

COVENTRY

REDEFINING INSURANCE®

THE SECONDARY MARKET FOR LIFE INSURANCE

THE VALUE OF LIFE INSURANCE IN THE HANDS OF CONSUMERS

The Value of Life Insurance in the Hands of Consumers

- Life Insurance is a Valuable Asset/Investment
- Life Insurance is Property
- The Secondary Market Benefits Consumers
 - Life Settlements
 - Non-Recourse Premium Financing
- Lack of Competition in Insurance Harms Consumers
- STOLI: What STOLI is and is NOT!
- NAIC and NCOIL Models on STOLI

Gramm-Leach-Bliley (Financial Services Modernization) Act of 1999

- Call for Competition in Financial Services
- Condemns Protectionist Regulation of Financial Services Products
- “We are pleased that the bill promotes innovation and competition in the financial sector.”
 - US Treasury Secretary Lawrence Summers
- “[I]t is designed with really one very simple basic thing in mind: it is to provide consumers with a wider range of choices.”
 - US Rep. David Drier

Life Insurance is a Valuable Asset

Life insurance is “a financial asset that probably has a higher rate of return than any other asset in my estate.” - Mass Mutual Settlement Disclosure Form

Life Insurance is an INVESTMENT: Corporate-Owned Life Insurance (COLI)

Q: Why do companies institute COLI programs?

A: Primarily to finance employee benefit plan expenses **and increase net income**. For example, companies have substantial costs for medical, group life, and other basic insurance as well as qualified and nonqualified benefit plan expenses that can be financed with COLI. The reasons companies use COLI for these costs include:

- COLI can earn a **higher after-tax yield than many other investments**.
- The **COLI policies produce financial statement income** for the company as the credited cash value increases exceed the premiums paid. The net after tax income earned may be **higher than the return available on many alternative investments**.

-- New York Life Insurance Company COLI FAQ

Life Insurance is an INVESTMENT: Bank-Owned Life Insurance (BOLI)

BOLI has many attributes.

The bank is both the owner and beneficiary of the policy.

The program is **designed for longer-term investments.**

BOLI can be a source of funds that potentially offers annual **after-tax returns that are higher than the returns earned on other bank investments.**

Policy **earnings come from growth in cash value each year and from life insurance proceeds.**

BOLI programs are considered to be a **longer-term type of investment** since the obligations they are designed to help fund become due in future years.

--- Mass Mutual BOLI webpage

COLI: NOT for “Traditional Purposes”

ACLI – Corporate Owned Life Insurance: Questions and Answers

“Do employees’ beneficiaries get death benefit protection from COLI policies?”

Usually not. COLI refers to any corporate-owned life insurance, and some arrangements do allow the employee to name policy beneficiaries. However, under other arrangements, COLI is not a direct employee benefit.”

Life Insurance is an INVESTMENT: United States Supreme Court

“Life 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...”

-- *Grigsby v. Russell*, 222 U.S. 149 (1911)

The Property Right of Assignment of Life Insurance

“...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.”

-- *Grigsby v. Russell*, 222 U.S. 149

FLORIDA

“The rule is also settled that a life insurance policy is a chose in action which may be assigned in the same manner that other instruments of like character are assigned.” McMullen v. St. Lucie County Bank, 128 Fla. 745 (1937).

"And it has also been held that one who has insured his own life may in good faith, by an assignment of the policy, provide for the payment of the insurance money to an assignee who has no insurable interest in the life insured." Knott v. State ex rel Guaranty Income Life Ins. Co., 136 Fla. 184 (1939).

