

Life Insurance Settlement Series Edition No. IV

## Blurring the Lines Between Truth and Myth

What is a life settlement?

What is a STOLI?

What is right for you?

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### A Request for Objective Information to Help Seniors

For the benefit of consumers, we are asking all publishers in the media to edit out fabrications and sensationalism in articles that describe financial, legal, and retirement matters for seniors and to assure such articles are thoroughly researched and accurately reported. We are asking all publishers to help educate consumers with fair and useful knowledge. It is to the benefit of consumers that they are allowed to make decisions based on factual information.

The recent upsurge in media coverage on topics related to selling life insurance policies (“life settlements”) renews our attention to the study ISI completed in September, 2009, “Portrayal of Life Settlements In Consumer-Focused Publications.” In this study, it was observed that “information about the life insurance secondary market (LISM) available to seniors is both sparse and inconsistent.” While some recent media articles defend the valued option enjoyed by a few seniors to sell a life insurance policy to investors,<sup>1</sup> other articles blur the lines between truth and myth of the life settlement option and what it can actually provide to seniors.<sup>2</sup>

Misconstrued information about Stranger Originated Life Insurance (“STOLI”) policies, such as in a recent article in the ACLI News Release,<sup>3</sup> is a clear example of erroneous reporting. Misleading articles like this leave readers misinformed,

confused, and distrustful of something that should make them feel good. Selling a life insurance policy as a life settlement is not right for everyone, but how can the consumer consider the option without fair and objective information? There is a fundamental need to educate consumers, particularly seniors, about the advantages and disadvantages of life settlement transactions. But disbursing fear and emotionally-charged language in unfair, misinformed, misguided, and distrustful articles is being disingenuous to those who desire and need to choose the best options available to manage their retirement and estate finances.

### Understanding the Investors’ Risks

The concept that investors are “betting on death” is wrong, extraneous, and intentionally designed to establish fear in the readers’ minds. Death is certain for everyone. In all walks of life there are situations where early or later death can have various impacts on subsequent events. Some survivors will benefit more or less, e.g., inheritance, business control, new freedoms, or political influence. So, why describe investors in life insurance policies as being any different than insurers who are betting on the mortality of the insured they cover with life insurance policies and annuities?

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The premise for accumulating a portfolio of life insurance policies is essentially the same as writing a series of annuity contracts. If the annuity provider were to write a single annuity on just one life, it could be argued that they were indeed betting on when that person will die. If the person dies sooner, the annuity writer experiences a greater profit. If that person lives longer, the annuity writer could end up losing money. While this could be considered a form of “betting on death,” most people see this as a financial business transaction designed to enhance the annuitant’s welfare in exchange for a risk weighted profit for the insurer. And likewise, life insurance settlements are designed to enhance the seller’s welfare in exchange for a risk weighted profit for the investor.

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To avoid the high win/loss mortality risk represented by a single life, investors in life insurance policies and annuity providers seek to spread their financial risk over a large number of lives. For example, when an annuity writer amasses a large portfolio of contracts using mortality projections the gains on policies that mature earlier than expected will be offset by the losses on those that mature later than expected. The mortality estimations, which are derived from a mortality curve, become increasingly more accurate and reliable as more contracts are added to a portfolio. This accomplishes the goal of reducing risk. Investors in life insurance policies share many financial profit/loss risks with insurers.

Annuity writers and legitimate investors in life insurance policies do not wish to “bet the farm” on a handful of policies or contracts. They are not “betting on death,” but rather they are carefully offering financial transactions that project profits based on normalized mortality tables. They do this while providing financial payments in lump sums or as annuity streams that provide valuable benefits to the policy sellers and the annuity purchasers. These are designed to be win-win transactions.

## The Insurance Studies Institute

ISI is a non-profit research think-tank focused on: a) researching and analyzing challenges and opportunities within the many paradigms of insurance based risk management; b) publishing research findings on industry relevant topics; c) educating industry stakeholders, public policy makers and consumers in insurance based risk management, and advancing related scholarship; and, d) promoting dialogue to foster industry advancements, fair public policy and greater risk protection for consumers.

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[www.InsuranceStudies.org](http://www.InsuranceStudies.org)

