

THE FLORIDA OFFICE OF INSURANCE REGULATION



SECONDARY LIFE INSURANCE MARKET REPORT TO THE FLORIDA LEGISLATURE

DECEMBER 2013

EXECUTIVE SUMMARY

The Florida Legislature directed the Office of Insurance Regulation to “review Florida law and regulations to determine whether there are adequate protections for purchasers of life insurance policies in the secondary life insurance market to ensure that this market continues to exist for Florida seniors.” In preparation for this report, the Office held an informational public hearing, accepted materials and comments, and surveyed Florida life insurance companies.

Florida law requires that insurable interest exist at inception under a life insurance contract. If the owner of a policy lacks an insurable interest in the life of the insured, the policy is void *ab initio* because it is considered a “wagering contract” contrary to public policy. After inception, the policy is an asset that may freely be sold, transferred, or devised. The initial sale of a life insurance policy in Florida is a “viatical settlement,” which is governed by statute. Viaticated policies may then be sold to an investor in the “secondary market.” The secondary market may contain policies that were not transacted through licensed viatical settlement providers.

Stranger-Owned Life Insurance (“STOLI”) is one of the many schemes that have arisen in the history of the viatical settlement industry. STOLI is a scheme to initiate a life insurance policy for the benefit of a third party investor that, at inception of the policy, had no insurable interest in the insured. STOLI policies are distinct from legitimately obtained policies; often obtained via fraudulent means; designed to circumvent insurable interest laws; and usually conducted so as to conceal from life insurance companies the subsequent transfer of ownership.

The size of the secondary life market in Florida is difficult to assess. The licensed viatical settlement providers have reported a large number of viaticated policies and a large total face value of viaticated policies. A much smaller number and face value of policies were identified as viaticated by the surveyed life insurance companies, indicating that they may be

largely unaware of which policies on their books have been viaticated and, consequently, may not be adequately prepared for expenditures that will arise upon the maturity of the policies. It is unknown how many viaticated policies or other life insurance policies have been sold on the secondary market.

At the hearing, interested parties expressed differing views as to the legislative directive. Fortress Investment Group (a large secondary market investor) asserted that “a small handful” of insurance companies pose a threat to the market by claiming a lack of insurable interest, asking courts to invalidate policies from inception, and seeking to retain the premiums. Fortress proposed five legislative changes: (1) make subjective intent irrelevant to insurable interest; (2) prohibit insurable interest challenges after the contestable period; (3) require a notice of validity of a policy from insurance companies within ninety days of inquiry; (4) require return of premiums to the policyowner if a policy is voided; and (5) monitor cost-of-insurance rate increases.

The American Council of Life Insurers (ACLI) contended that the legitimate markets are “doing just fine” and that the policies Fortress purchased were STOLI. ACLI asserted that whether a particular policy can be rescinded, whether an insurable interest existed, and whether premiums are returned depend on the facts of each individual case. ACLI opposed Fortress’s proposals because there is no need for legislation if this is a one-company issue, it would be difficult to legislate fairness, and the legislation would encourage toxic assets in the marketplace.

The Life Insurance Settlement Association (LISA) asserted that the litigation at issue does not concern policies transacted through a regulated viatical settlement, as STOLI is designed to circumvent this system. In LISA’s view, the law should require the return of premiums if the policy has gone through a regulated viatical settlement transaction, which involves a level of scrutiny and diligence. LISA also raised five issues that it asserted impede

the ability of seniors to enter into a viatical settlement or diminish the value received.

The Institutional Longevity Markets Association (ILMA) supported each of Fortress's proposed legislative changes, stating that institutional investors seek protections because they have limited access to information to evaluate policies in the secondary market. In ILMA's view, insurance companies are in the best position to conduct the proper diligence at policy origination. ILMA asserted that there is uncertainty in the market and that issues such as whether a policy can be challenged after the two-year contestable period are not settled in the case law.

Jim Tollerton of Professional Benefits spoke as a typical Florida insurance agent, stating that an agent is in the business of insuring lives for families, businesses, and charities, and that the vast majority of legitimate agents in Florida have no interest in participating in the viatical settlement market because of the ongoing problems that naturally happen once a policy is sold.

The Florida Insurance Council (FIC) asserted that life insurance companies do, in fact, conduct the proper diligence in underwriting, but may receive falsified or misleading documents. With respect to premium-return, FIC argued that a court needs to be able to assess the facts of each case in order to dispense equity.

Based on the evidence and testimony provided, the Office concludes that there appear to be adequate protections for purchasers of life insurance policies in the secondary life insurance market. The five legislative changes proposed by Fortress, and supported by ILMA, appear to be proposed in order to address the actions of a small handful of insurance companies. The courts are addressing these issues based on the fact-specific circumstances of each case, and there is a significant concern that enacting these legislative changes may have the unintended consequence of encouraging STOLI and fraud. The treatment of life insurance solely as a commodity from inception is at odds with the purpose of life insurance and may have negative ramifications for

the industry, to the detriment of Florida consumers, life insurance companies, and the legitimate viatical settlement industry. The Office has identified issues that may merit further investigation administratively, but has no recommendations for legislative action at this time.

TABLE OF CONTENTS

EXECUTIVE SUMMARY.....	1
I. INTRODUCTION	6
II. BACKGROUND & OVERVIEW	7
A. Definition of “Secondary Market” and “Viatical Settlements”	7
B. History and Regulation of Viatical Settlements in Florida.....	8
C. Current Law Governing Insurable Interest, Viatical Settlements, and the Secondary Life Insurance Market.....	13
III. SECONDARY LIFE INSURANCE MARKET REVIEW	17
A. Florida Market Size.....	17
B. Viewpoints Presented at the Hearing.....	21
1. Fortress Investment Group.....	22
2. American Council of Life Insurers (ACLI)	25
3. Life Insurance Settlement Association (LISA).....	29
4. Institutional Longevity Markets Association (ILMA).....	31
5. Professional Benefits, Inc.	34
6. Florida Insurance Council (FIC).....	35
C. Legislative Changes Proposed by Fortress	36
1. Make subjective intent irrelevant to insurable interest.	36
2. Prohibit insurable interest challenges after the two-year contestable period.....	39
3. Require a notice of validity from the insurance company within 90 days of inquiry.....	41
4. Require return of premiums if a policy is voided.	43
5. Require monitoring of any cost-of-insurance rate increases.....	47
D. Legislative Issues Asserted by LISA	48
1. Nonpayment of interest on death claims.....	48
2. Unauthorized changes of ownership data by insurance companies.....	49
3. Obstruction in obtaining verification of coverage.	49
4. Preventing life insurance producers or agents from advising or being involved in viatical settlement transactions.	49
5. Life expectancy provider registration requirement.....	50
IV. CONCLUSION.....	50

I. INTRODUCTION

The Florida Legislature directed the Office of Insurance Regulation (the “Office”) to “review Florida law and regulations to determine whether there are adequate protections for purchasers of life insurance policies in the secondary life insurance market to ensure that this market continues to exist for Florida seniors.”¹

The Office conducted an informational public hearing with respect to the legislative directive in Tallahassee, Florida, at the Knott Building, Room 412, Capitol Complex, on October 25, 2013. The hearing was broadcast via the Internet and was recorded by the Florida Channel.² A transcript is attached as Appendix A. Presenters at the hearing were Fortress Investment Group (an investor in the secondary life insurance market); the American Council of Life Insurers (ACLI); the Life Insurance Settlement Association (LISA); the Institutional Longevity Markets Association (ILMA); Professional Benefits, Inc. (an insurance agent); and the Florida Insurance Council (FIC). The presenters expressed differing views on the issue presented.

In addition to holding the public hearing, the Office also accepted materials and comments via e-mail. The materials and comments received are available on the Office’s website at <http://www.floridachannel.com/Sections/LandH/SecondaryLife.aspx>.

In preparation for this report, the Office also conducted a survey of Florida life insurance companies to inquire as to their knowledge of the status of their policies and whether those policies had potentially been viaticated or sold on the secondary market. The survey asked, as of June 30, 2013, for the number and face value of Florida in-force policies owned by a trust, owned by a bank or financial institution, financed through a premium-finance company or other

¹ Ch. 2013-40, §6, at 316, Laws of Fla.

² The video of the hearing can be viewed at <http://thefloridachannel.org/video/102513-office-of-insurance-regulation-hearing-on-secondary-life-market>.

structured loan program, and that have been viaticated. The survey allowed responses to these questions based on estimates. The survey also asked each company whether it has procedures in place to evaluate the impact of viaticated policies on the net-present-value of the life insurance book of business. Of the 426 companies surveyed, 393 completed the survey. Of those companies, 327 have active in-force life insurance policies in Florida that could be subject to viatication. The survey questions and a summary of the results are attached as Appendix B.