ALABAMA

A policy of life insurance, taken out by the insured himself or by a person having an insurable interest in the life of the insured, in good faith may, unless the policy provides otherwise, be assigned to anyone as any other chose in action without regard to whether the assignee has an insurable interest in the life insured or not. --
Alabama Code § 27-14-21(b)

"[I]t is not necessary for an assignee to have an insurable interest in the insured to make effective such assignment." -- *Sovereign Camp, W.O.W. v. Smith*, 7 F. Supp. 569, 570 (M.D. Ala. 1934)

ARKANSAS

“Subject to its terms relating to assignability, any life or accident and health policy, under the terms of which the beneficiary may be changed upon the sole request of the insured, may be assigned, either by pledge or transfer of title, by an assignment executed by the insured alone and delivered to the insurer, whether or not the pledgee or assignee is the insurer.” -- Arkansas Code § 23-79-124(b)

“[E]very person has an insurable interest in his own life, and as [the insured] had the right to take out a policy on his own life payable to his administrator or assigns, it is not disputed that this policy was valid. **The policy being valid and belonging to [the insured], he had, on the approach of death, the same right to give and transfer this property to anyone in whose welfare he felt an interest, as he had to dispose of any other property that he owned.**” *Corning Bank & Trust Co. v. Foster*, 74 S.W.2d 797, 800 (Ark. 1934)

NORTH CAROLINA

“We consider it ... as established by the great weight of authority that where an insurant makes a contract with a company, taking out a policy on his own life for the benefit of himself or his estate generally, or for the benefit of another, the policy being in good faith and valid at its inception, the same may ... be assigned to one not having an insurable interest in the life of the insured; provided this assignment is in good faith, and not a mere cloak or cover for a wagering transaction.” -- *Hardy v. Aetna*, 152 N.C. 286 (1910)

SOUTH CAROLINA

“We think both reason and authority sustain our conclusion that a life policy life of insurance, valid in its inception, may be assigned to one having no insurable interest in the life insured, with the consent of the ‘life’ and the insurer, if the assignment is bona fide, and not a device to evade the law against wager policies.” -- *Crosswell v. Connecticut Indemnity*, 51 S.C. 103 (S.C. 1897)

TENNESSEE

“[T]he weight of authority is that, when a policy has once been issued to a beneficiary legally entitled, he may assign it to another, who has no insurable interest, either by a transfer in his lifetime or by a last will and testament. . . . But, while this is true, the transfer and assignment must be made in good faith, and not as a mere colorable evasion of the provision in regard to wagering contracts, and in order to validate or legalize the same.” -- Clement v. New York Life Ins. Co., 101 Tenn. 22, 46 S.W. 561, 564 (1898)

WEST VIRGINIA

“We think there can be no question but that [the] insured had a property interest in the policies.... He had complete power over the policies ... As said by Mr. Justice Holmes in *Grigsby v. Russell* [citation omitted], ‘Life 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.’” -- *U.S. v. Metropolitan Life Ins. Co.*, 256 F.2d 17 (4th Cir. 1958)

The Value of Life Insurance as Collateral for a Loan

“If it be taken out in good faith, then a sound public policy, would seem to require that the payee should be permitted to treat it as he may any other chose in action, and **go to the best market he can find, either to sell it or borrow money on it.**”

-- *Steinback v. Diepenbrock*, 158 N.Y. 24 (1899).

The Value of Life Insurance as Collateral for a Loan

TENNESSEE

“Whenever the insured in a life insurance policy owned by the insured has reserved to the insured the right to change the beneficiary thereunder, **the insured has the right to and may assign the policy, to the extent and in the manner permitted by the terms thereof, as security for a loan, or for any other purpose**, without the beneficiary thereunder joining therein or assenting thereto, and the rights and interests of any such beneficiary, including a spouse or child of the insured, in the policy or its proceeds, shall be subject and subordinate to the rights and interests of the assignee as created and defined by such assignment.” -- Tennessee Code § 56-7-204(a)

The Value of Life Insurance as Collateral for a Loan

LOUISIANA

“The mere fact of assignment of a life insurance policy for a sum less than the face of the policy does not constitute proof that it is a gamble on the life of the assured. Should we so hold, it would not be possible for the assured to obtain any loan at all, upon the assignment of the policy as security for money advanced, or to be advanced to the assured.” -- *Travia v. Metropolitan Life*, 173 So. 721, 723 (La. 1937)

The Value of Life Insurance as Collateral for a Loan: Carrier's Own Non-Recourse Premium Financing

New for high-net-worth clients: Unlike traditional premium financing programs, [CARRIER] allows your client to fund a large insurance policy without large annual collateral requirements, with interest rates at or lower than most plans. Your client can be assured that our program does not require personal guarantees of the insured, or outside collateral beyond the policy itself. Plus, by pre-qualifying for the loan program at policy issue, they receive a discounted rate.