## Understanding and Avoiding STOLI

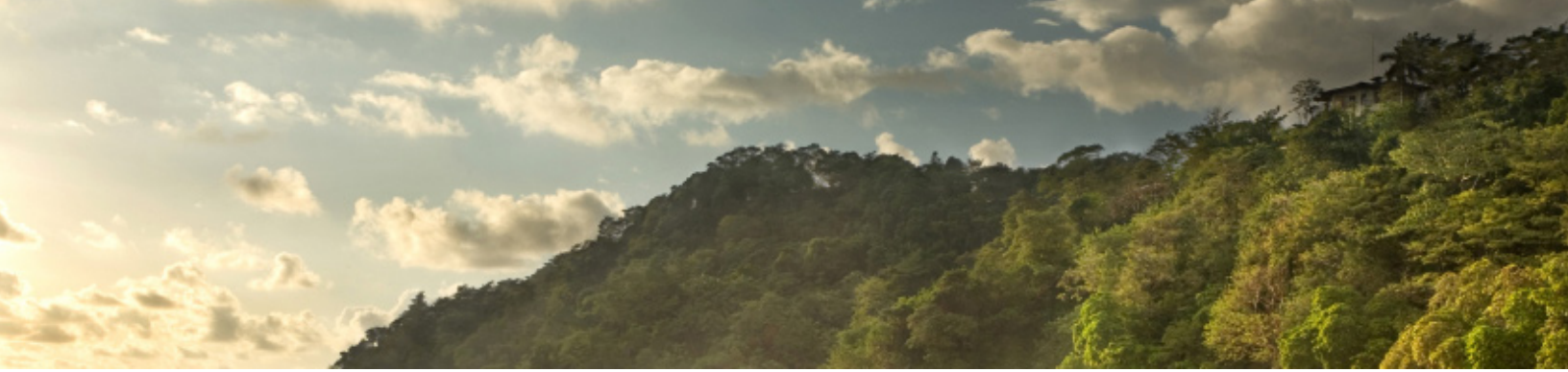
Articles reporting on Stranger Originated Life Insurance (“STOLI”) often confuse legitimate life settlement practices with illegal STOLI transactions. Purveyors of such myths are either woefully misinformed, poorly read, or are intentionally using deceitful tactics to imply that life settlement transactions or life settlement firms are illegitimate. This is wrong. Like the nation’s prominent insurers and banks, the prominent life settlement providers, brokers, agents, and investors do not seek to circumvent laws or take advantage of loopholes in the system. They work within the framework of established statutes and case law to provide legitimate property rights to those wishing to sell their life insurance policies.

A life settlement is a legal transaction whereby the owner of a life insurance policy sells his or her life insurance policy in return for an amount that exceeds the cash surrender value. In contrast, a STOLI is an illegal transaction where a third party, authorized to sell life insurance policies but having no “insurable interest” in the insured, convinces a person to take out a life insurance policy with an agreement that the third party will assume ownership of the policy in return for some sort of compensation. If that sounds complicated, it is, and it should be avoided.

The prominent operators in the life settlement industry adamantly oppose STOLI and have sought laws and regulations to stomp out STOLI activities. Already, the refusal of life insurance policy investors to purchase policies that come from STOLI transactions is helping to stop the practice. However, for a STOLI to occur a life insurance sales agent has to enable the insured to submit a policy application to the insurer and the insurer has to issue the policy. This is where fraudulent STOLI activities begin. This is where STOLI transactions must be stopped.

Consumers need to understand how to identify a STOLI transaction. Most simply, if a life insurance sales agent suggests that you should consider submitting an application for a large policy (\$1,000,000 or more) and you question your ability to justify or pay for such a policy, start questioning the agent’s intent. If the agent or some associate of the agent suggests that they will guarantee payment of the premiums and will undertake to get the policy issued, be wary. If the agent or their associates suggest that you create a special entity to own the policy along with the execution of an agreement that determines who will be the owner of the policy, and/or they offer some compensation or special consideration for your participating in the transaction, walk away.





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Attempts to confuse legitimate life settlement practices with STOLI transactions are harmful to investors, public policymakers, and consumers. Misinformation detracts from genuine efforts to pass legislation needed for transparency which will help flush out and stop STOLI at its source.

## **So is a Life Settlement the Right Option?**

Life insurance is a valuable asset and consumers are wise to purchase it. Life insurance provides a safety net for survivors and beneficiaries. However, many changes occur when you enter retirement, and one must consider all available options that can enhance enjoyment throughout retirement. One potentially very good option may exist if you own a life insurance policy. If that policy is no longer needed as a safety net or you can no longer afford the premiums, you may be able to sell it for an attractive price in the life insurance secondary market. Of course, another option is to allow the policy to lapse or to surrender it, but why do that if you can get more money by selling it? Life settlements may not be right for everyone, and deciding whether to keep a policy or sell it requires careful thought.

When contemplating the sale of a life insurance policy, be sure to assess the original reason the policy was purchased and determine if those reasons are still a consideration. If your life insurance was purchased to settle debts or obligations of the estate and not having it would burden your survivors with those debts or obligations, it may make sense to keep the policy.

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<sup>1</sup>“A new lease on life insurance,” The Miami Herald, December 13, 2009, and “New Life In Death Benefits Some Funds Are Consistently Delivering About 10pc Per Annum In This Relatively New Asset Class,” Sunday Telegraph, November 29, 2009.

<sup>2</sup>“Grim Risks of Reaping Death’s Rewards,” Wall Street Journal, February 6, 2010, and “5 Things You Need To Know About Life Settlements,” Money Magazine, January/February, 2010.

<sup>3</sup>“Life Insurers Urge Policymakers To Ban Securitization Of Life Settlements,” ACLI News Release, February 3, 2010.

If your survivors will be dependent on the death benefits to fund living expenses or health care, then a life settlement may not be the best option. Finally, if it is not a burden to pay the premiums on the policy and there is a desire to leave a large sum of money to survivors or beneficiaries, then it may make sense to keep the policy in force.

The considerations involved in selling a life insurance policy are many and some are complicated. You should seek all available information and consult your financial advisors. Perhaps you know other seniors who have sold their policies. Insurance Studies Institute has published a guide to help you think through this difficult decision.

You can find the guide at: <http://www.insurancestudies.org/Consumers/ConsumersGuideInsuranceStudiesInstitute.pdf>  
Read it. Think about it. Be sure that selling your policy is the right option.

To learn more link to:  
[www.InsuranceStudies.org](http://www.InsuranceStudies.org).

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