II. BACKGROUND & OVERVIEW

A. Definition of “Secondary Market” and “Viatical Settlements”

The Florida Administrative Code defines the “secondary market” as the “assignment, transfer, sale, devise, or bequest of the death benefit or ownership of all or a portion of a viaticated life insurance policy or viaticated certificate of insurance.”³ A “viatical settlement,” or viaticated life insurance policy, is a life insurance policy that has been sold by the policyowner in exchange for compensation or anything of value, usually for more than the policy’s cash surrender value, but less than the face value of the policy. The purchaser becomes the new owner, assigns the beneficiary or beneficiaries, and is responsible for making future premium payments. Although a distinction is often made in the terms used based on whether the insured is terminally ill—“viatical settlement” for terminally ill insureds and “life settlement” for everyone else⁴—Florida law does not make this distinction.⁵ Accordingly, this report will use the term “viatical settlement contract” or “viaticated policy” regardless of whether the insured was terminally ill when the policy was sold.

³ Fla. Admin. Code R. 69O-204.020(2).

⁴ See, e.g., James Vlahos, *Are You Worth More Dead Than Alive?*, N.Y. TIMES (Aug. 10, 2012), available at <http://www.floir.com/siteDocuments/FortressANYTArticleAreYouWorthMoreDeadThanAlive.pdf>.

⁵ See § 626.9911(10), Fla. Stat. (defining viatical settlement contract); see also Chapter 626, Part X, Fla. Stat. (governing viatical settlement contracts).

B. History and Regulation of Viatical Settlements in Florida

Since the regulation of viatical settlements came under the purview of the Florida Department of Insurance (“Department”)—now the Office⁶—in 1996, the Office has endeavored to protect not only the insureds, but also consumers investing in the viatical settlement market, through seeking the passage of legislation as well as examining viatical settlement providers. The Office has encountered a number of fraudulent practices⁷ detrimental to Florida consumers, life insurance companies, and the legitimate viatical settlement industry. Accordingly, the Office has, and continues to, endeavor to uncover and address fraudulent practices.

Early viatical settlements offered an alternative way to provide terminally ill individuals with the necessary money for medical and living expenses in their final days. Specifically, the idea of viatical settlements developed in the mid-1980s to allow AIDS patients to sell their existing life insurance.⁸ Many of these patients had short life expectancies and lacked the money to pay for their medical bills and treatments. In order to address this need, some individuals and companies began offering to purchase the patients’ life insurance policies for a portion of the death benefit amount, giving the patients money to pay their bills.⁹

In 1996, the Florida Legislature established a framework for the regulation of the viatical settlement industry, commonly referred to as the “Viatical Settlement Act” (the “Act”).¹⁰ The initial purpose of the Act was to protect policyowners selling their policies by requiring licensure of viatical settlement providers and viatical settlement brokers. Subsequently, in late 1997 and

⁶ Before 2003, the entity regulating, among other things, life insurance companies and viatical settlement companies was the Florida Department of Insurance. In 2003, the Department was reorganized, and the Office is now the entity tasked with regulating and licensing these companies.

⁷ See Transcript of Secondary Life Insurance Market Public Hearing (Oct. 25, 2013), at 137 (attached as Appendix A).

⁸ Susan Lorder Martin, *Betting on the Lives of Strangers: Life Settlements, STOLI, & Securitization*, 13 U. PA. BUS. L. 173, 174 (2010) (providing an overview of the early viatical settlement industry), available at <https://www.law.upenn.edu/journals/jbl/articles/volume13/issue1/Martin13U.Pa.J.Bus.L.173%282010%29.pdf>.

⁹ See generally *id.* at 184-86 (providing an overview of the early viatical settlement industry).

¹⁰ See ch. 96-336, Laws of Fla. The Viatical Settlement Act is now codified as Part X, Chapter 626, Florida Statutes.

1998, the Department began to receive numerous investor complaints from individual investors who were not receiving promised returns because the insureds were outliving estimated life expectancies. The typical investors of these viatical settlements were individuals, often seniors who had risked their life savings in what was represented as a safe investment and marketed as a compassionate way to help dying individuals.¹¹ With the advent of new, more effective drugs and medical treatments, the insureds had begun living longer and, in some cases, outlived investors.

The Act at this point did not specifically provide for regulation of investments. The Act did, however, authorize the Department to conduct pre-licensure examinations of viatical settlement provider applicants. In early 1998, during one such pre-licensure examination, evidence revealed, among other things, that the subject company knowingly and willfully engaged in the business of buying and selling “cleansheeted”¹² insurance policies. As a result, the company’s application was denied, and two of its officers were indicted and convicted of fraud. Subsequent examinations conducted by the Department of other licensed providers and applicants disclosed that such business practices appeared to be commonplace and widespread throughout the viatical industry.

Meanwhile, in view of increasing consumer complaints, mostly from individuals who had invested in viaticals, the Legislature enacted additional consumer protection legislation. In 1999, the Legislature gave the Department jurisdiction over viatical settlement purchase agreements, required minimum disclosures to purchasers, and prohibited fraudulent or misleading practices.¹³

¹¹ See Tom Stieghorst, *Questions Haunting Viatical Firm*, SUN SENTINEL (May 16, 2004), available at http://articles.sun-sentinel.com/2004-05-16/business/0405141212_1_doris-barrilleaux-mutual-benefits-regulators.

¹² “Cleansheeting” is the practice of obtaining life insurance policies via materially false information.

¹³ See ch. 99-212, Laws of Fla. (codified as § 626.9911, Fla. Stat. (1999)).

As a consequence of insureds outliving their projected life expectancies, some viatical settlement providers ceased new sales of policies. Other viatical settlement providers engaged in pyramid schemes, escalating new sales of policies to generate revenue to pay past obligations. One such example of a company participating in a pyramid scheme was Mutual Benefits Corporation (“MBC”), a Florida viatical settlement provider. In 2004, the Office filed an action against MBC and suspended its license. Simultaneously, the United States Securities & Exchange Commission (“SEC”) filed an action in the federal district court seeking an injunction and the appointment of a receiver. The receiver appointed by the court reported that MBC had procured, through fraud, insurance policies with a total face value of as much as \$1.4 billion. In December 2005, the SEC agreed to a \$25 million settlement in its civil action against MBC, Joel Steinger, Steven Steiner, and MBC’s president, Peter Lombardi, and referred the case to prosecutors for criminal proceedings. The civil case against MBC, *S.E.C. v. Mutual Benefits Corp.*, established a precedent that investments in viatical settlement contracts are securities under federal law.¹⁴

Federal prosecutors charged former company employees, including Mr. Lombardi, most of whom pled guilty and were sentenced to lengthy prison terms.¹⁵ In a factual statement filed with his plea agreement, Steven Steiner acknowledged that he and other MBC employees falsely promised investors a fixed rate of return. However, MBC could not deliver on those inflated returns, because the insureds continued to live longer than expected, and their premiums had to be paid to keep the underlying policies in force. The scheme relied on sales growth to generate new investor dollars in order to continue to pay premiums on previously viaticated contracts.

¹⁴ *S.E.C. v. Mutual Benefits, Corp.*, 408 F.3d 737, 738 (11th Cir. 2005).

¹⁵ Joel Steinger and a one-time MBC lawyer, Anthony M. Livoti Jr., are the only remaining defendants in the case. Livoti’s trial is currently ongoing in federal court. Joel Steinger recently received another postponement.

Viatical investment scams in Florida resulted in losses to investors, many of whom were seniors. As of April 22, 2009, the impact of these scams was as follows (may include nationwide book of business):

Company	Face Value of Policies Sold to Investors
Justus Viatical Group	\$ 2 million
American Benefit Services / Financial Federated Title & Trust	\$ 117 million
Accelerated Benefits Corporation	\$ 114 million
Future First Financial Group, Inc.	\$ 203 million
Resource Funding Group / Viatical Capital / Life Settlement Network	\$ 61 million
Lifetime Capital	\$ 100 million
Mutual Benefits Corporation	\$ 1.4 billion

A list of all Florida regulatory and enforcement actions pertaining to viatical settlement providers from October 1, 1996, through November 30, 2013, is attached as Appendix C.

