds to effect the life settlement contract or to purchase
13 one or more policies; and

14 (2) who has an agreement in writing with a life settlement provider to
15 finance the acquisition of a life settlement contract.

16 (f) "Financing transaction" means a transaction in which a licensed
17 life settlement provider obtains financing from a financing entity,
18 including any secured or unsecured financing, any securitization trans-
19 action, or any securities offering.

20 (g) "Insured" means a person covered under a policy that is or may be
21 the subject of a life settlement contract.

22 (h) "Insurer" means a life insurance company or a fraternal benefit
23 society.

24 (i) "Life expectancy" means the arithmetic mean of the number of
25 months the insured can be expected to live taking into consideration
26 medical records and appropriate experiential data.

27 (j) "Life settlement broker" means a person who, for compensation,
28 solicits, negotiates or offers to negotiate a life settlement contract;

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1 except that such term shall not include a licensed life settlement
2 provider, or representative thereof, licensed attorney at law, certified
3 public accountant, or financial planner that is accredited by a
4 nationally recognized accreditation agency acceptable to the superinten-
5 dent, who is retained in his or her professional capacity, does not
6 advertise as being in the business of life settlements and is compen-
7 sated without regard to whether a life settlement contract is effectuat-
8 ed.

9 (k)(1) "Life settlement contract" means an agreement establishing the
10 terms under which compensation is provided, which compensation is less
11 than the expected death benefit of the policy, in return for the assign-
12 ment, transfer, sale, release, devise or bequest of any portion of:

13 (A) the death benefit;

14 (B) the ownership of the policy;

15 (C) any beneficial interest in the policy, or in a trust or any other
16 entity that owns the policy, where a primary purpose of the transaction
17 is to acquire the policy; or

18 (D) any other agreement that the superintendent determines is substan-
19 tially similar to any of the foregoing.

20 (2) "Life settlement contract" shall include an agreement described in
21 paragraph one of this subsection regardless of the date the compensation
22 is provided and regardless of the date the assignment, transfer, sale,
23 devise or bequest is effectuated.

24 (3) "Life settlement contract" shall not include:

25 (A) an assignment of a policy as collateral for a loan by any deposi-
26 tory institution insured by the Federal Deposit Insurance Corporation or
27 the National Credit Union Administration;

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1 (B) an assignment of a policy as collateral for a loan made by a
2 licensed financial institution under which the lender takes an interest
3 in a life insurance policy solely to secure repayment of a loan or, if
4 there is a default on the loan and the policy is transferred, the trans-
5 fer of the policy by the lender, provided that the default itself is not
6 pursuant to an agreement or understanding with any other person for the
7 purpose of evading regulation under this article;

8 (C) an assignment of a policy as collateral for a loan made by a lend-
9 er that does not violate article twelve-B of the banking law;

10 (D) the making of a policy loan, or the paying of surrender benefits
11 or other benefits, by the issuer of a policy with respect to that poli-
12 cy;

13 (E) an exchange of life insurance policies in a transaction described
14 by section 1035 of the Internal Revenue Code of 1986, as amended;

15 (F) an agreement made by an individual to take an assignment,
16 purchase, or otherwise receive the death benefit or ownership of any
17 portion of a policy or policies on the life of a single insured or lives
18 of joint insureds; provided that, in a calendar year, the individual
19 enters into no other agreement to take an assignment, purchase, or
20 otherwise receive the death benefit or ownership of any portion of a
21 policy or policies on the life of any other insured or lives of any
22 other joint insureds;

23 (G) an agreement to assign, transfer or pledge a settled policy, or
24 any interest therein, to a licensed life settlement provider, an accred-
25 ited investor or qualified institutional buyer, financing entity,
26 special purpose entity, or related provider trust;

27 (H) an agreement where all the parties are closely related to the
28 insured by blood or law or have a lawful substantial economic interest

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1 in the continued life, health and bodily safety of the person insured,
2 or are trusts established primarily for the benefit of such parties;
3 (I) any designation, consent or agreement by an insured who is an
4 employee of an employer in connection with the purchase by the employer,
5 or trust established by the employer, of life insurance on the life of
6 the employee;
7 (J) a bona fide business succession planning arrangement between:
8 (i) one or more shareholders in a corporation or between a corporation
9 and one or more of its shareholders or one or more trusts established by
10 its shareholders;
11 (ii) one or more partners in a partnership or between a partnership
12 and one or more of its partners or one or more trusts established by its
13 partners; or
14 (iii) one or more members in a limited liability company or between a
15 limited liability company and one or more of its members or one or more
16 trusts established by its members;
17 (K) legitimate corporate or pension benefit plans, as determined by
18 the superintendent; or
19 (L) any other agreement that the superintendent determines is substan-
20 tially similar to any of the foregoing.
21 (1) "Life settlement intermediary" means a person who maintains an
22 electronic or other facility or system for the disclosure, through a
23 forum of offers and counteroffers to sell or purchase a policy or a
24 settled policy; and delivers to:
25 (1) a life settlement provider an offer from a life settlement broker
26 or owner to sell a policy;
27 (2) an owner or life settlement broker an offer from a life settlement
28 provider to purchase a policy; or

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1 (3) a life settlement provider an offer to sell or purchase a settled
2 policy.

3 (m) "Life settlement provider" means a person who enters into a life
4 settlement contract with the owner.

5 (n) "Owner" means the owner of a policy who enters or seeks to enter
6 into a life settlement contract.

7 (o) "Person" means any natural person or legal entity, including a
8 partnership, limited liability company, association, trust or corpo-
9 ration.

10 (p) "Policy" means an individual or group life insurance policy or
11 certificate.

12 (q) "Premium finance loan" means a loan made for the purposes of
13 making premium payments on a life insurance policy, which loan is
14 secured by an interest in such life insurance policy.

15 (r) "Qualified institutional buyer" shall be as defined in regulation
16 D, rule 144A of the Federal Securities Act of 1933, as amended.

17 (s) "Related provider trust" means a trust established by a licensed
18 life settlement provider or a financing entity for the sole purpose of
19 holding the ownership or beneficial interest in settled policies in
20 connection with a financing transaction; provided that the trust has a
21 written agreement with the licensed life settlement provider under
22 which:

23 (1) the licensed life settlement provider is responsible for ensuring
24 compliance with all statutory and regulatory requirements; and

25 (2) the trust agrees to make all records and files relating to life
26 settlement transactions available to the superintendent as if those
27 records and files were maintained directly by the licensed life settle-
28 ment provider.

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1 (t) "Settled policy" means a policy that at any time has been acquired
2 by a life settlement provider pursuant to a life settlement contract.

3 (u) "Special purpose entity" means a corporation, partnership, trust,
4 limited liability company, or other legal entity formed solely to
5 provide, either directly or indirectly, access to institutional capital
6 markets for a financing entity or licensed life settlement provider.

7 § 7803. License requirements for life settlement providers. (a) No
8 person shall engage in the business of life settlements as a life
9 settlement provider in this state without having authority to do so by
10 virtue of a life settlement provider license issued and in force pursu-
11 ant to this article.

12 (b)(1) The superintendent may issue a life settlement provider license
13 to any person who is deemed by the superintendent to be trustworthy and
14 competent to act as a life settlement provider and who is otherwise
15 qualified as required in this article and who has complied with the
16 prerequisites prescribed in this article.

17 (2) Every license issued pursuant to this section shall expire on June
18 thirtieth of odd-numbered years.

19 (c)(1) Application for a life settlement provider license shall be
20 made to the superintendent by the applicant on a form prescribed by the
21 superintendent, and the application shall be accompanied by a fee in an
22 amount to be established by the superintendent.

23 (2) The applicant for a life settlement provider license shall:

24 (A) fully disclose the identity of all stockholders (except stockhold-
25 ers owning fewer than ten percent of the voting shares of a life settle-
26 ment provider whose shares are publicly traded), partners, officers,
27 members, directors and persons with a controlling interest. For purposes
28 of this section, "controlling interest" means a person who directly or

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1 indirectly, has the power to cause to be directed the management,
2 control or activities of such licensee;

3 (B) provide a detailed plan of operation;

4 (C) provide, if a legal entity, a certificate of good standing from
5 the state of its domicile;

6 (D) provide an anti-fraud plan that meets the requirements of article
7 four of this chapter;

8 (E) demonstrate financial accountability as evidenced by a bond or
9 other method for financial accountability as determined by the super-
10 intendent pursuant to regulation; and

11 (F) provide any other information required by the superintendent.

12 (d) Each individual named in such application shall, with such appli-
13 cation, submit to the superintendent fingerprints of both hands recorded
14 in such manner as may be specified by the superintendent. The finger-
15 prints shall be submitted to the division of criminal justice services
16 for a state criminal history record check, as defined in subdivision one
17 of section three thousand thirty-five of the education law, and may be
18 submitted to the federal bureau of investigation for a national criminal
19 history record check.

20 (e)(1) As part of the application, the applicant shall submit a power
21 of attorney designating the superintendent as agent for the purpose of
22 receiving service of legal documents or process.

23 (2) The power of attorney shall include the name and address of the
24 officer, agent, or other person to whom such legal documents or process
25 shall be forwarded by the superintendent or his or her deputy on behalf
26 of such life settlement provider.

27 (3) Service of legal documents or process upon a life settlement
28 provider pursuant to this subsection shall be made by serving the super-

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1 intendent, any deputy superintendent or any salaried employee of the
2 department whom the superintendent designates for such purpose with two
3 copies thereof and the payment of a fee of forty dollars. The super-
4 intendent shall forward a copy of such legal documents or process by
5 registered or certified mail to the life settlement provider at the
6 address given in its written certificate of registration, and shall keep
7 a record of all legal documents or process so served upon him or her.
8 Service of legal documents or process so made shall be deemed made with-
9 in the territorial jurisdiction of any court in this state.