-- March 15, 2007 Carrier Bulletin.

The Value of Life Insurance as Collateral for a Loan: Carrier's Hybrid Premium Financing

“[A] well-designed and properly administered hybrid premium financing program can help certain customers meet their financial or estate planning needs without having to liquidate personal assets at the outset. Such customers are limited to wealthy individuals who, along with their legal and tax advisors, understand the benefits and risks of hybrid financing – which generally requires a combination of personal liability and/or pledged assets to collateralize a loan – **versus traditional premium financing and/or funding a policy out-of-pocket.**” -- July 10, 2007 Carrier Bulletin

THE SECONDARY MARKET FOR LIFE INSURANCE: GLBA FULFILLED

- LIFE SETTLEMENTS

- The assignment of valid life insurance.
- 300-500 percent more than cash surrender value.
- Coventry: Since November 2001: Policyowners have received \$1.7 billion more than cash surrender value.

- NON-RECOURSE PREMIUM FINANCING

- The collateral assignment of valid life insurance.
- The market value of the policy secures the loan.
- Eliminates the need for other collateral.
- Helps otherwise qualified applicants obtain needed life insurance.

Competition Benefits Consumers

“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.

“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.

“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. There will be a secondary market for these contracts, and this will not be good for the life insurance industry.”

-- William Koenig, Chief Actuary Northwestern Mutual
June, 2000 Best's Review, “Don't Forfeit Nonforfeiture.”

Will History Repeat Itself?

THE ARMSTRONG INVESTIGATION of 1905 was not, strictly speaking, a “bolt from the blue.” For some time the weather forecasters in the insurance business had been watching the storm clouds gather. They had heard rumblings from the insurance press, insurance officers, and policyholders, and some of them had predicted the coming of far-reaching reforms. So when the storm broke, the perspicacious were not surprised—they were only astonished at the size of the tempest. Among the signs of the approaching disturbance were the large losses to policyholders resulting from lapses. In 1890 93 percent of policy terminations in fifty-five companies were from lapse, and only 4.9 percent were from death.¹⁵

-- A Century of American Life Insurance: A History of the Mutual Life Insurance Company of New York 1843 – 1943, Shepard B Clough (Columbia University Press, 1946)

Will History Repeat Itself?

“Using recent industry levels of mortality and lapse experience, nearly 88% of universal life policies issued in the United States ultimately do not terminate with the payment of a death claim, according to Milliman USA, a leading actuarial consulting firm. By way of comparison, over 85% of term policies issued in the U.S. fail to result in a death claim. For policies issued to seniors, aged 65, the corresponding percentages of non-claim paying contracts are 76% for universal life and 74% for term insurance.”

Stranger-Originated Life Insurance

- STOLI is the manufacturing of a new life insurance policy by a person that lacks insurable interest.
- STOLI is an investor owning or controlling the policy and/or death benefit from INCEPTION.
- STOLI is NOT the assignment of a valid policy.
- STOLI is NOT a consumer's awareness or intention to utilize market value of the policy for her benefit.
- Existing Insurance Laws Prevent STOLI (insurable interest, rebating, settlement laws)
- State legislatures and regulators are addressing STOLI.

What STOLI Is...

- STOLI is the manufacturing of a new life insurance policy by a person that lacks insurable interest.
- State Bulletins
 - Louisiana
 - Ohio
 - Idaho
 - Alabama
 - Utah
 - New York
 - Et. At.

Existing State Laws Protect Against STOLI

“Insurance departments around the nation are stepping up to the plate to warn senior citizens about abusive STOLI transactions. In California, Texas, North Carolina and Florida, insurance regulators have issued bulletins or backed legislation reasserting the need for an insurable interest to exist at the time an insurance policy was purchased.”

— ACLI “STOLI Alert”, September 2007

Carriers are Addressing STOLI Under Existing Laws

“So I think you've seen for the large life companies a fall-off in STOLI or IOLI.” (ING CEO during Q4 2006 earnings call; February 15, 2007.)

“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 (Lincoln National CEO, Q2 2007 Lincoln National Earnings Conference Call published August 1, 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.)