A practice known as Stranger-Originated Life Insurance (“STOLI”) was the next in a long line of schemes. STOLI policies are distinct from legitimately obtained policies. Generally, a party purchasing life insurance must have an “insurable interest” in the person being insured at the inception date of coverage under the life insurance contract.¹⁶ STOLI is a scheme to initiate a life insurance policy for the benefit of a third party investor that, at inception of the policy, had no insurable interest in the insured and seeks to profit by purchasing life insurance on a stranger.¹⁷ In a typical STOLI transaction, the promoters and investors may establish an irrevocable trust, obtain an insurance policy on a senior, obtain a premium-finance loan, and pay the life insurance policy premiums for two years (*i.e.*, the contestable period). The money needed to pay these premiums, which can be substantial, is financed through premium-finance

¹⁶ See § 627.404(1), Fla. Stat.

¹⁷ Fla. Office of Ins. Regulation, *Report on Stranger Originated Life Insurance (“STOLI”) and the use of Fraudulent Activity to Circumvent the Intent of Florida’s Insurable Interest Law*, at 12 & n.18 (Jan. 2009), available at <http://www.flair.com/siteDocuments/STOLIRpt012009.pdf> [hereinafter STOLI Report].

lenders.¹⁸ Typically, these premium-finance loans are non-recourse loans, meaning that the life insurance policy is the only collateral for the loan and the premium-finance lender can pursue only the collection of the collateral if there is a default.¹⁹ The beneficial interest in the trust is then sold without the life insurance company being aware of the sale, as the trust remains the policyowner in the insurance company's records.²⁰

STOLI transactions often use fraudulent means such as misrepresentation, falsification, or omission of material facts in the life insurance application.²¹ This may also entail misrepresenting the true net worth of the applicant to obtain large face value life insurance policies.²² Further, STOLI policies are designed to circumvent insurable interest laws, and the sale of the policy is usually completed after the two-year contestable period has expired.²³ Finally, as illustrated above, STOLI policies are usually conducted in such a manner so as to conceal the sale from the life insurance company. More information regarding STOLI can be found in the Office's *Report on Stranger Originated Life Insurance ("STOLI") and the use of Fraudulent Activity to Circumvent the Intent of Florida's Insurable Interest Law* (January 2009), which is available at <http://www.floir.com/siteDocuments/STOLIRpt012009.pdf>.²⁴

The viatical settlement market in Florida has evolved since its inception—both in the kind of policies being transacted by viatical settlement providers and the type of investors that are investing in these policies. The market now encompasses more than the sale of policies for terminally ill insureds. Viatical settlements of policies for non-terminally ill insureds, often

¹⁸ *Id.* at 14.

¹⁹ *Id.* However, not all life insurance policies obtained by the usage of a non-recourse loan are STOLI transactions. *Id.*

²⁰ Transcript at 119-21.

²¹ STOLI Report, *supra* note 17, at 12.

²² *See id.* at 2.

²³ *Id.* at 14.

²⁴ *See also* Martin, *supra* note 8, at 187-88.

called “life settlements” (a term used by many of the participants at the public hearing) offer the opportunity for some insured individuals who no longer want, need, or can afford their life insurance policies to sell them. Rather than allowing a policy to lapse and forfeiting the value or selling the policy back to the insurance company for the current cash value, an insured can sell, or “viaticate,” the policy for more money than he or she would receive if the policy was surrendered. According to a source submitted by Fortress, one study calculated that an individual with a \$2 million life insurance policy can receive up to \$300,000 more for it in the viatical settlement market than by surrendering it back to the insurance company.²⁵

The individual investors involved in the early viatical settlement market have since been replaced primarily by institutional investors and investment firms, such as hedge funds or pension funds, which often invest in large blocks of policies sold as a portfolio in the secondary market.²⁶ In addition, viatical settlement investments are now considered securities under both federal²⁷ and Florida law.²⁸ Some life insurance companies are currently litigating what they assert are STOLI policies that were purchased by investors in the secondary market.²⁹

C. Current Law Governing Insurable Interest, Viatical Settlements, and the Secondary Life Insurance Market

²⁵ Sam Rosenfeld, *Life Settlements: Signposts to a Principal Asset Class*, Wharton Fin. Institutions Ctr., Working Paper #09-20, at 24 (2009), available at <http://www.floir.com/siteDocuments/FortressBWharton.pdf>. Another source stated that an insured may be able to receive up to three times a policy’s cash surrender value in the viatical settlement market. Dafina Dunmore, *Our Take on the Secondary Market for Life Insurance*, MORNINGSTAR (June 16, 2006), available at <http://www.floir.com/siteDocuments/FortressCMorningstarArticleHighlight.pdf>.

²⁶ See LISA Letter to Commissioner McCarty, at 1 (Oct. 25, 2013), available at <http://www.floir.com/siteDocuments/LISASLSubmission10252013.pdf> [hereinafter LISA Submission].

²⁷ *S.E.C. v. Mutual Benefits, Corp.*, 408 F.3d 737, 738 (11th Cir. 2005).

²⁸ In 2004, the Florida Legislature passed legislation promoted by the viatical industry that made the Office the exclusive regulator of viatical settlement investments in an attempt to avoid the classification of these investments as securities. See ch. 2004-390, § 78, Laws of Fla. In 2005, viatical settlement investments were reclassified as securities under Florida law. See ch. 2005-237, Laws of Fla. The new law subjected these investments to the Florida Securities and Investor Protection Act, which included, among other things, requiring persons selling these investments to be licensed securities brokers.

²⁹ See Martin, *supra* note 8, at 206-16 (discussing STOLI litigation in various courts and states).

The requirement of an insurable interest for life insurance policies is well-settled in American jurisprudence, dating back to the nineteenth and early twentieth century.³⁰ If the owner of an insurance policy lacks an insurable interest in the life of the insured, the policy is void *ab initio* (null from the beginning³¹) because it is considered a “wagering contract” contrary to public policy.³²

Florida’s insurable interest law requires that insurable interest exist at the inception date of coverage under a life insurance contract and sets forth nine categories in which an insurable interest is recognized to exist.³³ Examples include that an individual has an insurable interest in his own life; an individual has an insurable interest in the life of “another person to whom the individual is closely related by blood or by law and in whom the individual has a substantial interest engendered by love and affection”; and a trust or trustee “has an insurable interest in the life of an individual insured under a life insurance policy owned by a trust.”³⁴

Florida law expressly provides that “insurable interest need not exist after the inception date of coverage under the contract.”³⁵ Thereafter, life insurance is an asset that may freely be sold, transferred, or devised.

The initial sale of a life insurance policy in Florida is called a “viatical settlement”³⁶ and is governed by statute.³⁷ A written agreement to transfer ownership or change the beneficiary designation of a life insurance policy is called a “viatical settlement contract” and must establish

³⁰ STOLI Report, *supra* note 17, at 7-9.

³¹ BLACK’S LAW DICTIONARY 1574 (6th ed. 1990).

³² *TTSI Irrevocable Trust v. ReliaStar Life Ins. Co.*, 60 So. 3d 1148, 1150 (Fla. 5th DCA 2011).

³³ See § 627.404(1), Fla. Stat.

³⁴ See § 627.404(2), Fla. Stat. (listing the nine categories where an insurable interest is recognized).

³⁵ See § 627.404(1), Fla. Stat.

³⁶ See § 626.9911(10), Fla. Stat. (defining viatical settlement contract).

³⁷ See ch. 626, Part X, Fla. Stat. (governing viatical settlement contracts).

the terms under which the life insurance policy is transferred or sold.³⁸ The Office does not have authority to regulate the amount paid as consideration for a viatical settlement contract.³⁹ The Act requires an insurance company be notified if a policy is viaticated within the two-year contestable period.⁴⁰ A viatical settlement contract entered into within the contestable period is enforceable only if certain conditions are met.⁴¹

A viatical settlement provider is a person who effectuates a viatical settlement contract and must be licensed.⁴² Viatical settlement providers are required by law to file annual reports with the Office.⁴³ Individuals acting as viatical settlement brokers are also required to be licensed,⁴⁴ and viatical settlement providers are permitted to use only licensed viatical settlement brokers.⁴⁵

Viatical settlement providers or brokers must make certain minimum disclosures to viators (policyowners who seek to enter into viatical settlement contracts), including that there are possible alternatives to viatical settlements for persons who have a catastrophic or life-threatening illness, that the proceeds from a viatical settlement could be taxable, that the proceeds could be subject to creditors' claims, and that income from the proceeds could adversely affect the recipient's eligibility for Medicaid or other government benefits.⁴⁶

³⁸ § 626.9911(10), Fla. Stat.

³⁹ § 626.9926, Fla. Stat.