10 (f) The superintendent, in the exercise of the superintendent's
11 discretion, may refuse to issue a life settlement provider license in
12 the name of any person if not satisfied that any officer, employee,
13 stockholder, partner, director, member, agent, or responsible person
14 thereof, who may materially influence the applicant's conduct, meets the
15 standards of this article.

16 (g) Every license issued pursuant to this section may be renewed for
17 the ensuing period of twenty-four months upon the filing of an applica-
18 tion in conformity with this section.

19 (h)(1) Before the renewal of any life settlement provider license
20 shall be issued, an application for renewal of the license shall be made
21 to the superintendent by the applicant on a form prescribed by the
22 superintendent and containing such information as the superintendent may
23 prescribe. The application shall be accompanied by a fee in an amount to
24 be established by the superintendent.

25 (2) If an application for a renewal license shall have been filed with
26 the superintendent before the expiration of the license, then the
27 license sought to be renewed shall continue in full force and effect
28 either until the issuance by the superintendent of the renewal license

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1 applied for or until five days after the superintendent shall have
2 refused to issue such renewal license and shall have given notice of
3 such refusal to the applicant. Before refusing to renew any such
4 license, the superintendent shall notify the applicant of the super-
5 intendent's intention to do so and shall give such applicant a hearing.

6 (3) An application for the renewal of a license shall be filed with
7 the superintendent not less than sixty days prior to the date the
8 license expires or the applicant may be subject to a further fee for
9 late filing, as prescribed by the superintendent.

10 (i) A life settlement provider licensee shall provide to the super-
11 intendent new or revised information about stockholders (except stock-
12 holders owning fewer than ten percent of the voting shares of a life
13 settlement provider whose shares are publicly traded), partners, offi-
14 cers, members, directors, designated employees or persons with a
15 controlling interest within thirty days of the change.

16 § 7804. Registration requirements for life settlement intermediaries.

17 (a) No person shall act as a life settlement intermediary in this state
18 without having authority to do so by virtue of a registration issued and
19 in force pursuant to this article.

20 (b)(1) The superintendent may issue a life settlement intermediary
21 registration to any person who:

22 (A) is deemed by the superintendent to be trustworthy and competent to
23 act as a life settlement intermediary;

24 (B) is otherwise qualified as required in this article; and

25 (C) has complied with the prerequisites prescribed in this article.

26 (2) Every registration issued pursuant to this section shall expire on
27 June thirtieth of odd-numbered years.

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1 (c)(1) Application for a life settlement intermediary registration
2 shall be made to the superintendent by the applicant on a form
3 prescribed by the superintendent, and the application shall be accompa-
4 nied by a fee in an amount established by the superintendent.

5 (2) The applicant for a life settlement intermediary registration
6 shall provide:

7 (A) the state in which the life settlement intermediary is domiciled
8 or resident;

9 (B) the principal place of business of the life settlement interme-
10 diary;

11 (C) all other states in which the life settlement intermediary is
12 doing or intends to do business; and

13 (D) the identities of the life settlement intermediary executive offi-
14 cer or officers directly responsible for such business, and all stock-
15 holders (except stockholders owning fewer than ten percent of the voting
16 shares of a life settlement intermediary whose shares are publicly trad-
17 ed), partners, officers, members, directors and persons with a control-
18 ling interest. For purposes of this section, "controlling interest"
19 means a person who directly or indirectly, has the power to cause to be
20 directed the management, control or activities of such registrant.

21 (d) Each life settlement intermediary that is required to register
22 pursuant to this section shall also furnish such information as may be
23 required by the superintendent to:

24 (1) verify that the person or persons qualify as a life settlement
25 intermediary; and

26 (2) determine compliance with any applicable state law.

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1 (e)(1) As part of the application, the applicant shall submit a power
2 of attorney designating the superintendent as agent for the purpose of
3 receiving service of legal documents or process.

4 (2) The power of attorney shall include the name and address of the
5 officer, agent, or other person to whom such legal documents or process
6 shall be forwarded by the superintendent or the superintendent's deputy
7 on behalf of the life settlement intermediary.

8 (3) Service of legal documents or process upon a life settlement
9 intermediary pursuant to this subsection shall be made by serving the
10 superintendent, any deputy superintendent or any salaried employee of
11 the department whom the superintendent designates for such purpose with
12 two copies thereof and the payment of a fee of forty dollars. The super-
13 intendent shall forward a copy of such legal documents or process by
14 registered or certified mail to the life settlement intermediary at the
15 address given in its written certificate of registration, and shall keep
16 a record of all legal documents or process so served. Service of legal
17 documents or process so made shall be deemed made within the territorial
18 jurisdiction of any court in this state.

19 (f) The superintendent may require any individual named in the regis-
20 tration application to submit fingerprints of both hands recorded in
21 such manner as may be specified by the superintendent. The fingerprints
22 shall be submitted to the division of criminal justice services for a
23 state criminal history record check, as defined in subdivision one of
24 section three thousand thirty-five of the education law, and may be
25 submitted to the federal bureau of investigation for a national criminal
26 history record check.

27 (g) The superintendent, in the exercise of the superintendent's
28 discretion, may refuse to issue a life settlement intermediary registra-

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tion in the name of any person if not satisfied that any officer, employee, stockholder, partner, director, member, agent, or responsible person thereof who may materially influence the applicant's conduct meets the standards of this article.

(h) Every registration issued pursuant to this section may be renewed for the ensuing period of twenty-four months upon the filing of an application in conformity with this section.

(i)(1) Before the renewal of any life settlement intermediary registration shall be issued, an application for renewal of the registration shall be made to the superintendent by the applicant on a form prescribed by the superintendent and containing such information as the superintendent may prescribe, and the application shall be accompanied by a fee in an amount to be established by the superintendent.

(2) If an application for renewal registration shall have been filed with the superintendent before the expiration of the registration, the registration sought to be renewed shall continue in full force and effect either until the issuance by the superintendent of the renewal registration applied for or until five days after the superintendent shall have refused to issue such renewal registration and shall have given notice of such refusal to the applicant. Before refusing to renew any such registration, the superintendent shall notify the applicant of the superintendent's intention to do so and shall give such applicant a hearing.

(3) An application for the renewal of a registration shall be filed with the superintendent not less than sixty days prior to the date the registration expires or the applicant may be subject to a further fee for late filing, as prescribed by the superintendent.

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1 (j) A life settlement intermediary shall, as to any subsequent changes
2 in any of the items set forth in paragraph two of subsection (c) and
3 paragraph one of subsection (d) of this section, notify the superinten-
4 dent in writing within thirty days of any such change.

5 § 7805. License and registration revocation. (a) The superintendent
6 may suspend, revoke or refuse to renew the license of any life settle-
7 ment provider or the registration of any life settlement intermediary,
8 if, after notice and hearing, the superintendent determines that the
9 life settlement provider or life settlement intermediary, or any offi-
10 cer, partner, member, or key management personnel thereof, has:

11 (1) violated any insurance laws or any regulation promulgated there-
12 under, any subpoena or order of the superintendent or of another state's
13 insurance commissioner, or any other law in the course of the licensee's
14 dealings in such capacity;

15 (2) provided materially incorrect, materially misleading, materially
16 incomplete or materially untrue information in the license or registra-
17 tion application;

18 (3) obtained or attempted to obtain a license or registration through
19 misrepresentation or fraud;

20 (4)(A) used fraudulent, coercive or dishonest practices;

21 (B) demonstrated incompetence;

22 (C) demonstrated untrustworthiness; or

23 (D) demonstrated financial irresponsibility in the conduct of business
24 in this state or elsewhere;

25 (5) improperly withheld, misappropriated or converted any monies or
26 properties received in the course of business in this state or else-
27 where;

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1 (6) intentionally misrepresented the terms of any insurance contract
2 or life settlement contract or any application therefor;

3 (7) been found guilty of, pleaded guilty or nolo contendere to, any
4 felony, or to a misdemeanor involving fraud or moral turpitude, regard-
5 less of whether a judgment of conviction has been entered by the court;

6 (8) admitted or been found to have committed any insurance unfair
7 trade practice or fraud;

8 (9) had a life settlement provider license or life settlement interme-
9 diary registration, or an equivalent denied, suspended or revoked in any
10 other state, province, district or territory;

11 (10) forged another person's name to an application for insurance or
12 life settlement contract or to any document related to an insurance or
13 life settlement transaction;

14 (11) knowingly conducted the business of life settlements with a
15 person who is not licensed or registered unless such person is not
16 required to be licensed or registered;

17 (12) demonstrated a pattern of unreasonable payments to owners or
18 insureds;

19 (13) failed to honor contractual obligations set out in a life settle-
20 ment contract;

21 (14) sold, assigned, pledged or otherwise transferred the ownership of
22 a settled policy to a person other than as provided in this article; or

23 (15) failed to protect the privacy of the insured or owner or other
24 person for whom the licensee or registrant was required to provide
25 protection pursuant to this article.

26 (b)(1) Before the superintendent suspends, revokes or refuses to renew
27 the license of a life settlement provider or the registration of a life
28 settlement intermediary, the superintendent shall give notice to the

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1 licensee or registrant and shall hold, or cause to be held, a hearing
2 not less than ten days after the giving of such notice, except that
3 where, in the judgment of the superintendent, the public health, safety
4 or welfare so requires, a license or registration may be suspended for
5 up to ten days prior to a hearing.

6 (2) In lieu of revoking or suspending the license or registration for
7 any of the causes enumerated in subsection (a) of this section, the
8 superintendent may impose a civil penalty not to exceed ten thousand
9 dollars for each violation.

