

**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**

<u>Life Settlements Defined</u>	1
<u>Why Life Settlements are beneficial to seniors</u>	1
<u>Risks to seniors posed by life settlements</u>	2
<u>Specific abuses and challenges that must be addressed</u>	5
<u>Suggestions for reducing risks and abuses</u>	9

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](#).