⁴⁰ See § 626.9924(7), Fla. Stat. (requiring notification of a viatical settlement if it takes place at any time during the contestable period); § 627.455, Fla. Stat. (providing that every insurance contract shall contain a provision that the policy shall be incontestable for a period of two years).

⁴¹ See § 626.99287, Fla. Stat.

⁴² § 626.9911(12), Fla. Stat. (defining viatical settlement provider); § 626.9912, Fla. Stat. (requiring licensing for viatical settlement providers and setting forth the application requirements).

⁴³ § 626.9913, Fla. Stat. (setting forth the annual reporting requirements).

⁴⁴ § 626.9916, Fla. Stat.

⁴⁵ § 626.992(1), Fla. Stat.

⁴⁶ § 626.9923, Fla. Stat. (setting forth the required disclosures to viators). An emerging issue in the viatical settlement market is whether viatical settlements are an option for funding long-term care expenses, including for policyowners qualifying for Medicaid. LISA Submission, *supra* note 26, at 1. In 2013, Texas passed legislation

The Office has the authority under the Act to examine the business and affairs of viatical settlement provider applicants and licensees.⁴⁷ In addition, under the Act, the Office is required to suspend, revoke, deny, or refuse to renew the license of a viatical settlement provider if the Office finds that it has, among other things, “engaged in fraudulent or dishonest practices, or otherwise has been shown to be untrustworthy or incompetent to act as a viatical settlement provider”; demonstrated “a pattern of unreasonable payments to viators”; dealt “in bad faith with viators”; or “been found guilty of, or has pleaded guilty or nolo contendere to, any felony, or a misdemeanor involving fraud or moral turpitude, regardless of whether a judgment of conviction has been entered by the court.”⁴⁸

A person who determines life expectancies or mortality ratings used to determine life expectancies is a life expectancy provider and must be registered under the Act.⁴⁹ The Act prohibits a viatical settlement broker, viatical settlement provider, or insurance agent in the business of viatical settlements in Florida from directly or indirectly owning or being an officer, director, or employee of a life expectancy provider.⁵⁰

Viatical settlement providers and registered life expectancy providers are required to adopt an anti-fraud plan and file it with the Division of Insurance Fraud. The plan must include a description of the procedures for detecting and investigating possible fraudulent acts and prohibited practices.⁵¹

enabling state residents to use the proceeds of a life settlement to help fund Medicaid long-term care expenses. The ability to utilize life settlement proceeds to fund long-term care expenses has been a legislative issue in several states.

⁴⁷ § 626.9922, Fla. Stat.

⁴⁸ § 626.9914(1), Fla. Stat.

⁴⁹ § 626.9911(4), Fla. Stat. (defining life expectancy provider); § 626.99175, Fla. Stat. (requiring registration).

⁵⁰ § 626.99175(6), Fla. Stat.

⁵¹ § 626.99278, Fla. Stat. (setting forth what must be included in an anti-fraud plan).

An agreement for the sale or transfer of a viaticated policy on the secondary market is called a “viatical settlement investment,”⁵² and is regulated as a security.⁵³ A viatical settlement provider is not required to notify the insurance company when the viaticated policy is sold on the secondary market. Rather, the insured must be notified of a change in ownership or beneficiary the first time that the policy is sold after being viaticated.⁵⁴ The insured is not required to be notified of subsequent sales of the policy in the secondary market.

III. SECONDARY LIFE INSURANCE MARKET REVIEW

The Office begins its review by discussing the size of the viatical settlement and secondary markets in Florida and the reasons that the size of those markets is difficult to assess. Then the Office presents a summary of the differing viewpoints presented at the hearing. Finally, the Office reviews each legislative change proposed by Fortress Investment Group and the Life Insurance Settlement Association (LISA).

A. Florida Market Size

The size of the secondary life insurance market in Florida is difficult to assess. Fortress submitted an article that indicated that there was approximately \$35 billion in life insurance in force on the secondary market in the United States as of 2009.⁵⁵ However, this number represents the size of the market four years ago in the United States, not Florida.

The difficulty in assessing the size of the market in Florida is the result of several factors. The first factor is that the exact number of life insurance policies in Florida that have been sold

⁵² See § 517.021(23) (defining a viatical settlement investment).

⁵³ See § 517.072(3), Fla. Stat. (providing that viatical settlement investments are not subject to the registration provisions of sections 514.07 and 517.12, Florida Statutes, provided that certain conditions are met).

⁵⁴ See § 626.9924(9), Fla. Stat. (providing that if the viatical settlement provider sells the policy, it must communicate the initial change in ownership to the insured).

⁵⁵ Oliver Suess, et al., *Death Derivatives Emerge From Pension Risks of Living Too Long*, BLOOMBERG (May 16, 2011), available at <http://www.flor.com/siteDocuments/FortressExhibitQ.pdf>.

by policyowners is not known. Currently, as of November 30, 2013, there are 17 licensed viatical settlement providers in Florida.⁵⁶ The licensed viatical settlement providers in Florida have reported a large number of viaticated policies and a large total face value of viaticated policies. However, it is important to recognize that many STOLI transactions may not be included in the above-referenced count because they are not transacted through licensed viatical settlement providers.⁵⁷

The reported viatical settlement business in Florida from 1996 through December 31, 2012, is follows:

Year	# of Policies	Total Settlements Paid	Total Face value
1997	595	\$ 28,092,334.15	\$ 52,647,174.53
1998	926	\$ 42,743,130.07	\$ 112,543,865.37
1999	457	\$ 14,897,514.34	\$ 46,343,838.87
2000	226	\$ 8,660,583.96	\$ 24,597,165.56
2001	159	\$ 10,953,111.97	\$ 50,886,210.00
2002	149	\$ 30,214,217.62	\$ 165,846,096.00
2003	177	\$ 39,601,642.92	\$ 216,633,538.00
2004	213	\$ 64,023,628.00	\$ 398,437,492.01
2005	263	\$ 100,569,253.00	\$ 612,021,215.00
2006	416	\$ 181,362,091.00	\$ 932,908,140.82
2007	578	\$ 293,385,415.00	\$ 1,568,502,603.92
2008	703	\$ 315,926,617.40	\$ 1,799,042,106.00
2009	783	\$ 349,085,202.00	\$ 2,233,276,397.92
2010	197	\$ 52,423,952.37	\$ 504,781,652.00
2011	161	\$ 76,580,004.12	\$ 590,475,730.00
2012	93	\$ 30,444,088.75	\$ 241,651,032.00
TOTAL	6,096	\$ 1,638,962,786.67	\$ 9,550,594,258.00

Although Florida licensed viatical settlement providers have reported in excess of \$9.5 billion in face value of death benefits transacted on just over 6,000 Florida policies from 1997 through 2012, only 15.7% of that face value amount was identified as viaticated by surveyed life

⁵⁶ A list of licensed viatical settlement providers is attached as Appendix D.

⁵⁷ At the hearing, LISA stated that viatical settlements in Florida are regulated transactions and asserted that much of the STOLI litigation involves policies that did not occur through regulated transactions and were not conducted by licensed viatical settlement providers. Transcript at 118-20.

insurance companies actively writing policies in Florida. A summary of the survey results, which reflects that Florida life insurance companies may be largely unaware of which policies on their books have been viaticated, is attached as Appendix B. It is unknown how many of these policies have matured since being reported. Sixty-four insurance companies estimated or were aware of only a total of 1,928 viaticated Florida policies with a total face amount of approximately \$1.5 billion. Of the 327 active Florida life insurance companies that responded with policies that could be subject to viatication,⁵⁸ 263 companies did not report any viaticated policies.

Although an assertion was made at the hearing that insurance companies know which policies have been sold, because they are notified of a potential sale of the policy (via a verification of coverage request) as well as when the policy is actually sold (via a change of ownership form),⁵⁹ this was not substantiated by the survey results. The reason for this discrepancy is not clear. With respect to the verification of coverage request, insurance companies may receive such a request for various reasons, not only the potential sale of a policy. Further, a verification of coverage request would only provide notification of a potential sale, and it is unknown how many such requests insurance companies receive as compared to the number of policies sold. With respect to change of ownership forms as a means of notification, it may be the case that many insurance companies are not tracking change of ownerships for the purpose of evaluating how many of their policies have been viaticated. It may also be the case that a change of ownership form does not always indicate that the ownership was changed to an

⁵⁸ This excludes companies that expressly indicated that they do not have life insurance business in Florida as of June 30, 2013, or write only the kinds of policies that would not be subject to viatication (*e.g.*, credit life, group, term, or accidental death and dismemberment).