10 (3) Upon the failure of such licensee or registrant to pay such penal-
11 ty ordered pursuant to paragraph two of this subsection within twenty
12 days after the mailing of such order, postage prepaid, registered, and
13 addressed to the last known place of business of such licensee or regis-
14 trant, unless such order is stayed by a court of competent jurisdiction,
15 the superintendent may revoke the license of such licensee or the regis-
16 tration of such registrant, or may suspend the same for such period as
17 the superintendent determines.

18 § 7806. Life settlement contract forms. (a) No licensed life settle-
19 ment provider shall enter into a life settlement contract subject to
20 this chapter unless the life settlement contract form, application form,
21 and any other form as may be prescribed by regulation, has been filed
22 with and approved by the superintendent. The superintendent may disap-
23 prove any such form if the superintendent finds the form or any
24 provisions contained therein to be unreasonable, contrary to law or the
25 interests of the people of this state, or otherwise misleading or
26 unfair.

27 (b) Whenever, by the provisions of this chapter, the superintendent
28 has approved any life settlement contract form, application form, or any

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1 other form, the superintendent may, after notice and hearing given to
2 the life settlement provider that submitted the form for approval, with-
3 draw an approval previously given if:

4 (1) the use of the form is contrary to the requirements applicable to
5 the form at the time of such withdrawal,

6 (2) in the superintendent's judgment the use of the form would be
7 prejudicial to the interests of policyholders or members, or

8 (3) it contains provisions that are unjust, unfair or inequitable.

9 Any withdrawal of approval shall be effective at the expiration of
10 such period, at least ninety days after the giving of notice of with-
11 drawal or as the superintendent shall in such notice prescribe.

12 § 7807. Reporting requirements. (a)(1) Every licensed life settlement
13 provider shall file in the office of the superintendent, annually on or
14 before the first day of March, a statement, to be known as its annual
15 statement, verified by the oath of at least two of its principal offi-
16 cers, showing its condition at the end of the preceding calendar year.
17 The statement shall be in such form and shall contain such other matters
18 as the superintendent shall prescribe. In addition to any other require-
19 ments, the annual statement shall specify the total number, aggregate
20 face amount and life settlement proceeds of policies settled during the
21 immediately preceding calendar year, together with a breakdown of the
22 information by policy issue year. The information shall not include
23 individual transaction data regarding the business of life settlements
24 or information if there is a reasonable basis to believe the information
25 could be used to identify the owner or the insured.

26 (2) Every life settlement provider that willfully fails to file an
27 annual statement as required in this section, or willfully fails to
28 reply within thirty days to a written inquiry by the superintendent in

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1 connection therewith, shall, in addition to other penalties provided by
2 this chapter, be subject, upon due notice and opportunity to be heard,
3 to a penalty not to exceed five hundred dollars per day of delay, not to
4 exceed fifty thousand dollars in the aggregate, for each such failure.

5 § 7808. Examinations or investigations. The superintendent may make an
6 examination or investigation into the affairs of any life settlement
7 provider, life settlement broker, life settlement intermediary, appli-
8 cant for licensure as a life settlement provider or life settlement
9 broker, or applicant for registration as a life settlement intermediary
10 as prescribed under article three of this chapter.

11 § 7809. Advertising. (a) A life settlement provider, life settlement
12 intermediary or life settlement broker licensed pursuant to this article
13 may conduct or participate in advertisements within this state. The
14 advertisements shall comply with all advertising and marketing laws or
15 rules and regulations as may be promulgated by the superintendent.

16 (b) Advertisements shall be accurate, truthful and not misleading in
17 fact or by implication.

18 (c) No life settlement provider, life settlement intermediary, life
19 settlement broker, or any person acting on behalf thereof shall:

20 (1) directly or indirectly, market, advertise, solicit or otherwise
21 promote the purchase of a policy for the primary purpose of, or with an
22 emphasis on, settling the policy; or

23 (2) use the words "free", "no cost" or words of similar import in the
24 marketing, advertising, soliciting or otherwise promoting of the
25 purchase of a policy.

26 (d) The failure to follow the provisions of this section shall be a
27 defined violation under article twenty-four of this chapter.

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1 § 7810. Privacy. (a) Except as otherwise permitted or required by
2 law, no life settlement provider, life settlement broker, or life
3 settlement intermediary, or any authorized representative thereof,
4 insurer, information bureau, rating agency or company, or any other
5 person with actual knowledge of an insured or owner's identity, shall
6 disclose the identity of the insured or owner, or any information that
7 there is a reasonable basis to believe could be used to identify the
8 insured or owner, or the insured's financial or medical information, to
9 any person unless the disclosure is:

10 (1) necessary to effect a life settlement contract between the owner
11 and a life settlement provider and the owner and insured have provided
12 prior written consent to the disclosure;

13 (2) necessary to effectuate the sale of a life settlement contract or
14 a settled policy, or interest therein, as an investment, provided that
15 every sale is conducted in accordance with applicable state and federal
16 securities law and provided further that the owner and the insured have
17 both provided prior written consent to the disclosure;

18 (3) provided in response to an investigation or examination by the
19 superintendent, any other governmental officer or agency, or a self-re-
20 gulating entity established pursuant to federal securities law;

21 (4) a term or condition to the transfer of a policy by one licensed
22 life settlement provider to another licensed life settlement provider,
23 in which case the receiving life settlement provider shall be required
24 to comply with the confidentiality requirements of this section;

25 (5) necessary to allow the life settlement provider or life settlement
26 broker, or any authorized representative thereof, to make contacts for
27 the purpose of determining health status. For the purposes of this
28 section, the term "authorized representative" shall not include any

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1 person who has or may have any financial interest in the life settlement
2 contract other than a licensed life settlement provider, licensed life
3 settlement broker, financing entity, related provider trust or special
4 purpose entity; further, a life settlement provider or life settlement
5 broker shall require its authorized representative to agree in writing
6 to adhere to the privacy provisions of this article;

7 (6) required to purchase insurance; or
8 (7) otherwise permitted by regulation promulgated by the superinten-
9 dent.

10 (b) Any person who obtains or may obtain a settled policy, or any
11 interest therein, pursuant to a transfer, sale, conveyance or assignment
12 of a settled policy, or any interest therein, shall:

13 (1) comply with the provisions of this chapter and regulations promul-
14 gated thereunder and all other applicable laws, governing the protection
15 of the identity and privacy of the insured or owner; and

16 (2) protect against the unlawful release of all information concerning
17 the identity of any insured or owner, which information would or could
18 reasonably be expected to be used to identify or contact such insured or
19 owner, including the name, address or social security number of the
20 insured or the owner, or representative thereof, the related insurance
21 policy number or the insured's medical information.

22 (c) Non-public personal information solicited or obtained in
23 connection with a proposed or executed life settlement contract shall be
24 subject to the provisions applicable to financial institutions under the
25 Gramm Leach Bliley Act, P.L. 106-102 (1999), and all other applicable
26 laws relating to confidentiality of non-public personal information.

27 (d) The failure to follow the provisions of this section shall be a
28 defined violation under article twenty-four of this chapter.

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1 § 7811. Disclosures to owners and insureds. (a) The life settlement
2 provider or life settlement broker shall provide to the owner and
3 insured with a separate written document conspicuously displaying the
4 information and disclosures required by this subsection. The separate
5 document shall be signed by the owner, insured and life settlement
6 provider, no later than the date the life settlement contract is signed
7 by all parties. At a minimum, the document shall state:
8 (1) that there are possible alternatives to life settlement contracts,
9 including accelerated benefits offered by the issuer of the policy;
10 (2) that some or all of the proceeds of a life settlement contract may
11 be taxable and that advice should be sought from a professional tax
12 advisor;
13 (3) that the proceeds from a life settlement contract could be subject
14 to the claims of creditors;
15 (4) that receipt of proceeds from a life settlement contract may
16 adversely affect the recipients' eligibility for public assistance or
17 other government benefits or entitlements and that advice should be
18 obtained from the appropriate agencies;
19 (5) that the owner has a right to terminate a life settlement contract
20 within fifteen days of the receipt of the life settlement proceeds by
21 the owner;
22 (6) that proceeds will be sent to the owner within three business days
23 after the life settlement provider has received the insurer or group
24 administrator's acknowledgement that ownership of the policy or interest
25 in the certificate has been transferred and the beneficiary has been
26 designated in accordance with the terms of the life settlement contract;
27 (7) that entering into a life settlement contract may cause other
28 rights or benefits, including conversion rights and waiver of premium

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1 benefits, that may exist under the policy or certificate of a group
2 policy to be forfeited by the owner and that assistance should be sought
3 from a professional financial advisor;

4 (8) the amount and method of calculating the compensation provided or
5 to be provided to the life settlement broker, and any other person in
6 connection with the transaction, including the identity thereof;

7 (9) the date by which the funds will be available to the owner and the
8 transmitter of the funds;

9 (10) that the life settlement provider or life settlement broker is
10 required to provide an owner or insured during the solicitation process
11 with a consumer information booklet in a form prescribed by the super-
12 intendent;

13 (11) that the insured may be contacted by either the life settlement
14 provider or life settlement broker, or any authorized representative
15 thereof, for the purpose of determining the insured's health status or
16 to verify the insured's address, and that the contact shall be limited
17 to once every three months if the insured has a life expectancy of more
18 than one year, and no more than once per month if the insured has a life
19 expectancy of one year or less;

20 (12) any affiliations or contractual arrangements between the life
21 settlement provider and the issuer of the policy to be settled;

22 (13) any affiliations or contractual arrangements with any other life
23 settlement provider, life settlement broker, life settlement interme-
24 diary or party financing the transaction;

25 (14) that a life settlement broker represents exclusively the owner,
26 and not the insurer or the life settlement provider or any other person,
27 and owes a fiduciary duty to the owner, including a duty to act accord-
28 ing to the owner's instructions and in the best interest of the owner;

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1 (15) the name, business address, telephone number and e-mail address
2 of the independent, third party escrow agent and that the owner has the
3 right to inspect or receive copies of the relevant escrow or trust
4 agreements or documents;

5 (16) that a change of ownership could in the future limit the
6 insured's ability to purchase future insurance on the insured's life
7 because there is a limit to how much coverage insurers will issue on one
8 life;

9 (17) the name, business address, telephone number and e-mail address
10 of the life settlement provider; and

11 (18) any other information or disclosure that the superintendent may
12 require.

