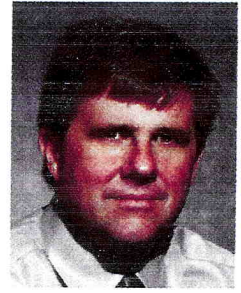


Life Settlement Regulation

By Steve Shorrock, ChFC, CLTC, FLMI



Life settlements, the secondary market for life insurance policies, have attracted much attention from the media, consumers, institutional investors, financial advisors, and the primary market insurers. As a result, regulators and policy makers are also tuning in.

Life settlement-backed securities have seen tremendous growth in the past 12 months, expanding in 2006 to approximately \$12 billion. While this is still a fraction of what some predict it will be in 10 years, it represents a significant increase over the prior year.

The National Association of Insurance Commissioners (NAIC) adopted a new Model Regulation for Viatical Settlements at their recent meeting. This contains some troubling provisions which unnecessarily abridge consumer rights and could inhibit participation in the secondary market by financial advisors. Moreover, both the process and the end-product have been widely criticized as deeply flawed.

The model act has a five-year prohibition on the sale of "financed" insurance policies. While this provision is ostensibly designed to curtail so-called STOLI policies ("manufactured" life insurance policies specifically for sale into the secondary market), the language is broad, ambiguous and could be construed to capture many fully legitimate policies. The act requires disclosures to sellers, including "all offers and counter-offers . . ." and full disclosure (in dollars) of any and all compensation received by anyone involved in the transaction. Also, "life settlement brokers" (including agents working with brokers) would have to

post \$250,000 in cash, surety bond or certificates of deposit to "demonstrate financial responsibility."

So far, only North Dakota has enacted legislation based on the new model. The National Conference of Insurance Legislators (NCOIL), representative of policy makers who will consider such legislation, has largely rejected the NAIC approach. NCOIL, which is developing its own model, has been much more open and consultative than the commissioners (regulators). Some troubling provisions in the NAIC model act have already been rejected or substantially revised in the NCOIL version, which is expected to be finalized this fall. Since many states are expected to take up this legislation in 2008, a good model bill from NCOIL, as a constructive alternative to the NAIC model, could be very helpful.

The real action now moves back to the states—New York in particular. There was a strong push to pass a bill near the end of the last legislative session, but both the Insurance Department and sponsoring legislators recognized that further work was needed. There is determination, however, to have a bill ready for action at the beginning of the next legislative session. Since New York is an important state with a strong regulatory framework, the outcome is likely to influence what happens in other states.

Along with these model bills, other life settlement issues important to financial advisors are on the legislative docket. Items:

- ◆ Licensing standards for life settlement brokers and life insurance agents involved in the life settlement process.

- ◆ Disclosure provisions (including the disclosure of commissions).
- ◆ Standards for financial responsibility (requirement for fidelity bonds and/or E & O coverage).
- ◆ Provisions to prohibit (or at least curtail) the manufacture of new life policies for sale into the secondary market.
- ◆ Privacy issues and the ability of owners of settled policies to transfer ownership of those policies in the future.

Many of these issues potentially have implications for primary market participants as well. Commission disclosure, for example, could be a very slippery slope. The desire to "stop STOLI" will also have implications for life insurance agents and their clients. The five-year ban on the settlement of all financed policies clearly threatens consumer rights. Other anti-STOLI initiatives are likely to be squarely aimed at life insurance agents who are seen to be involved in such transactions.

As life settlement brokers, we strongly support regulation that prohibits STOLI activities, protects privacy and preserve consumers' rights. **FA**

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