⁵⁹ Transcript at 122. An assertion was also made that insurance companies treat viaticated policies differently at every stage than non-viaticated policies. *Id.* at 122-23.

investor as the result of a sale. Regardless, notification of change of ownership may not occur with STOLI policies as the true owners are typically concealed via a trust or other means.

The survey also inquired as to Florida in-force policies that were owned by a trust, owned by a bank or financial institution, or financed through a premium-finance company or other structured loan program, because such policies have the potential to represent policies that have been sold. For example, in a STOLI transaction, a life insurance agent may convince an elderly individual to form a trust, which would purchase and become the beneficiary of a newly issued life insurance policy with a large face amount.⁶⁰ The beneficial interest in the trust would then be transferred to the investor, and the trust would continue to own and be the beneficiary of the policy—without the insurance company knowing that the transfer had occurred.⁶¹

Of the 327 active Florida life insurance companies that responded with policies that could be subject to viatication, 186 of the companies relied on estimates to respond as they were not able to readily identify trust-owned, bank-owned, and/or premium-financed policies. Of the companies that responded, 169 identified 52,418 in-force Florida policies that were owned by a trust, with a face value of \$72.2 billion; 85 companies identified 9,633 policies owned by a bank or financial institution, with a face value of \$6.274 billion; and 64 companies identified 8,134 policies that were financed through a premium-finance company or another structured loan program, with a face value of \$1.340 billion. However, it is unknown whether these numbers are an accurate reflection of the number and face value of trust-owned, bank-owned, and/or premium-financed policies in Florida as many responding insurance companies relied on estimates. Further, it is unknown whether these policies, in fact, represent policies present in the secondary market.

⁶⁰ STOLI Report, *supra* note 17, at 14-15.

⁶¹ Transcript at 119-21.

The second factor contributing to the difficulty in assessing the size of the secondary market in Florida is that it is unknown how many viaticated policies or other life insurance policies have been sold on the secondary market. In addition to policies transacted through licensed viatical settlement providers, the secondary market likely contains a large number of policies acquired by banks, financial institutions, or premium-finance companies upon default of a financing or lending agreement.⁶² The exact number of these policies in the secondary market is not known.

In sum, the size of the viatical market in Florida is difficult to assess and, in turn, the size of the secondary life insurance market in Florida is even more difficult to assess given the data currently available to the Office. Additionally, many life insurance companies appear to be largely unaware of the future potential financial impact of viaticated policies. Only eight life insurance companies acknowledged having “procedures in place to evaluate the impact of viaticated policies on the net-present-value of the life insurance book of business.” Many of the life insurance companies actively writing in Florida acknowledged that they had not established procedures to track viaticated policies and had no way of knowing the volume of policies that have been viaticated. Accordingly, insurance companies appear to be unaware of the financial impact of viaticated policies on their current and future portfolio and, consequently, may not be adequately prepared for expenditures that will arise upon the maturity of these investor-owned policies, which are generally less likely to lapse than non-viaticated policies.

B. Viewpoints Presented at the Hearing

The presenters at the public hearing expressed differing views as to the legislative directive. Those views are summarized below.

⁶² A financial institution that takes an assignment of a life insurance policy as collateral for a loan is not a viatical settlement provider regulated under the Viatical Settlement Act. § 626.9911, Fla. Stat.

1. Fortress Investment Group

Present at the hearing on behalf of Fortress Investment Group, a large investor in the secondary life market, were Mr. Tom Welsh and Mr. Jerry Kroll. Fortress is an investment management firm that manages \$54.6 billion in investment assets on behalf of clients that include university endowments, public pensions, and non-profit foundations.⁶³ In 2010, Fortress began buying portfolios of life insurance policies on the secondary market.⁶⁴ All of the policies were past the standard two-year contestable period and available at reduced rates because other investors were struggling to pay the premiums.⁶⁵ About 200 of these policies were issued by Phoenix Life Insurance Company, which has asserted in court that a number of these policies are void because they lacked an insurable interest at the time of inception.⁶⁶

In Fortress's view, secondary market investors provide liquidity to the viatical settlement and secondary markets. Viatical settlement providers frequently look to move the policies into a secondary market and, thus, need access to well-managed secondary market players, which provide the capital necessary to continue to acquire policies.⁶⁷ In a well-regulated market, investments in life insurance policies are desirable because they are not vulnerable to wild fluctuations like other equities. Fortress asserted that a market will not exist if investors do not believe that there is some degree of certainty and predictability.⁶⁸

⁶³ Transcript at 6-7, 13.

⁶⁴ See Leslie Scism, *Vulture Investor Battles for Death-Bet Payouts*, WALL ST. J. (Apr. 19, 2012), available at <http://www.floir.com/siteDocuments/ACLI4-19-12WSJArticle.pdf>.

⁶⁵ *Id.*

⁶⁶ *Id.*

⁶⁷ Transcript at 14-15.

⁶⁸ Transcript at 16-19.

According to Fortress, “a small handful of insurers,”⁶⁹ primarily Phoenix Life Insurance Company, pose a threat to the secondary market that will ultimately reduce Florida seniors’ ability to access the market and achieve the values that they would receive in a well-regulated market. These companies refuse to honor policies owned by investors after collecting premiums for years and are asking courts to invalidate policies from inception for lack of insurable interest.⁷⁰

Fortress contended that the remedy being sought for lack of insurable interest is nothing more than a rescission remedy.⁷¹ According to Fortress, it is a basic principle of law that when one party rescinds an agreement, the opposing party must be put back in the position it occupied when the agreement was entered, which includes returning the premiums paid.⁷² However, Fortress asserted that the insurance companies challenging policies are not only seeking to void the policies, but also to keep the premiums. Fortress alleged that they are accomplishing this objective by litigating cases with particularly bad facts and by misleading judges. Fortress asserted that the consequence of such tactics is that investors will refuse to buy policies in a state where a policy can be rescinded after the contestable period and the premiums not returned.⁷³

Fortress asserted that Phoenix in particular has tried to game the system in order to avoid paying its obligations. According to Fortress, Phoenix is resisting and denying a large percentage of claims in a demonstrable upward trend that far exceeds the national average.⁷⁴ At

⁶⁹ Transcript at 20.

⁷⁰ Transcript at 20-22.

⁷¹ Transcript at 22.

⁷² Written Submission to Florida Office of Insurance Regulation Further to October 25, 2013, Public Hearing on Secondary Life Insurance Market, at 14 (Oct. 15, 2013), *available at* <http://www.flair.com/siteDocuments/Fortress1October152013FLOIRSubmission.pdf> [hereinafter Fortress Written Submission].

⁷³ Transcript at 22-24, 26.

⁷⁴ Fortress asserted that Phoenix resisted or denied less than 1% of claims in 2008 to almost 21% in 2011, as compared to the national average of 1.5%. Fortress submitted a chart illustrating Phoenix’s denial rates. Transcript at 17, 24-25; *see also* Chart of Life Insurance Policy Resistance/Denial Rates, *available at* <http://www.flair.com/siteDocuments/FortressGPHLDenialRateChart.pdf>.

the hearing, Jerry Kroll spoke about his experience handling a case involving Phoenix on behalf of two life settlement funds. When the investors requested a change of ownership, Phoenix responded months later threatening rescission if various documents were not provided. At that point, the investors sued Phoenix, and Phoenix sought to void the policies and keep the premiums.⁷⁵ Depositions revealed that Phoenix had encouraged its sales personnel to sell policies attractive to investors.⁷⁶

Although many investors are no longer buying Phoenix policies, Fortress argued that this means that Phoenix's behavior has dramatically diminished the market value of the Phoenix policies owned by Florida seniors.⁷⁷ Fortress further argued that there is a "contagion risk" of other insurance companies following suit because Phoenix is generating case law that they can avoid the two-year contestable period by asserting a lack of insurable interest.⁷⁸

Fortress asserted that investors want a marketplace free of fraud and STOLI policies. They endeavor to do as much underwriting as they can⁷⁹; however, they have access to a more limited data set than what is available to life insurance companies and, as a result, sometimes buying portfolios with STOLI policies is unavoidable. Fortress argued that fraud prevention is best addressed at the front end by the life insurance companies. Fortress contended that the law

⁷⁵ Transcript at 52-54.