13 (b) The disclosure document provided by the life settlement provider
14 shall contain the following language, or such other language required by
15 the superintendent by regulation: "All medical, financial or personal
16 information solicited or obtained by a life settlement provider or life
17 settlement broker about an insured, including the insured's identity or
18 the identity of family members, a spouse or a significant other may be
19 disclosed as necessary to effect the life settlement contract between
20 the owner and provider. If you are asked to provide this information,
21 you will be asked to consent to the disclosure. The information may be
22 provided to someone who buys the policy or provides funds for the
23 purchase. You may be asked to renew your permission to share information
24 every two years".

25 (c) The life settlement broker shall provide the owner and insured
26 with a separate written document conspicuously displaying the informa-
27 tion and disclosures required by this subsection. The separate document
28 shall be signed by the owner, insured and life settlement broker, no

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1 later than the date the life settlement contract is signed by all
2 parties. At a minimum, the document shall state:

3 (1) the name, business address, telephone number and e-mail address of
4 the life settlement broker;

5 (2) a full, complete and accurate description of all the offers, coun-
6 ter-offers, acceptances and rejections relating to the proposed life
7 settlement contract;

8 (3) any affiliations or contractual arrangements with any life settle-
9 ment provider, other life settlement broker, life settlement interne-
10 diary or any financing entity;

11 (4) the name of each life settlement broker and any other person who
12 receives or will receive compensation due to the life settlement
13 contract and the amount of compensation received or to be received by
14 that broker or other person;

15 (5) a complete reconciliation of the gross offer or bid by the life
16 settlement provider to the net amount of proceeds or value to be
17 received by the owner, provided that for the purpose of this section,
18 "gross offer or bid" shall mean the total amount or value offered by the
19 life settlement provider for the purchase of one or more life insurance
20 policies, inclusive of commissions and fees; and

21 (6) any other information or disclosure that the superintendent may
22 require.

23 (d) The failure to provide the disclosures described in this section
24 shall be a defined violation under article twenty-four of this chapter.

25 § 7812. Life insurance applications. (a) Without limiting the ability
26 of an insurer to assess the insurability of a policy applicant and to
27 determine whether or not to issue the policy, and in addition to other
28 questions an insurer may lawfully pose to a life insurance applicant,

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1 insurers may inquire in the application for insurance whether the
2 proposed owner intends to pay premiums with the assistance of financing
3 from a lender that will use the policy as collateral to support the
4 financing.

5 (b) The insurer may include the following notice to the applicant and
6 the insured, or other notice acceptable to the superintendent, on the
7 application or as an amendment thereto: "If you enter into a loan
8 arrangement where the policy is used as collateral, and the policy
9 changes ownership at some point in the future in satisfaction of the
10 loan, then the following may be true:

11 (1) a change of ownership may lead to a person unknown to you owning
12 an interest in the insured's life;

13 (2) a change of ownership may limit your ability to purchase insurance
14 in the future on the insured's life because there is a limit to how much
15 coverage insurers will issue on one life;

16 (3) if ownership of the life insurance policy changes, and you wish to
17 obtain more insurance coverage on the insured's life in the future, the
18 insured's higher issue age, a change in health status, and/or other
19 factors may reduce the ability to obtain coverage and/or may result in
20 significantly higher premiums; and

21 (4) you should consult a professional advisor, since a change in
22 ownership in satisfaction of the loan may result in tax consequences to
23 the owner."

24 § 7813. General rules. (a) A life settlement provider entering into a
25 life settlement contract shall first obtain a written consent from the
26 insured to the release of the insured's medical records subject to the
27 limitations contained in section seven thousand eight hundred ten of
28 this article.

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1 **(b) The insurer shall respond to a request for verification of cover-**
2 **age submitted by a life settlement provider, life settlement broker or**
3 **life settlement intermediary within fifteen days after the date the**
4 **request is received. The insurer shall complete and issue the verifica-**
5 **tion of coverage or indicate the specific reasons why it is unable to**
6 **respond. In its response, the insurer shall indicate whether, based on**
7 **the medical evidence and documents provided, the insurer is pursuing or**
8 **intends to pursue an investigation regarding the validity of the policy.**

9 **(c) The life settlement provider shall give written notice to the**
10 **insurer that issued the policy within ten days after the life settlement**
11 **contract is executed by all parties.**

12 **(d) Unless the insurer is pursuing or intends to pursue an investi-**
13 **gation, the insurer shall, within fifteen days of receipt of a request**
14 **for a change of ownership or assignment used to effectuate the transfer**
15 **or assignment of the owner's rights or benefits under a policy to a life**
16 **settlement provider, process the change of ownership or assignment and**
17 **notify the life settlement provider and the owner that the transfer or**
18 **assignment has been effectuated.**

19 **(e) If a life settlement broker performs any activity required of the**
20 **life settlement provider in this section or provides any disclosures**
21 **required by section seven thousand eight hundred eleven of this article,**
22 **then the life settlement provider is deemed to have performed that**
23 **activity or provided that disclosure.**

24 **(f) All medical information solicited or obtained by any licensee or**
25 **any other person shall be subject to the provisions applicable to health**
26 **care providers under the public health law and all applicable laws**
27 **relating to confidentiality of medical information, provided that, to**

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1 the extent that this chapter provides for greater confidentiality of
2 medical information, this chapter shall govern.

3 (g)(1) Every life settlement contract shall provide that the owner has
4 an unconditional right to rescind the life settlement contract for
5 fifteen days after the receipt of the life settlement proceeds by the
6 owner by giving notice of rescission to the life settlement provider by
7 midnight of the fifteenth day.

8 (2) Within five days after receipt of the notice of rescission, the
9 life settlement provider shall provide a written statement to the owner
10 itemizing the amount of all life settlement proceeds and any premiums,
11 loans and loan interest paid or to be paid as of a date certain as may
12 be requested by the owner.

13 (3) Within fifteen days after the receipt of the written, itemized
14 statement by the owner, the owner must repay all such life settlement
15 proceeds and any premiums, loans and loan interest paid by the life
16 settlement provider.

17 (4) If the insured dies during the rescission period, the life settle-
18 ment contract shall be deemed to have been rescinded, subject to repay-
19 ment of all life settlement proceeds and any premiums, loans and loan
20 interest paid by the life settlement provider.

21 (5) Within five days after receipt of notice of the insured's death
22 during the rescission period, the life settlement provider shall provide
23 a written statement to the owner or, if the owner is deceased, to the
24 legal representative of the owner's estate, itemizing the amount of all
25 life settlement proceeds and any premiums, loans and loan interest paid
26 or to be paid as of a date certain as may be requested by the owner or
27 the legal representative of the owner's estate. As soon as practicable,

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1 the owner or the owner's estate shall repay all such proceeds and any
2 premiums, loans and loan interest paid by the life settlement provider.

3 (h) Within three business days after receipt from the owner of docu-
4 ments to effect the transfer of the insurance policy, the life settle-
5 ment provider shall deposit the proceeds of the life settlement contract
6 into an escrow or trust account maintained in an insured bank located in
7 this state or other bank acceptable to the superintendent. The escrow
8 agent or trustee shall be required to transfer the proceeds due to the
9 owner within three business days of acknowledgement of the transfer from
10 the insurer.

11 (i) Failure to tender the life settlement contract proceeds to the
12 owner by the date disclosed to the owner shall render the life settle-
13 ment contract voidable by the owner for lack of consideration until the
14 time the proceeds are tendered to and accepted by the owner. A failure
15 to give written notice of the right of rescission hereunder shall toll
16 the right of rescission until thirty days after the written notice of
17 the right of rescission has been given.

18 (j) The value of any compensation provided to a life settlement broker
19 in exchange for services provided to the owner pertaining to a life
20 settlement contract shall be computed as a percentage of the offer
21 obtained, not the face value of the policy. A life settlement broker may
22 reduce the compensation provided below this percentage.

23 (k)(l) No person, at any time prior to, or at the time of, the appli-
24 cation for, or issuance of, a policy, or during the two-year period
25 commencing with the date of issuance of the policy, shall enter into a
26 life settlement contract, regardless of the date the compensation is to
27 be provided and regardless of the date the assignment, transfer, sale,

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1 devise or bequest of the policy is to occur. This prohibition shall not
2 apply if the owner certifies to the life settlement provider that:

3 (A) the policy was issued upon the owner's exercise of conversion
4 rights arising out of a policy, provided the total of the time covered
5 under the conversion policy plus the time covered under the prior policy
6 is at least twenty-four months. The time covered under a group policy
7 shall be calculated without regard to a change in insurers, provided the
8 coverage has been continuous and under the same group sponsorship; or

9 (B) one or more of the following conditions, for which the owner
10 submits independent evidence to the life settlement provider, have been
11 met within the two-year period:

12 (i) the owner or insured is terminally or chronically ill;

13 (ii) the owner or insured disposes of ownership interests in a closely
14 held corporation, pursuant to the terms of a buyout or other similar
15 agreement in effect at the time the insurance policy was initially
16 issued;

17 (iii) the owner's spouse dies;

18 (iv) the owner divorces his or her spouse;

19 (v) the owner retires from full-time employment or involuntarily ceas-
20 es employment;

21 (vi) the owner becomes physically or mentally disabled and a physician
22 determines that the disability prevents the owner from maintaining full-
23 time employment;

24 (vii) a final order, judgment or decree is entered by a court of
25 competent jurisdiction, on the application of a creditor of the owner,
26 adjudicating the owner bankrupt or insolvent, or approving a petition
27 seeking reorganization of the owner or appointing a receiver, trustee or
28 liquidator to all or a substantial part of the owner's assets; or

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1 (viii) any other condition that the superintendent may determine by
2 regulation to be an extraordinary circumstance for the owner or the
3 insured.