“[W]e 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.)

LIMRA (September 2008): “STOLI NOT SIGNIFICANT”

Life settlements are a hot topic in the industry, with estimates of the amount of coverage settled increasing and companies citing stranger-originated life insurance (STOLI) as a factor in new premium increases. This market targets a small segment of the population (affluent, age 65 and over), however, and despite the possibility that these large policies may significantly impact company premium, they are not widespread. Less than one third of survey respondents have heard of the concept, and only 1 percent purchase their policy with the intent to sell.

STOLI is NOT a Policyowner's Intent to Assign a Policy

- “The most important factor in determining the parties’ intent is “whether or not the assignment (from the insured to the third party) was done in pursuance of a preconceived agreement.”
- Paulson intended to sell it at the conclusion of the contestability period... Paulson’s intent, however, is irrelevant without facts or allegations suggesting that a third party lacking an insurable interest intended, at the time [the owner] procured the [policy], to acquire the policy upon expiration of the contestability period”

--- *Sun Life Assurance Company of Canada v. Paulson*,
2008 WL 451054 (D. Minn. February 15,2008)

STOLI is NOT a Policyowner's Intent to Assign a Policy

“The evidence shows indisputably that Moore planned to sell all or most of his life insurance policies at the time he applied for them, but the scheme did not involve other parties working together with him to procure policies and immediately effect their assignment.”

“There is no evidence that anyone other than Moore was a participant in the scheme at the time Moore obtained the First Penn policy; at the time he procured the policy he was entitled to do so.”

“Once a policy has been issued, it is an asset of the insured and he or she is free to sell it.”

First Penn-Pacific Life Insurance Company v. William R. Evans, et.al. (2008 WL 1810707, District court of Maryland)

Types of STOLI transactions

- Premium Finance
- Trusts
- Pre-arranged settlements
- 99.9999% of STOLI transactions involve written agreements – *ACLI President Frank Keating*

NAIC and NCOIL comparison of STOLI

	NCOIL	NAIC
Defines STOLI and makes it a fraudulent act.	YES	NO
Prohibits trust-initiated STOLI schemes.	YES	NO
Strengthens state insurable interest laws to prohibit the use of an insured's insurable interest as a "cloak" for a wager policy.	YES	NO
Prohibits advertising "free insurance".	YES	NO
Makes STOLI a "fraudulent life settlement act" and requires settlement companies to have anti-fraud plans that prohibit purchasing STOLI policies.	YES	NO

NAIC and NCOIL comparison of STOLI

	NCOIL	NAIC
Protects consumers against STOLI schemes by authorizing the issuance of consumer disclosures of certain risks related to premium financing where the life insurance policy is used as collateral.	YES	NO
Prohibits “pre-arranged settlements” whereby there is an agreement to sell the policy PRIOR to the application or issuance of the policy or for a two year period from the date of inception of the policy.	YES	YES
Prohibits premium financing transactions whereby (A) the proceeds of the loan are not used to pay premiums, (B) there is a “guarantee of the future life settlement value of the policy”, or (C) the owner agrees to sell the policy at the time of the loan.	YES	YES

NAIC Measures That Do Not Address STOLI

- 5 year ban on life settlements
 - Attacks the property right of assignment
 - Conflicts with life settlement definition
 - Punishes informed consumers
 - Attacks life expectancy evaluations of insureds or policy
- Disclosure to insurers
 - Requires providers to disclose business plans to insurers
- Rescission
 - Expands rescission to 60 days from contract execution or 30 days from release funds

NAIC Measures That Do Not Address STOLI

- Size of and Restrictions on Evidence of Financial Responsibility for Brokers and Providers
- Disclosure of Business Relationships with Investors.

Recap

- Secondary Market is Precisely What GLBA Intended.
- Secondary Market Benefits Consumers
 - Life Settlements
 - Non-Recourse Premium Financing
- Competition Benefits Life Insurance Policyowners
- STOLI is Illegal.
- Life Settlements/Non-Recourse are NOT STOLI
 - WARNING: Carriers Anti-Consumer Market Conduct
- Public Policy: Protect Consumers in Competitive Markets

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