⁷⁶ Fortress Written Submission, *supra* note 72, at 6; Transcript at 54-55. Excerpts from deposition videos were played at the hearing. Fortress also submitted excerpts of transcripts from two depositions. *See Fenton v. Phoenix Life Ins. Co.*, Deposition of James Michael (Max) Labar (Mar. 29, 2010), available at <http://www.flor.com/siteDocuments/FortressEJamesLabarDepositionExcerptHighlighted.pdf>; *PHL Variable Ins. Co. Cases*, Deposition of Edwards James Humphrey (Dec. 20, 2010), available at <http://www.flor.com/siteDocuments/FortressEHumphreyDepositionExcerptHighlighted.pdf>.

⁷⁷ Transcript at 27-28.

⁷⁸ Transcript at 31-32.

⁷⁹ For example, according to Fortress, investors can find and evaluate the address of the underlying insured in order to figure out whether he or she lives in a neighborhood that suggests that he or she should have a \$2 to \$3 million life insurance policy. Transcript at 43.

should not allow insurance companies to turn a blind eye to fraud and then later claim a lack of insurable interest, void the policy, and retain the premiums.⁸⁰

Fortress proposed five legislative changes: (1) make subjective intent irrelevant to insurable interest; (2) prohibit insurable interest challenges after the contestable period; (3) require a notice of validity of the policy from the insurance company within ninety days of inquiry; (4) require return of premiums to the policyowner if a policy is voided; and (5) monitor cost-of-insurance rate increases.⁸¹ Each proposal is addressed in detail below in section III.C.

2. American Council of Life Insurers (ACLI)

Mr. David McDowell was present at the public hearing on behalf of the American Council of Life Insurers (ACLI).⁸² According to its website, ACLI is an association of more than 300 member companies, which advocates for public policy that supports the industry market place and the millions of American families that rely on life insurance products for financial and retirement security.⁸³ ACLI opposed Fortress's proposed legislative changes.⁸⁴

Mr. McDowell stated that the issue presented involves two markets. The first is the legitimate life settlement market (termed "viatical settlement" market in Florida law), which has existed for a long time. With respect to these policies, when the insured bought insurance coverage, he or she was buying it to address a legitimate insurance need.⁸⁵ ACLI does not believe that this market should be abolished as it provides a third option—other than lapse or

⁸⁰ Transcript at 42-44.

⁸¹ Transcript at 33-51.

⁸² Transcript at 56-57.

⁸³ See About ACLI, <https://www.acli.com/About%20ACLI/Pages/Default.aspx> (last visited Nov. 18, 2013).

⁸⁴ See Transcript at 67-76.

⁸⁵ Transcript at 57.

cash surrender—to insureds who no longer need or want their policies.⁸⁶ ACLI asserted that this market “is doing just fine.”⁸⁷

According to ACLI, the second market is what the hearing was actually about—a market of stranger-originated life insurance (or “STOLI”), which is not life insurance at all. Those buying STOLI policies suffer no financial consequences when the insureds die. Instead, those investors want the insureds to die as quickly as possible in order to ensure a greater profit.⁸⁸ These STOLI policies were disguised to look like legitimate life insurance transactions in order to induce the insurance companies into issuing them. ACLI argued that the notion that insurance companies turn a blind eye to fraud is belied by the fact that the STOLI policies had to be obtained by deceit.⁸⁹

When life insurance companies and regulators became aware of STOLI policies in 2006 and 2007, they both reacted. Because of the combination of legal and regulatory forces, the value of these toxic assets on the secondary market was “absolutely crushed.”⁹⁰ These assets were not able to be sold on the legitimate secondary market; however, the hedge funds smelled a bargain. Fortress and other companies were able to buy these blocks of policies for pennies on the premium dollars already paid.⁹¹ In seeking the funds to buy these toxic assets, Fortress issued notices to the investing public, in which it alerted the investing public that they were

⁸⁶ Transcript at 57, 92.

⁸⁷ Transcript at 57.

⁸⁸ Transcript at 57-58.

⁸⁹ Transcript at 59.

⁹⁰ Transcript at 60.

⁹¹ A recent article stated that Fortress bought the \$6.2 billion KBC Bank NV portfolio for \$332.5 million in late 2010. It later acquired the SageCrest portfolio with \$514 million in face value for \$27.6 million in a bankruptcy sale, and the \$1.34 billion HM Ruby fund portfolio through a default on a \$65 million loan by fund manager Himelsein Mandel Fund Management LLC. See Donna Horowitz, *Fortress Told Investors Its Portfolio Could Contain STOLI*, THE DEAL PIPELINE (Nov. 20, 2013), <http://www.thedeal.com/content/private-equity/fortress-told-investors-its-portfolio-could-contain-stoli.php> [hereinafter Horowitz, *Fortress Told Investors*]. This totals \$425.1 million paid for \$8 billion in face value.

looking to buy assets that may lack an insurable interest, may have been procured by fraud, that may be subject to litigation and regulatory risk, and may be outright illegal. They told the investing public that if any of these factors came to pass, it would have a significant and profound effect on the value and liquidity of the policies in the portfolio.⁹²

Now, Fortress is having difficulty selling these policies in the legitimate secondary marketplace.⁹³ ACLI opined that the Office should view the legitimate secondary life insurance marketplace's hesitancy and unwillingness to purchase these policies as a healthy vital sign of a thriving marketplace and not an indication of a weakness that needs to be addressed through legislation.⁹⁴

In resorting to court, ACLI contended, the life insurance companies are simply seeking to affirm the three legal certainties that have long existed with respect to life insurance. First, if the applicant lies on a life insurance application, the life insurance company can rescind the policy within two years of policy issuance. Second, if the life insurance policy is issued without an adequate insurable interest, it is an illegal contract and is therefore void *ab initio*. Third, if a life insurance company knew or should have known of problems on the application or problems associated with insurable interest, that life insurance company should bear the consequences. Nothing has changed these legal certainties.⁹⁵

According to ACLI, whether or not a particular policy can be rescinded, whether or not an insurable interest existed, and whether or not the premiums should be returned depend on the

⁹² Transcript at 59-61.

⁹³ A recent article stated that Fortress began “shopping around its portfolio in September, only three years after entering the market.” Horowitz, *Fortress Told Investors*, *supra* note 91. At this time, Fortress is not selling the \$1 billion in Phoenix policies, which are tied up in litigation. See Donna Horowitz, *Fortress Shops Life Settlement Portfolio*, THE DEAL PIPELINE (Oct. 22, 2013), <http://www.thedeal.com/content/restructuring/fortress-shops-life-settlement-portfolio.php>.

⁹⁴ Transcript at 61-62.

⁹⁵ Transcript at 62-63.

facts of each individual case. It would be difficult to legislate fairness and craft legislation that would adequately address the equitable issues that could crop up in any individual case, which is why no state has tried to do so, despite similar efforts by hedge funds to get legislation passed.⁹⁶

Mr. McDowell represented Phoenix in the lawsuit referenced earlier. If those depositions presented an accurate reflection of what Phoenix was actually doing at the time, Phoenix would not have been as successful as it has been in court. Phoenix has won the cases that it has because, like a lot of other companies that were duped into issuing these policies, Phoenix has credible issues it brought before the courts, which were able to look at the equities and reach a reasoned decision. Phoenix has only contested eight death claims in the last four years; the majority of the contest has been on policies that are still in force where the insured is still alive.⁹⁷

If this is really a one-company issue, then there's no reason for legislation. The legitimate marketplace is doing just fine, and legislation would encourage toxic assets in the marketplace.⁹⁸ Life insurance companies do not have any interest in issuing fraudulent policies. Further, life insurance companies have generally been seeking rescissions while the insured is still alive and not collecting the premiums until the insured dies before challenging the policies. Moreover, life insurance companies do adequately police their agents.⁹⁹

ACLI explained that STOLI transactions are concealed from the insurance companies and disguised to look like normal life insurance transactions.¹⁰⁰ During the underwriting

⁹⁶ Transcript at 62-65. Fortress provided the Office with copies of legislation that was proposed in Connecticut (Bill No. 409 in 2012 addressing cost of insurance increases), Delaware (HB 87 in 2013 providing for premium-return if a policy is voided), and Minnesota (HF1031 in 2013 providing for premium refund and the right to seek a judicial determination of policy's validity if the insurance company refuses to state that it will not contest a policy for lack of insurable interest within 120 days of receipt of a verification of coverage request). The text of these proposed bills is available at <http://www.floir.com/siteDocuments/FortressIDEHB87.pdf>.

⁹⁷ Transcript at 66-67, 89.

⁹⁸ Transcript at 76.

⁹⁹ Transcript at 87-88, 90.

