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Vulture Investor Battles for Death-Bet Payouts

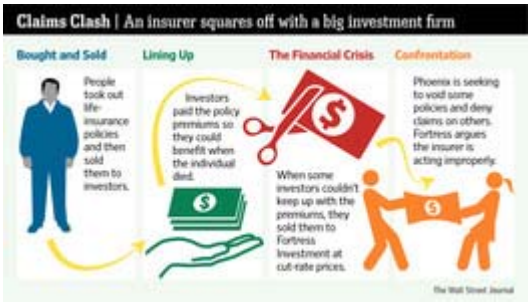
By LESLIE SCISM

Fortress Investment Group, a self-described "garbage collector" of distressed assets, thought it had uncovered another winning junk pile when the market for repurchased life-insurance policies crashed.

Following its usual blueprint, Fortress starting in late 2010 snapped up about 1,000 of these policies at cut-rate prices, then waited to reap the benefits due once the original holders died. The firm had raised a $500 million fund for these "life-settlements," which were available in the bargain bin in part because other investors were struggling to pay the premiums.

Along this path to easy profits, Fortress encountered an unlikely obstacle: Phoenix Cos., a beaten -down insurer with a penchant for suing to void many of the policies that have since been sold to hedge funds and other investors, and denying death claims on some policies.

Phoenix, which issued about 200 of the contracts owned by Fortress, is seeking through lawsuits to shed policies it contends shouldn't have been taken out in the first place. The company alleges that commission-hungry agents defrauded it when they induced older people to take out the policies for the sole purpose of reselling them to investors.



Fortress is fighting back, arguing in court that the insurer improperly denied some of its claims. "We will pursue every course necessary to protect our investors' interest," said Doug Thomas, a managing director for the New York firm, which has $43.7 billion under management.

Phoenix defends its practices and says it will continue to fight what it sees as the improper use of life-insurance policies.

The unfolding fight is the latest sign that the controversial secondary market in life policies remains a treacherous place for investors. In the mid 2000s, money managers piled into life

settlements for their high returns and independence from a volatile stock market. But arcane insurance rules and mounting litigation have caught many sophisticated investors flat-footed.

Less than a decade ago, Phoenix was one of the U.S.'s top-10 life insurers. Its specialty: multimillion-dollar policies wealthy Americans bought to help limit estate taxes. Some of those policies were eventually bought by investors.

Phoenix, of Hartford, Conn., fell hard during the financial crisis, and in 2009 four rating firms sharply downgraded its financial strength—all but stripping the company of its ability to sell new policies.

Since then, Phoenix has focused on selling annuities and consulting services, while paying out claims and managing its remaining liabilities. On its website, the company touts "A history of keeping our promises since 1851."

Phoenix has denied tens of millions of dollars in investors' claims for death benefits since 2007, its regulatory filings show. In 2008, its peak year for challenges, it reported seven claims in dispute, totaling $50 million, or 7.6% of the face amount of claims it received that year. The industry average is less than 1%.

It has been involved in dozens of lawsuits asking courts to void policies. It also boosted the premium rates for keeping in force certain types of policies that are favored by hedge funds and other investors.

Fortress is a practiced distressed-asset investor: It once invested in singer Michael Jackson's debt and bought mortgage-backed securities after the housing market tanked.

The firm has filed four federal suits against Phoenix. One contends the insurer's rate increases breach its contracts; the others allege Phoenix has improperly denied $33 million in benefits from three deaths since November.

Fortress has lobbied legislators in Connecticut and other states to pass laws to protect policyholders' rights to sell to investors and other matters relevant to investor-owners. And it has pushed regulators to probe alleged bad-faith practices at Phoenix and other insurers. It is unclear if any inquiries are under way.

Phoenix says it has done nothing wrong. "We take seriously the instances where there is misrepresentation, fraud or the misuse of insurance policies as wagers on human life, and where appropriate, take action," said Gina Collopy O'Connell, a senior executive. The company pays all valid claims, she added.

Insurers have filed several hundred lawsuits since 2008 seeking to void policies and keep some or all of the premiums, attorneys estimate. Meanwhile, several state and federal prosecutors have brought criminal actions alleging fraud by agents and other middlemen who sold the policies. Judicial rulings and jury verdicts have been mixed.

Investors often assert that insurers failed to properly vet their customers' applications and should be forced to honor what they sold. In some lawsuits, investors argue that Phoenix's managers had

encouraged investor-driven sales to boost revenue and their own compensation. Phoenix said it continually takes appropriate steps to screen out fraud.

Fortress made its push into the market in late 2010, when its executives believed that prices had fallen far enough to justify the risks, people familiar with its thinking said. The policies it bought were all past the standard two-year contestability period, Mr. Thomas said.

But Phoenix has continued to bring lawsuits. It filed seven suits in federal court on a single day in March, in the wake of a state Supreme Court ruling that makes it easier for insurers to challenge older policies.

Some market participants speculate that Phoenix finds it more worthwhile than bigger insurers to bring such suits because each multimillion-dollar policy it voids represents a meaningful reduction in its liabilities. Phoenix posted $8.1 million in net income for 2011, reversing a loss of $12.6 million in 2010.

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