4 (2) Copies of the independent evidence required by subparagraph (B) of
5 paragraph one of this subsection shall be submitted to the insurer when
6 the life settlement provider submits a request to the insurer for
7 verification of coverage. The copies shall be accompanied by a letter of
8 attestation from the life settlement provider that the copies are true
9 and correct copies of the documents received by the life settlement
10 provider. Nothing in this section shall prohibit an insurer from exer-
11 cising its right to contest the validity of any policy.

12 (3) For the purposes of this section a person is:

13 (A) terminally ill if the individual has an illness, sickness or phys-
14 ical condition that can reasonably be expected to result in death in
15 twenty-four months or less; or

16 (B) chronically ill if that individual has been certified by a
17 licensed health care practitioner as:

18 (i) being unable to perform without substantial assistance from another
19 individual at least two activities of daily living (i.e., eating,
20 toileting, transferring, bathing, dressing or continence) for a period
21 of at least ninety days, due to a loss of functional capacity;

22 (ii) requiring substantial supervision to protect the individual from
23 threats to health and safety due to severe cognitive impairment for a
24 period of at least ninety days, due to a loss of functional capacity; or

25 (iii) having a level of disability similar to that described in clause
26 (i) of this subparagraph, as determined by the United States Secretary
27 of Health and Human Services.

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1 (l) Contacts with the insured for the purpose of determining the
2 health status of the insured by a licensed life settlement provider
3 after the life settlement contract has been executed shall be made only
4 by the licensed life settlement provider or licensed life settlement
5 broker, or any authorized representative thereof, and shall be limited
6 to once every three months for an insured with a life expectancy of more
7 than one year, and to no more than once per month for an insured with a
8 life expectancy of one year or less.

9 (m) The life settlement broker shall represent only the owner and owes
10 a fiduciary duty to the owner, including a duty to act according to the
11 owner's instructions and in the best interest of the owner.

12 (n)(l) A life settlement provider, life settlement broker, or life
13 settlement intermediary shall be responsible for the actions of its
14 authorized representative.

15 (2) An authorized representative of a life settlement provider, life
16 settlement broker, or life settlement intermediary shall not have any
17 financial interest in the life settlement contract or a settled policy.

18 (o)(l) A life settlement intermediary's services shall not be limited
19 to life settlement providers or life settlement brokers that are affil-
20 iates, parents, or subsidiaries of the life settlement intermediary.

21 (2) A life settlement intermediary shall establish and maintain
22 systems, practices and procedures to ensure that:

23 (A) every transaction with an affiliate, parent or subsidiary of the
24 life settlement intermediary is fair and equitable and conducted on an
25 arms-length basis; and

26 (B) an affiliate, parent or subsidiary of the life settlement interme-
27 diary is not granted or provided with preferential treatment or access
28 to information or services that are not granted or provided to an unaf-

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1 filiated life settlement provider or life settlement broker that
2 conducts business with the life settlement intermediary.

3 (p) A life settlement provider may sell, assign, pledge or otherwise
4 transfer the ownership of a settled policy only to a licensed life
5 settlement provider, an accredited investor or qualified institutional
6 buyer, financing entity, special purpose entity, or related provider
7 trust; provided, however, a life settlement provider may sell, assign,
8 pledge or otherwise transfer a beneficial interest in a settled policy
9 to someone other than a life settlement provider licensed in this state,
10 an accredited investor or qualified institutional buyer, financing enti-
11 ty, special purpose entity, or related provider trust if a licensed life
12 settlement provider continues to administer and service the settled
13 policy and protects the privacy of the insured and owner pursuant to
14 section seven thousand eight hundred ten of this article.

15 (q) The failure to follow the provisions of this section shall be a
16 defined violation under article twenty-four of this chapter.

17 § 7814. Prohibited practices. (a) No person shall:

18 (1) enter into a life settlement contract if the person knows or
19 reasonably should have known that the policy was obtained by means of a
20 false, deceptive or misleading application for such policy;

21 (2) engage in any transaction, practice or course of business if the
22 person knows or reasonably should have known that the intent was to
23 avoid the disclosure or other notice requirements of this article;

24 (3) engage in any fraudulent act or practice in connection with any
25 transaction relating to any life settlement;

26 (4)(A) enter into a premium finance loan with any person or agency, or
27 any person affiliated with such person or agency, pursuant to which the
28 person shall receive any proceeds, fees or other consideration, directly

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1 or indirectly, from the policy or owner of the policy or any other
2 person, other than commissions earned by a licensed insurance producer
3 on the policy, with respect to the premium finance loan or any settle-
4 ment contract or other transaction related to such policy that are in
5 addition to the amounts required to pay the principal, interest and any
6 reasonable costs or expenses incurred by the lender or borrower related
7 to the premium finance loan or subsequent sale of such loan; provided,
8 further, that any payments, charges, fees or other amounts in addition
9 to the amounts required to pay the principal, interest and any reason-
10 able costs or expenses incurred by the lender or borrower related to the
11 premium finance loan shall be remitted to the original owner of the
12 policy or to the original owner's estate if the original owner is not
13 living at the time of the determination of the overpayment;

14 (B) If, at any time, a policy that is the subject of a premium finance
15 loan is sold, assigned, transferred, devised or bequeathed to a person
16 or agency specified in subparagraph (A) of this paragraph or to a life
17 settlement provider pursuant to the terms of a premium finance loan, any
18 proceeds or other consideration received other than the amounts speci-
19 fied in subparagraph (A) of this paragraph shall be remitted to the
20 original owner of the policy or to the original owner's estate if the
21 original owner is not then living.

22 (5) with respect to any life settlement contract, knowingly fail to
23 disclose any affiliation or contractual arrangement as required by this
24 article;

25 (6) directly or indirectly, purchase or obtain an interest in any
26 policy that is the subject of a life settlement contract where the
27 person has acted as a life settlement broker or life settlement interme-
28 diary with respect to the policy;

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1 (7) directly or indirectly provide or offer to provide any compen-
2 sation to any person acting in this state as a life settlement broker,
3 unless the person is a licensed life settlement broker pursuant to the
4 provisions of section two thousand one hundred thirty-seven of this
5 chapter;

6 (8) directly or indirectly pay or offer to pay any referral or
7 finder's fee or provide or offer to provide any other compensation to
8 any owner's physician, attorney, accountant or other person providing
9 medical, legal or financial planning services to the owner, or to any
10 other person, other than a life settlement broker, representing the
11 owner with respect to the life settlement contract;

12 (9) directly or indirectly provide or offer to provide compensation to
13 a life settlement broker, except where the compensation is for a specif-
14 ic life settlement contract and is clearly disclosed to the owner as
15 required in this article;

16 (10) directly or indirectly engage in any act determined by the super-
17 intendent to be an unfair or deceptive act or practice pursuant to this
18 chapter;

19 (11) remove, conceal, alter, destroy or sequester from the superinten-
20 dent the assets or records of a life settlement provider, life settle-
21 ment broker, life settlement intermediary or other person engaged in the
22 business of life settlements;

23 (12) misrepresent or conceal the financial condition of a life settle-
24 ment provider; or

25 (13) in relation to the business of life settlements, file with the
26 superintendent a document containing materially false information
27 concerning any fact material thereto or otherwise conceal information
28 about a fact material thereto from the superintendent.

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1 (b) No life settlement provider, life settlement broker, life settle-
2 ment intermediary, owner or any other person, as a condition of entering
3 into a life settlement contract, shall request or require an insured to
4 submit to a medical examination at any time subsequent to the settlement
5 of the policy.

6 (c) No life settlement provider shall enter into any life settlement
7 contract in which payments of proceeds are made in installments.

8 (d) No life settlement provider, life settlement broker or life
9 settlement intermediary shall directly or indirectly:

10 (1) be a party to or enter into an agreement or understanding limiting
11 or restricting an owner's or life settlement broker's ability to seek
12 competitive bids on policies to the extent that the agreement or under-
13 standing unlawfully restrains trade or constitutes anticompetitive
14 behavior;

15 (2) monopolize or attempt to monopolize, or combine or conspire with
16 any other person or persons to monopolize, in this state, the business
17 of life settlements;

18 (3) be a party to or enter into an agreement with a life settlement
19 provider, life settlement broker or life settlement intermediary to the
20 extent that the agreement fixes or limits the value paid to owners;

21 (4) be a party to or enter into any agreement or communication with a
22 life settlement provider or life settlement intermediary with respect to
23 the terms to be offered to an owner to the extent that the agreement or
24 understanding unlawfully restrains trade or constitutes anticompetitive
25 behavior;

26 (5) be a party to or enter into any agreement with a life settlement
27 provider, life settlement broker, life settlement intermediary or other

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1 person to restrain trade or engage in any other anticompetitive behav-
2 ior;

3 (6) be party to or enter into any agreement with a life settlement
4 provider, life settlement broker, life settlement intermediary or other
5 person the effect of which may be substantially to lessen competition in
6 the business of life settlements subject to this chapter; or

7 (7) be a party to or enter into any agreement with a life settlement
8 provider, life settlement broker, life settlement intermediary or other
9 person to refuse to conduct business with any person in the business of
10 life settlements.

