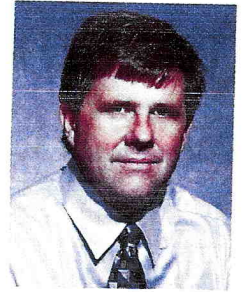


The Vast Difference Between Life Settlements and STOLI



Steve Shorrock

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Stranger-owned life insurance, called STOLI or SOLI, has been discussed at length by those opposed to the life settlement industry, specifically because it confuses the real issue.

All life settlements are ultimately “stranger-owned life insurance,” but it is well established by both practice and case law that the owner of a legitimate in-force life insurance policy has the right to sell it—even to a third party who has no valid insurable interest in the life of the insured. The problem is insurance initiated—or “originated”—by a third party who does not have an insurable interest.

Although many people confuse the two, life settlements and what are more properly called Investor-Initiated Life Insurance (IILI) are very different. A legitimately owned life insurance policy, in force for more than two years, that is no longer wanted or needed, or which is no longer affordable, can legally be sold as a life settlement. Life settlements can be an excellent exit strategy under those circumstances. During the past five years, life settlements have returned \$5 billion above Cash Surrender Value to policyowners.

Investor-Initiated Life Insurance involves the issuance of a new life insurance policy where the owner of the policy (directly or indirectly) lacks a bona fide insurable interest in the life of the insured. Essentially, an investor induces a consumer to purchase a life insurance policy and pays the premium, either directly or via a premium finance

agreement, and effectively “owns” the policy from inception. The investor then continues to pay the premium and eventually collects the proceeds when the insured dies.

For example, a financing organization will approach an agent who has, say, a client 75 years old, a net worth of \$3 million and \$500,000 worth of life insurance. He offers a \$2.5 million policy free and 2-5% of the death benefit up front. The client pays no premiums and finances the premium forever until he dies, at which time the finance company collects the death benefit. This is a bad deal. The insurance is written for the sole purpose of selling to an investor. Non-recourse: We don’t care if you default; we’re going to sell that policy. It’s transactions such as this that taint the market and the industry.

Many confuse the two

IILI transactions can have adverse consequences for seniors: unexpected income tax liabilities, credit score issues, limits on future insurability and (potentially) higher life insurance rates in the future. Unlike life insurance proceeds, which are generally exempt from income tax, any monies received in an IILI transaction are fully taxable.

LISA, the Life Insurance Settlement Association, is against IILI/STOLI as it

violates the purpose of life insurance as well as insurable interest laws.

The principle of insurable interest is fundamental to the business of life insurance. Insurable interest laws exist in virtually every state or country where life insurance is sold. IILI transactions are inappropriate and illegal and represent a legitimate public policy concern. Unfortunately, many of the proposed “solutions” to the IILI problem are focused on the secondary market and unnecessarily limit the legitimate property rights of consumers rather than attacking the *real* problem, which is at the inception of the policy.

Especially being a former life company CEO, I strongly support regulation that prohibits IILI activities while still protecting consumers’ rights and privacy and promoting a transparent and efficient secondary market.

Life settlements can be a wonderful exit strategy and provide financial advisors the opportunity to reconnect with clients and sell them new services. Indeed, you have the fiduciary responsibility to discuss this option within your clients’ financial plan. **FA**

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