¹⁰⁰ Transcript at 78-79.

process, if requests for information continually result in fraudulent information being produced, at some point it is no longer the fault of the insurance company.¹⁰¹

3. Life Insurance Settlement Association (LISA)

Present at the hearing on behalf of the Life Settlement Association (LISA) were Mr. Darwin Bayston and Mr. Michael Freeman.¹⁰² According to LISA's website, LISA, established in 1994, is the oldest and largest trade organization in the life settlement market with the goal of advancing the highest standards for market participants and promoting education and awareness.¹⁰³

According to LISA, the life settlement market (termed "viatical settlement" market in Florida) has evolved from a largely unregulated viatical marketplace to today's well-regulated market, which has provided billions of dollars to tens of thousands of policyowners. This market is one that includes a lot of lower-to-middle class policyowners in need of financial resources for retirement, and several states are considering the use of life insurance policies for long-term care, including policyowners qualifying for Medicaid.¹⁰⁴ Any market needs liquidity, and in the current market, the money for the sale of policies comes from institutional investors, which buy portfolios of policies that have already been viaticated.¹⁰⁵

LISA stated that it was referring to life settlements, not STOLI.¹⁰⁶ The litigation being brought by insurance companies is not against life settlement companies and does not concern policies assigned through a regulated life settlement transaction.¹⁰⁷ Instead, STOLI policies are

¹⁰¹ Transcript at 91-92.

¹⁰² Transcript at 93, 103.

¹⁰³ See LISA, <http://www.lisa.org> (last visited Nov. 20, 2013).

¹⁰⁴ Transcript at 94.

¹⁰⁵ Transcript at 101-03.

¹⁰⁶ Transcript at 95.

¹⁰⁷ Transcript at 104-05.

sold via selling the beneficial interest in a trust, or in the case of premium-financed schemes, there is a relinquishment or abandonment of the policy. The seventeen licensed viatical settlement providers in Florida are not the entities involved in STOLI transactions. There should be a benefit of having a regulated transaction.¹⁰⁸

LISA disagreed with ACLI's statement that investors hope insureds die as quickly as possible. According to LISA, this is not true; rather, the investor assembles an investment portfolio in an attempt to achieve a certain cash flow.¹⁰⁹

LISA asserted that certain issues either impede the ability of seniors to enter into a life settlement transaction or diminishes the value received by seniors when they sell those policies. These issues are discussed in more detail below in section III.D. LISA also supported premium return legislation. The life insurance company conducts due diligence at the inception of the policy.¹¹⁰ When a life settlement occurs, the life settlement provider is required to go back to the insurance company and ask for verification of coverage, which effectively notifies the insurance company of the potential sale of the policy. This step provides another opportunity for the life insurance company to evaluate the policy.¹¹¹ Insurance companies know which policies are being sold, and they treat those changes of ownership differently. They track life settlements and treat them differently at every stage.¹¹²

Under Florida law, there is also a requirement that the life settlement company, as part of its anti-fraud plan, evaluate the policy. This requirement includes looking at the original underwriting of the policy, the individual or entity paying the premiums, the issue of insurable

¹⁰⁸ Transcript at 118-20.

¹⁰⁹ Transcript at 99-100.

¹¹⁰ Transcript at 109.

¹¹¹ Transcript at 107-11.

¹¹² Transcript at 122-23.

interest, and any potential fraud or misrepresentation in the sale of the policy. Despite each of these steps, sometimes policies will still slip through that should never have been issued.¹¹³

LISA argued that legislation should be passed to allow for the return of premiums if the policy has gone through a regulated life settlement transaction. LISA asserted that there is a level of scrutiny and diligence in life settlement transactions, and the investors were not part of any transaction that was originating the policy improperly.¹¹⁴ At the point of sale, investors need certainty and clarity that they will be restored to their original position if the policy is voided.¹¹⁵

LISA asserted that anything that is perceived as increasing the risk to the investors results in them paying a lower price to the consumer. If actions are taken that reduce the perception of risks that investors have, then the benefit flows back to the seniors who are selling policies.¹¹⁶ LISA has provided its suggested language for a premium-return amendment.¹¹⁷

4. Institutional Longevity Markets Association (ILMA)

Mr. Thomas Weinberger spoke on behalf of the Institutional Longevity Markets Association at the public hearing. ILMA was formed by institutional investors and leading investment banks that were focused on longevity and mortality markets and life settlements.¹¹⁸ These investors participate primarily in what ILMA called the tertiary market but is termed the “secondary market” under Florida law (the subsequent trading after a policy is first sold). The

¹¹³ Transcript at 109.

¹¹⁴ Transcript at 109-10, 114-18.

¹¹⁵ Transcript at 111-12.

¹¹⁶ Transcript at 124.

¹¹⁷ LISA Submission, *supra* note 26, at 7.

¹¹⁸ Transcript at 125. Members include Wells Fargo, Wilmington Trust, Credit Suisse, Fortress, Neo Partners, and other groups, some of whom are investors on behalf of pension funds. *Id.*

Institutional Longevity Markets Association (ILMA) submitted a written comment supporting each of Fortress’s proposed legislative changes.¹¹⁹

According to ILMA, the life settlement industry provides a great service to seniors and a reasonable return to institutional investors. In ILMA’s view, the issue presented at the hearing was not STOLI-related, but rather whether what it called the secondary market (termed the “viatical settlement” market in Florida) will continue to exist in Florida. ILMA asserted that the tertiary market (termed the “secondary settlement” market in Florida) is crucial because it provides liquidity. Investors provide the capital that ultimately feeds the life settlement market.¹²⁰ ILMA estimates that the size of secondary and tertiary markets is probably in the billions of dollars.¹²¹

The institutional investors seek protections because investors who buy blocks of policies have limited access to information. Mr. Weinberger stated that he is actively involved in helping the companies do the due diligence on these policies, and they do not have access to the insureds. Typically, the investors are provided with some sale documentation that was provided at the time of the life settlement. When an investor buys a policy, it receives updated medical information. However, due to privacy laws, there are significant limitations on who can contact the insured and when. Despite the limited information available, investors do a good job of identifying fraudulently originated policies and refusing to buy them.¹²²

Insurance companies, however, are in the best position to do the proper diligence—when the policy is originated. In ILMA’s view, it is simple for insurance companies to determine what

¹¹⁹ See ILMA, Letter to Commissioner McCarty at 3, available at <http://www.floir.com/siteDocuments/ILMAcommentstoOIR.pdf> [hereinafter ILMA Submission].

¹²⁰ Transcript at 125-26.

¹²¹ Transcript at 136.

¹²² Transcript at 126-30.

is going on with the policy in the two-year contestable period. The insurable interest issues are going to arise in only a small subset of policies—large face-value whole life policies with older age issuances. All the insurance companies need to do is take the inexpensive step of contacting the insured six months after origination. This will enable them to quickly discern if the insured sold the policies. Unfortunately, insurance companies are frequently not interested in taking that step. Institutional investors cannot take the same steps as the insurance companies years later.¹²³

ILMA disagreed with ACLI that there are legal certainties, contending that uncertainty in the market is driving the interest in reforms and legislation. The issue of whether a policy can be challenged after the two-year contestable period is far from settled in Florida. Limiting insurable interest challenges to the contestable period will not open the door to fraud.¹²⁴

The secondary life market is needed and is poised to grow. Seniors nearing retirement age need to be able to settle their policies to either fund a comfortable retirement or perhaps pay for long-term care needs.¹²⁵ Some states, including Florida, have been considering whether they should get in the market of life settlements in order to fund Medicaid long-term care costs. In order for this market to grow, there needs to be greater legal certainty. The balance of equities has to happen on a more global scale rather than just on individual policy issuances.¹²⁶

ILMA asserted that STOLI transactions have largely disappeared from the market, and insurance companies and investors have become better at identifying them. ILMA is not aware of any institutional investors that are actively participating in STOLI transactions; the most egregious practices probably took place in the 2007-2008 period. However, this does not obviate the need for more certainty in the market, especially in Florida courts. Because of this

¹²³ Transcript at 131-32.

¹²⁴ Transcript at 128-29.

¹²⁵ Transcript at 130.

¹²⁶ Transcript at 136-37.

uncertainty, the prices that investors are willing to pay for Florida policies are much lower than the rest of the country.¹²⁷

5. Professional Benefits, Inc.

Mr. James Tollerton of Professional Benefits in Sarasota, Florida, was invited by representatives at the Florida Chapter of the National Association of Insurance and Financial Advisors (NAIFA) to speak as a typical Florida insurance agent about his experiences. In Mr. Tollerton's view, the further we get away from the essential underpinnings of the life insurance industry of insurable interest, the more slippery the slope. When a stranger owns a life insurance policy on an insured, the insured does not know who owns the policy, where the policy is, or what is going to happen. It is a very uncomfortable prospect. Most of the seniors that settle their policies have no idea of the potential tax implications and have no idea what is happening.