11 (e) No life settlement intermediary shall:

12 (1) represent, solicit, negotiate or act on behalf of, an owner, a
13 life settlement provider, or a life settlement broker; or

14 (2) act as a life settlement provider or life settlement broker.

15 (f) No insurer shall prohibit an insurance agent from disclosing to a
16 client the availability of a life settlement contract.

17 (g) The failure to follow the provisions of this section shall be a
18 defined violation under article twenty-four of this chapter.

19 § 7815. Stranger-originated life insurance. (a) No life settlement
20 provider, life settlement broker, or any representative thereof, shall
21 directly or indirectly engage in any act, practice or arrangement, at or
22 prior to policy issuance, to facilitate the issuance of a policy for the
23 intended benefit of a person who, at the time of policy origination, has
24 no insurable interest in the life of the insured.

25 (b) The failure to follow the provision of this section shall be a
26 defined violation under article twenty-four of this chapter.

27 § 7816. Penalties and civil remedies. (a)(1) If, after notice and
28 hearing, the superintendent determines that any information required by

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1 subsection (c) of section seven thousand eight hundred eleven of this
2 article was not provided or was delayed in being provided to the materi-
3 al detriment of the owner, then the superintendent, in addition to any
4 other penalty prescribed by law, may require the life settlement broker
5 to pay the owner an amount not to exceed the compensation due or
6 provided to the life settlement broker.

7 (2) If, after notice and hearing, the superintendent determines that
8 any information required by subsection (b) of section seven thousand
9 eight hundred eleven of this article was not provided or was delayed in
10 being provided to the material detriment of the owner, then the super-
11 intendent, in addition to any other penalty prescribed by law, may
12 require the life settlement provider to pay the owner an amount not to
13 exceed the death benefit under the policy at the time the policy was
14 settled.

15 (b)(1) If, after notice and hearing, the superintendent determines
16 that any life settlement broker or any representative thereof violates
17 subsection (a) of section seven thousand eight hundred fifteen of this
18 article, then the superintendent, in addition to any other penalty
19 prescribed by law, may require the life settlement broker to pay the
20 owner an amount not to exceed the compensation due or provided to the
21 life settlement broker.

22 (2) If, after notice and hearing, the superintendent determines any
23 life settlement provider or any representative thereof violates
24 subsection (a) of section seven thousand eight hundred fifteen of this
25 article, then the superintendent, in addition to any other penalty
26 prescribed by law, may require the life settlement provider to pay the
27 owner an amount not to exceed the death benefit under the policy at the
28 time the policy was settled.

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1 (c) If, after notice and hearing, the superintendent determines that
2 any person violated section seven thousand eight hundred ten of this
3 article, then the superintendent, in addition to any other penalty
4 prescribed by law, may require the person to pay the insured an amount
5 not to exceed twenty thousand dollars.

6 (d)(1) If, after notice and hearing, the superintendent determines
7 that any person that acted as a life settlement provider without a
8 license in violation of subsection (a) of section seven thousand eight
9 hundred three of this article, then the superintendent may impose a
10 civil penalty not to exceed twenty thousand dollars for each policy
11 settled in violation thereof; and, in addition, the superintendent may
12 require the life settlement provider to pay the insured an amount not to
13 exceed the death benefit under the policy at the time the policy was
14 settled.

15 (2) If, after notice and hearing, the superintendent determines that
16 any person acted as a life settlement broker without a license in
17 violation of subsection (a) of section two thousand one hundred thirty-
18 seven of this chapter, then the superintendent may impose a civil penal-
19 ty not to exceed ten thousand dollars for each policy and require the
20 life settlement broker to pay the owner an amount not to exceed the
21 compensation due or provided to the life settlement broker.

22 (3) If, after notice and hearing, the superintendent determines that
23 any person acted as a life settlement intermediary without a registra-
24 tion in violation of subsection (a) of section seven thousand eight
25 hundred four of this article, then the superintendent may impose a civil
26 penalty not to exceed ten thousand dollars for each transaction and
27 require the life settlement intermediary to pay the owner an amount not

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1 to exceed the compensation due or provided to the life settlement inter-
2 mediary.

3 (e) Nothing provided in this article shall limit or restrict any
4 common law, contractual or other right of action.

5 § 7817. Authority to promulgate regulations. The superintendent may
6 promulgate regulations implementing this article, including regulating
7 activities and relationships of life settlement providers, life settle-
8 ment brokers and insurers; promoting a fair, transparent and competitive
9 life settlements market; protecting the privacy of owners, insureds and
10 other persons; and safeguarding the public policy goals embodied in the
11 insurable interest requirements of this chapter.

12 § 7818. Nonconforming contracts. (a) Except as otherwise specifically
13 provided in this chapter, any life settlement contract subject to this
14 chapter that is in violation of any of the provisions of this chapter
15 shall be valid and binding upon the life settlement provider, but in all
16 respects in which the contract's provisions are in violation of the
17 requirements or prohibitions of this chapter it shall be enforceable as
18 if it conformed with such requirements or prohibitions.

19 (b) In any action to recover under the provisions of any life settle-
20 ment contract that the superintendent is authorized by this chapter to
21 approve, if in the superintendent's opinion its provisions are more
22 favorable to owners, the court shall enforce such contract as if its
23 provisions were the same as those specified in this chapter unless the
24 court finds that its actual provisions were more favorable to owners at
25 the date when the contract was entered into.

26 § 7819. Applicability. (a) The provisions of this article shall apply
27 to any life settlement contract made, proposed to be made, or solicited:

28 (1) inside this state; or

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1 (2) outside this state by a licensed life settlement provider with
2 respect to a resident of this state.

3 (b)(1) If there is more than one owner on a single policy, and the
4 owners are residents of different states, then the state of residency
5 shall be the state in which the owner having the largest percentage of
6 ownership resides or, if the owners hold equal ownership, the state of
7 residence of one owner, agreed upon in writing by all of the owners.

8 (2) A life settlement contract entered into with an owner who is a
9 resident of another state may be governed by the laws of the other
10 state; provided that:

11 (A) the other state has enacted statutes or adopted regulations
12 governing life settlement contracts;

13 (B) the life settlement provider and the life settlement broker are
14 licensed in the other state;

15 (C) the owner elects in writing to be governed by the statutes and
16 regulations of the other state after the life settlement provider or the
17 life settlement broker has advised the owner of the right to select the
18 governing law; and

19 (D) if the owner is also a resident of this state, the life settlement
20 contract is made, proposed to be made and solicited outside this state.

21 (c) For the purposes of this section, the state of residence shall be:

22 (1) with respect to any person other than a natural person or a trust,
23 a state in which the person maintains an office; or

24 (2) with respect to a trust, a state in which the grantor resides.

25 § 7820. Severability. If any clause, sentence, paragraph, section or
26 part of this article shall be adjudged by any court of competent juris-
27 dition to be invalid and after exhaustion of all further judicial
28 review, the judgment shall not affect, impair or invalidate the remain-

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1 der thereof, but shall be confined in its operation to the clause,
2 sentence, paragraph, section or part of this article directly involved
3 in the controversy in which the judgment shall have been rendered.

4 § 12. Subsection (b) of section 403 of the insurance law, as amended
5 by chapter 805 of the laws of 1984, is amended to read as follows:

6 (b) For the purpose of section one hundred nine of this chapter, it is
7 a violation of this chapter for any individual, firm, association or
8 corporation subject to the provisions of this chapter to commit a frau-
9 dulent insurance act or a fraudulent life settlement act.

10 § 13. Section 403 of the insurance law is amended by adding a new
11 subsection (f) to read as follows:

12 (f) In this article, "fraudulent life settlement act" means a fraud as
13 defined in section 176.40 of the penal law.

14 § 14. Subsection (c) of section 403 of the insurance law, as amended
15 by chapter 262 of the laws of 1998, is amended to read as follows:

16 (c) In addition to any criminal liability arising under the provisions
17 of this section, the superintendent shall be empowered to levy a civil
18 penalty not exceeding five thousand dollars and the amount of the claim
19 for each violation upon any person, including those persons and their
20 employees licensed pursuant to this chapter, who is found to have: (i)
21 committed a fraudulent insurance act, fraudulent life settlement act or
22 otherwise violates the provisions of this section; or (ii) knowingly and
23 with intent to defraud files, makes, or assists, solicits or conspires
24 with another to file or make an application for a premium reduction,
25 pursuant to subsection (a) of section two thousand three hundred thir-
26 ty-six of this chapter, containing any materially false information or
27 which, for the purpose of misleading, conceals information concerning
28 any fact material thereto.

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1 § 15. Subsection (a) of section 404 of the insurance law is amended to
2 read as follows:

3 (a) If the insurance frauds bureau has reason to believe that a person
4 has engaged in, or is engaging in, an act defined in section 155.05 of
5 the penal law, with respect to personal or commercial insurance trans-
6 actions (or), the business of life settlements, section 176.05 or
7 section 176.40 of such law, the superintendent may make such investi-
8 gation within or without this state as [he] the superintendent deems
9 necessary to aid in the enforcement of this chapter or to determine
10 whether any person has violated or is about to violate any such
11 provision of the penal law.

12 § 16. Section 405 of the insurance law, subsection (a) as amended by
13 chapter 635 of the laws of 1996, subsection (d) as added by chapter 57
14 of the laws of 1993, the opening paragraph of subsection (d) as amended
15 by chapter 191 of the laws of 2008, paragraphs 9 and 10 of subsection
16 (d) as amended and paragraph 11 of subsection (d) as added by chapter
17 678 of the laws of 1997, is amended to read as follows:

18 § 405. Reports. (a) Any person licensed or registered pursuant to the
19 provisions of this chapter, and any person engaged in the business of
20 insurance or life settlement in this state who is exempted from compli-
21 ance with the licensing requirements of this chapter, including the
22 state insurance fund of this state, who has reason to believe that an
23 insurance transaction or life settlement act may be fraudulent, or has
24 knowledge that a fraudulent insurance transaction or fraudulent life
25 settlement act is about to take place, or has taken place shall, within
26 thirty days after determination by such person that the transaction
27 appears to be fraudulent, send to the insurance frauds bureau on a form
28 prescribed by the superintendent, the information requested by the form

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1 and such additional information relative to the factual circumstances of
2 the transaction and the parties involved as the superintendent may
3 require. The insurance frauds bureau shall accept reports of suspected
4 fraudulent insurance transactions or fraudulent life settlement acts
5 from any self insurer, including but not limited to self insurers
6 providing health insurance coverage or those defined in section fifty of
7 the workers' compensation law, and shall treat such reports as any other
8 received pursuant to this section.

9 (b) The insurance frauds bureau shall review each report and undertake
10 such further investigation as it deems necessary and proper to determine
11 the validity of the allegations.

12 (c) Whenever the superintendent is satisfied that a material fraud,
13 deceit, or intentional misrepresentation has been committed in an insur-
14 ance transaction or in the business of life settlements or purported
15 insurance transaction or business of life settlements, he or she shall
16 report any such violation of law to the appropriate licensing agency,
17 the district attorney of the county in which such acts were committed,
18 when authorized by law, to the attorney general, and where appropriate,
19 to the person who submitted the report of fraudulent activity, as
20 provided by the provisions of this article. Within one hundred twenty
21 days of receipt of the superintendent's report, the attorney general or
22 the district attorney concerned shall inform the superintendent as to
23 the status of the reported violations.

24 (d) No later than March fifteenth of each year, beginning in nineteen
25 hundred ninety-four, the superintendent shall furnish to the governor,
26 the speaker of the assembly and the president pro tem of the senate a
27 report containing:

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1 (1) a comprehensive summary and assessment of the frauds bureau's
2 efforts in discovering, investigating and halting fraudulent activities
3 and assisting in the prosecution of persons who are parties to insurance
4 fraud or life settlement fraud;

5 (2) the number of reports received from any person or persons engaged
6 in the business of insurance or life settlements, the number of investi-
7 gations undertaken by the bureau pursuant to any reports received, the
8 number of investigations undertaken not as a result of reports received,
9 the number of investigations that resulted in a referral to a licensing
10 agency, a local prosecutor or the attorney general, the number of such
11 referrals pursued by a licensing agency, a local prosecutor or the
12 attorney general, and the disposition of such cases;

13 (3) a delineation of the number of reported and investigated cases by
14 line of insurance and those that relate to life settlements;

15 (4) a comparison of the frauds bureau's experience, with regard to
16 paragraphs two and three of this (subdivision) subsection, to the
17 bureau's experience of years past;

18 (5) the total number of employees assigned to the frauds bureau delin-
19 eated by title and location of bureau assigned;

20 (6) an assessment of the activities of insurance [company] companies
21 and life settlement providers activities in regard to detecting, inves-
22 tigating and reporting fraudulent activities, including a list of compa-
23 nies which maintain special investigative units for the sole purpose of
24 detecting, investigating and reporting fraudulent activities and the
25 number of investigators assigned to such units per every thirty thousand
26 policies or life settlement contracts in force with such company or
27 provider;

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1 (7) the amount of technical and monetary assistance requested and
2 received by the frauds bureau from any insurance company or companies,
3 any life settlement provider or providers, or any organization funded by
4 insurance companies or life settlement providers;

5 (8) the amount of money returned by the frauds bureau to insurance
6 companies pursuant to any fraudulent claims that were recouped by the
7 bureau;

8 (9) the number and amount of civil penalties levied by the frauds
9 bureau pursuant to chapter four hundred eighty of the laws of nineteen
10 hundred ninety-two;

11 (10) recommendations for further statutory or administrative changes
12 designed to meet the objectives of this article; and

13 (11) an assessment of law enforcement and insurance company activities
14 to detect and curtail the incidence of operating a motor vehicle without
15 proper insurance coverage as required by this chapter.

16 § 17. Section 406 of the insurance law, as amended by chapter 6 of the
17 laws of 2007, is amended to read as follows:

18 § 406. Immunity. (a) In the absence of fraud or bad faith, no person
19 shall be subject to civil liability, and no civil cause of action of any
20 nature shall arise against such person [(1)] for any: (1) information
21 relating to suspected fraudulent insurance transactions or fraudulent
22 life settlement acts furnished to law enforcement officials, their
23 agents and employees; (and (ii) for any) (2) information relating to
24 suspected fraudulent insurance transactions or fraudulent life settle-
25 ment acts furnished to other persons subject to the provisions of this
26 chapter; and [(iii) for any] (3) such information furnished in reports
27 to the insurance frauds bureau, its agents or employees or any state
28 agency investigating fraud or misconduct relating to workers' compen-

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1 sation insurance, its agents or employees. Nor shall the superintendent
2 or any employee of the insurance frauds bureau, in the absence of fraud
3 or bad faith, be subject to civil liability and no civil cause of action
4 of any nature shall arise against them by virtue of the publication of
5 any report or bulletin related to the official activities of the insur-
6 ance frauds bureau. Nothing herein is intended to abrogate or modify in
7 any way any common law privilege of immunity heretofore enjoyed by any
8 person.

9 (b) A person identified in subsection (a) of this section shall be
10 entitled to an award of attorney's fees and costs if he or she is the
11 prevailing party in a civil cause of action for libel, slander or any
12 other relevant tort arising out of activities in carrying out the
13 provisions of this article and the party bringing the action was not
14 substantially justified in doing so. For purposes of this section a
15 proceeding is "substantially justified" if it had a reasonable basis in
16 law or fact at the time that it was initiated.

17 (c)(1) The documents and evidence provided pursuant to subsection (a)
18 of section four hundred five of this article or obtained by the super-
19 intendent in an investigation of suspected or actual fraudulent insur-
20 ance acts or fraudulent life settlement acts shall be privileged and
21 confidential and shall not be a public record.

22 (2) Paragraph one of this subsection shall not prohibit release by the
23 superintendent of documents and evidence obtained in an investigation of
24 suspected or actual fraudulent insurance acts or life settlement acts:

25 (A) in administrative or judicial proceedings to enforce laws adminis-
26 tered by the superintendent; or

27 (B) to federal, state or local law enforcement or regulatory agencies;
28 any organization established for the purpose of detecting and preventing

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1 fraudulent insurance acts or fraudulent life settlement acts; or the
2 National Association of Insurance Commissioners.

3 (3) Release of documents and evidence under paragraph two of this
4 subsection does not abrogate or modify the privilege granted in para-
5 graph one of this subsection.

6 § 18. The insurance law is amended by adding a new section 411 to read
7 as follows:

8 § 411. Life settlements fraud prevention plans. (a) Every life
9 settlement provider shall file with the superintendent a plan for the
10 detection; investigation and prevention of fraudulent life settlement
11 acts in this state and those fraudulent life settlement acts affecting
12 life settlement contracts in this state.

13 (1) The plan shall provide the time and manner in which such plan
14 shall be implemented, including provisions for a special investigations
15 unit and staffing levels within such unit. Such investigators shall be
16 responsible for investigating information on or cases of suspected frau-
17 dulent activity and for effectively implementing fraud prevention and
18 reduction activities pursuant to the plan filed with the superintendent.
19 A life settlement provider shall include in such plan staffing levels
20 and allocations of resources of such special investigations unit that
21 shall be sufficient and appropriate for the proper implementation of the
22 plan and approval of such plan pursuant to subsection (c) of this
23 section.

24 (2) In lieu of a special investigations unit, a life settlement
25 provider may contract with a provider of services related to the inves-
26 tigation of information on or cases of suspected fraudulent activities;
27 provided, however, that a life settlement provider that opts for
28 contracting with a separate provider of services, shall provide to the

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1 superintendent a detailed plan therefor, pursuant to requirements set
2 forth in regulation by the superintendent.

3 (3) A person employed by a special investigations unit or an independ-
4 ent provider of investigative services under contract with a life
5 settlement provider shall be qualified by education or experience to act
6 in such capacity, subject to requirements established by the superinten-
7 dent in a regulation.

8 (b) The plan shall provide for the following:

9 (1) interface of special investigations unit personnel with law
10 enforcement and prosecutorial agencies, including the insurance frauds
11 bureau in the department;

12 (2) reporting of fraud data to a central organization approved by the
13 superintendent;

14 (3) in-service education and training for personnel in identifying and
15 evaluating instances of suspected fraudulent activity;

16 (4) coordination with other units of a life settlement provider for
17 the investigation and initiation of civil actions based upon information
18 received by or through the special investigation unit;

19 (5) public awareness of the cost and frequency of fraudulent activ-
20 ities, and the methods of preventing fraud;

21 (6) development and use of a fraud detection and procedures manual to
22 assist in the detection and elimination of fraudulent activity; and

23 (7) the time and manner in which such plan shall be implemented and a
24 demonstration that the fraud prevention and reduction measures outlined
25 in the plan will be fully implemented.

26 (c)(1) A fraud detection and prevention plan filed by a life settle-
27 ment provider with the superintendent pursuant to this section shall be
28 deemed approved by the superintendent if not returned by the superinten-

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1 dent for revision within one hundred twenty days of the date of filing.
2 If the superintendent returns a plan for revision, the superintendent
3 shall state the points of objection with such plan, and any amendments
4 as the superintendent may require consistent with the provisions of this
5 section, including staffing levels, resource allocation, or other policy
6 or operational considerations. An amended plan reflecting the changes
7 shall be filed with the superintendent within forty-five days from the
8 date of return.

9 (2) If the superintendent has returned a plan for revision more than
10 one time, then the life settlement provider shall be entitled to a hear-
11 ing pursuant to the provisions of article three of this chapter and
12 regulations promulgated thereunder.

13 (3) If a life settlement provider fails to submit a final plan within
14 thirty days after a determination of the superintendent after the hear-
15 ing held pursuant to paragraph two of this subsection, or otherwise
16 fails to submit a plan, or fails to implement the provisions of a plan
17 in a time and manner provided for in such plan, or otherwise refuses to
18 comply with the provisions of this section, the superintendent may
19 impose:

20 (A) a fine of not more than two thousand dollars per day for such
21 failure by a life settlement provider until the superintendent deems the
22 life settlement provider to be in compliance;

23 (B) upon the life settlement provider a fraud detection and prevention
24 plan deemed to be appropriate by the superintendent, which shall be
25 implemented by the life settlement provider; or

26 (C) both a fine and a fraud detection and prevention plan pursuant to
27 subparagraphs (A) and (B) of this paragraph.

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1 (d) Any plan, the information contained therein, or correspondence
2 related thereto, or any other information furnished pursuant to this
3 section shall be deemed to be a confidential communication and shall not
4 be open for review or be subject to a subpoena except by a court order
5 or by request from any law enforcement agency or authority.

6 (e) Every life settlement provider required to file a fraud prevention
7 plan shall report to the superintendent on an annual basis, no later
8 than March fifteenth, describing the provider's experience, performance
9 and cost effectiveness in implementing the plan, utilizing such forms as
10 the superintendent may prescribe. Upon consideration of such reports,
11 the superintendent may require amendments to the provider's fraud
12 detection and prevention plan as deemed necessary.

13 § 19. The penal law is amended by adding seven new sections 176.40,
14 176.45, 176.50, 176.55, 176.60, 176.65 and 176.70 to read as follows:

15 § 176.40 Fraudulent life settlement act; defined.

16 A fraudulent life settlement act is committed by any person who, know-
17 ingly and with intent to defraud, presents, causes to be presented, or
18 prepares with knowledge or belief that it will be presented to, or by, a
19 life settlement provider, life settlement broker, life settlement inter-
20 mediary, or purchaser of a settled life insurance policy or any interest
21 therein, or any agent thereof, or to any owner any written statement or
22 other physical evidence as part of, or in support of, an application for
23 a life settlement contract, a claim for payment or other benefit under a
24 life settlement contract or the sale of a settled life insurance policy
25 or any interest therein, which the person knows to:

26 (1) contain materially false information concerning any material fact
27 thereto; or

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1 (2) conceal, for the purpose of misleading, information concerning any
2 fact material thereto.

3 § 176.45 Life settlement fraud in the fifth degree.

4 A person is guilty of life settlement fraud in the fifth degree when
5 he or she commits a fraudulent life settlement act.

6 Life settlement fraud in the fifth degree is a class A misdemeanor.

7 § 176.50 Life settlement fraud in the fourth degree.

8 A person is guilty of life settlement fraud in the fourth degree when
9 he or she commits a fraudulent life settlement act and thereby wrongfull-
10 ly takes, obtains or withholds, or attempts to wrongfully take, obtain
11 or withhold property with a value in excess of twenty-five thousand
12 dollars.

13 Life settlement fraud in the fourth degree is a class E felony.

14 § 176.55 Life settlement fraud in the third degree.

15 A person is guilty of life settlement fraud in the third degree when
16 he or she commits a fraudulent life settlement act and thereby wrongfull-
17 ly takes, obtains or withholds, or attempts to wrongfully take, obtain
18 or withhold property with a value in excess of fifty thousand dollars.

19 Life settlement fraud in the third degree is a class D felony.

20 § 176.60 Life settlement fraud in the second degree.

21 A person is guilty of life settlement fraud in the second degree when
22 he or she commits a fraudulent life settlement act and thereby wrongfull-
23 ly takes, obtains or withholds, or attempts to wrongfully take, obtain
24 or withhold property with a value in excess of one hundred thousand
25 dollars.

26 Life settlement fraud in the second degree is a class C felony.

27 § 176.65 Life settlement fraud in the first degree.

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1 A person is guilty of life settlement fraud in the first degree when
2 he or she commits a fraudulent life settlement act and thereby wrongfull-
3 ly takes, obtains or withholds, or attempts to wrongfully take, obtain
4 or withhold property with a value in excess of one million dollars.

5 Life settlement fraud in the first degree is a class B felony.

6 § 176.70 Aggravated life settlement fraud.

7 A person is guilty of aggravated life settlement fraud when he or she
8 commits a fraudulent life settlement act, and has been previously
9 convicted within the preceding five years of any offense, an essential
10 element of which is the commission of a fraudulent life settlement act.

11 Aggravated life settlement fraud is a class D felony.

12 § 20. Section 570 of the banking law, as added by chapter 488 of the
13 laws of 1960, is amended to read as follows:

14 § 570. Restrictions on premium finance agreements. 1. No premium
15 finance agreement shall contain any provision by which:

16 (a) In the absence (of) or default of the insured, the premium finance
17 agency holding the agreement may, arbitrarily and without reasonable
18 cause, accelerate the maturity of any part or all of the amount owing
19 thereunder;

20 (b) A power of attorney is given to confess judgment in this state; or

21 (c) The insured relieves the insurance agent or broker or the premium
22 finance agency holding the agreement from liability for any legal rights
23 or remedies (which) that the insured may otherwise have against (him)
24 the insurance agent or broker.

25 2. No person may use a premium finance agreement in a manner designed
26 to evade any requirement of article seventy-eight of the insurance law.

27 3. Every person or premium finance agency that enters into a premium
28 finance agreement, as such terms are defined pursuant to article

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1 twelve-B of this chapter, shall file in the office of the superintendent
2 of insurance, on or before the first day of March, a statement, to be
3 known as its annual statement, verified by the oath of at least two of
4 its principal officers, showing its condition at the end of the preced-
5 ing calendar year. The statement shall be in such form and shall contain
6 such other matters as the superintendent of insurance shall prescribe.
7 In addition to any other requirements, the annual statement shall speci-
8 fy the total number, aggregate face amount and life settlement proceeds
9 of, policies settled during the immediately preceding calendar year,
10 together with a breakdown of the information by policy issue year.

11 § 21. This act shall take effect on the one hundred eightieth day
12 after it shall have become a law, provided that:

13 (1) a person lawfully operating as a life settlement provider, life
14 settlement broker or life settlement intermediary in this state with
15 respect to life settlement transactions not heretofore regulated under
16 the insurance law may, with respect to such transactions, continue to do
17 so after such one hundred eightieth day, pending approval or disapproval
18 of the person's application for a license or registration, as applica-
19 ble, if the appropriate application is filed with the superintendent of
20 insurance not later than 30 days after the superintendent publishes, on
21 the insurance department's website, the application form for such licen-
22 sure or registration, and provided further that such person certifies in
23 the application that such person shall comply with all applicable
24 provisions of the insurance law and regulations thereunder;

25 (2) a person licensed as a viatical settlement company or a viatical
26 settlement broker immediately prior to the effective date of this act
27 may act as a life settlement provider or a life settlement broker after
28 such one hundred eightieth day, for the duration of the term of the

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1 provider or the broker's license, without having to file a new applica-
2 tion, including with respect to transactions not heretofore regulated
3 under the insurance law;

4 (3) with respect to life settlement transactions not heretofore regu-
5 lated under the insurance law, a person licensed as a viatical settle-
6 ment company immediately prior to the effective date of this act or a
7 person lawfully operating as a life settlement provider in this state,
8 as described in subdivision one of this section, that has filed, no
9 later than 30 days prior to the effective date of this act, specimen
10 copies of the contract forms, application forms and other forms that it
11 intends to use, and certified to the superintendent of insurance that
12 such forms are in compliance with the insurance law and any regulations
13 promulgated thereunder, may use the unapproved forms until the super-
14 intendent of insurance has either approved or disapproved the forms;

15 (4) with respect to viatical settlement transactions heretofore regu-
16 lated under the insurance law, a person licensed as a viatical settle-
17 ment company immediately prior to the effective date of the act, as
18 described in subdivision two of this section, shall not continue to
19 issue contract forms, application forms and other forms approved by the
20 superintendent of insurance prior to the effective date of this act,
21 after the effective date of this act. Any such person that has filed, no
22 later than thirty days prior to the effective date of this act, specimen
23 copies of the contract forms, application forms and other forms that it
24 intends to use, and that has certified to the superintendent of insur-
25 ance that such forms are in compliance with the insurance law and any
26 regulations promulgated thereunder, as of the effective date of this
27 act, may use such unapproved forms until the superintendent of insurance
28 has either approved or disapproved the forms;

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1 (5) sections 7810, 7811 and 7815 of the insurance law, as added by
2 section eleven of this act, shall take effect immediately; and

3 (6) effective immediately, the superintendent of insurance may promul-
4 gate any rules and regulations necessary for the implementation of the
5 provisions of this act on its effective date.