Mr. Tollerton does not have a great deal of experience with viatical settlements personally, but he did assist in settling a policy for a friend fifteen years ago who had cancer. Mr. Tollerton became very uncomfortable with the process, because he received phone calls every few months inquiring as to how his friend was doing. In another situation, a senior sold his \$2 million policy and subsequently realized that he no longer knew who owned his policy.

Mr. Tollerton expressed that the bottom line from an insurance agent's perspective is that an agent is in the business of insuring lives for families, businesses, and charities in some instances. The vast majority of the agents in NAIFA and legitimate agents in Florida have no interest in participating in the viatical settlement market because of the ongoing problems that naturally happen once a policy is sold. The secondary life market can be analogized to the

¹²⁷ Transcript at 138-39.

mortgage industry, where mortgages were packaged together and sold in the secondary market, which brought about a great deal of trouble.¹²⁸

6. Florida Insurance Council (FIC)

Mr. Paul Sanford spoke at the hearing on behalf of the Florida Insurance Council (FIC), Florida's largest insurance trade association.¹²⁹ Mr. Sanford stated that when an insurance company receives a verification of coverage request, it is unlikely that any substantial underwriting will take place at that time. With respect to premium-return legislation, the facts are different in every case and a court needs to be able to assess those facts to dispense equity.

The underwriting practices by life insurance companies are about as strong as they can get, unless they expend huge sums of money and large amounts of time, which will increase the cost of insurance. The larger the policy, the more checking that takes place. However, Mr. Sanford has seen, for example, situations in which an insurance company received financial statements from CPAs that did not exist.

In FIC's view, if legislation is considered, it would be good to review the National Association of Insurance Commissioner's (NAIC) model act on STOLI transactions,¹³⁰ in particular, the five-year provision on nonrecourse premium financing and the limitations on transferring these policies and combine those provisions with the trust provisions from the National Conference of Insurance Legislators (NCOIL) model act,¹³¹ which would get to the

¹²⁸ Transcript at 139-42.

¹²⁹ Florida Insurance Council, <http://www.flains.org> (last visited Nov. 18, 2013).

¹³⁰ See NAIC, Viatical Settlements Act (July 2009), <http://www.naic.org/store/free/MDL-697.pdf>; see also NAIC Press Release, NAIC Adopts Viatical Settlements Model Act Revisions (June 4, 2007) (describing revisions to the model act to address STOLI), http://www.naic.org/Releases/2007_docs/viatical_settlements_model.htm; see also Martin, *supra* note 8, at 201 (discussing the NAIC Model Act provisions relating to STOLI).

¹³¹ NCOIL Life Settlements Model Act (Nov. 17, 2007); see also NCOIL Press Release, NCOIL Closes in on Illegal STOLI, Unanimously Adopts Amended Model Act (Nov. 20, 2007) (describing the model act), <http://www.ncoil.org/HomePage/2007/LifeSettlementsPR.pdf>; see also Martin, *supra* note 8, at 201 (discussing the NCOIL Model Act provisions relating to STOLI).

heart of the situations where STOLI originators are able to deceive insurance companies. The implementation of these two measures could possibly eliminate STOLI transactions, which appears to be the real hazard that the secondary market is having.

C. Legislative Changes Proposed by Fortress

Fortress suggested five legislative changes to address what it perceives as the lack of protections for investors in the secondary life insurance market, asserting that one or all of the legislative changes would bring greater certainty and stability to the market. The Institutional Longevity Markets Association (ILMA) supported each of these proposed legislative changes.¹³² The American Council of Life Insurers (ACLI) opposed these changes. This report discusses each of Fortress's proposed legislative changes in turn.

1. Make subjective intent irrelevant to insurable interest. Fortress's first proposed legislative change was to clarify that an insured's subjective intent is irrelevant to the issue of insurable interest.¹³³ Fortress asserted that "[i]nsurers have been able to cloud the issue and successfully create uncertainty in the law where none should exist. By doing so, they have chilled the market. To curb such baseless litigation and provide market stability, the [Office] and Florida Legislature should make clear that intent is irrelevant to the insurable interest requirement under Florida law."¹³⁴ In the hearing, Fortress emphasized that, in its view, the subjective intent of an insured, who may have died by the time the issue is in dispute, is a difficult and unpredictable test to apply.¹³⁵ As a specific example, Fortress pointed to the 2012 federal court decision of *Sciaretta v. Lincoln National Life Ins. Co.*,¹³⁶ asserting that in that case,

¹³² ILMA Submission, *supra* note 119, at 3.

¹³³ See Transcript at 33-37.

¹³⁴ Fortress Written Submission, *supra* note 72, at 12.

¹³⁵ Transcript at 35-36.

¹³⁶ *Sciaretta v. Lincoln National Life Ins. Co.*, 899 F. Supp. 2d 1318, 1320-21 (S.D. Fla. 2012).

although the policy was not actually sold, the insurance company nonetheless argued that the insured, Mr. Cotton, had considered settling the policy and, therefore, there was no insurable interest and the policy was void *ab initio*.¹³⁷

ACLI responded that a determination of insurable interest rarely involves consideration of subjective intent. According to ACLI, the Delaware Supreme Court and other courts have instead looked at the factual circumstances of the policy issuance and decided, based on that set of facts, whether there was an insurable interest.¹³⁸

A review of the *Sciaretta* decision reveals that the circumstances surrounding the policy indicated many of the classic hallmarks of a STOLI arrangement. The insured, Mr. Cotton, had entered into an Exclusive Rights Agreement with Wealthmodes, LLC, in which Wealthmodes paid Mr. Cotton a fee that was equal to the initial premiums owed to Lincoln, in exchange for a twelve-month exclusive right to arrange for the future sale of any life insurance policies it obtained for Mr. Cotton.¹³⁹ Shortly thereafter, Mr. Cotton formed an irrevocable trust and sought an \$8 million life insurance policy from Lincoln. The application represented that Mr. Cotton's annual income was \$730,000, although his tax return from the previous year reflected an annual income of only \$170,999. Mr. Cotton also represented in the application that the policy was not being funded via premium financing loan or with funds borrowed, advanced, or paid from another person or entity and that he would not receive any compensation as a result of the policy being issued.¹⁴⁰ Subsequently, Lincoln issued a \$5 million policy to the trust and Mr. Cotton paid for the initial premiums with funds received from Wealthmodes. After the initial premium payments, the trust obtained a premium-finance loan in order to continue to pay

¹³⁷ Transcript at 37; *see also* Fortress Written Submission, *supra* note 72, at 1, 7-8.

¹³⁸ Transcript at 70.

¹³⁹ *Sciaretta*, 899 F. Supp. 2d at 1321, 1325.

¹⁴⁰ *Id.* at 1321.

premiums.¹⁴¹ The premium-finance company marketed the policy to secondary market investors, receiving two offers to purchase the policy.¹⁴² Almost two years after the policy was issued, Mr. Cotton was diagnosed with terminal cancer and died six months later.¹⁴³ Before Mr. Cotton passed away, the premium-finance company notified the trust that the loan must be repaid in order to satisfy the loan and retain the policy; the premium-finance company later foreclosed on the policy in satisfaction of the loan.¹⁴⁴

The Southern District of Florida ruled that, consistent with Florida contract law¹⁴⁵ and two other Florida decisions (*Pruco Life Insurance Co. v. Brasner*¹⁴⁶ and *AXA Equitable Life Insurance Co. v. Infinity Finance Group*¹⁴⁷), there is an implied covenant of good faith that attaches to Florida's insurable interest requirement.¹⁴⁸ Thus, the Southern District held, if the insurance policy at issue was procured with the intention that it would be assigned or otherwise transferred to a person or entity with no insurable interest in the insured, it is void *ab initio*.¹⁴⁹

After reviewing the circumstances and the arguments made by the parties, the Southern District found that there was a genuine issue of material fact and denied the life insurance company's motion for summary judgment that the policy was void *ab initio* because it lacked an

¹⁴¹ *Id.* at 1321-22.

¹⁴² *Id.* at 1322, 1325-26.

¹⁴³ *Id.* at 1322.

¹⁴⁴ *Id.* at 1322, 1325-26.

¹⁴⁵ The Southern District quoted a Eleventh Circuit Court of Appeals decision, which stated that “[u]nder Florida law, every contract contains an implied covenant of good faith and fair dealing, requiring the parties follow standards of good faith and fair dealing designed to protect the parties’ reasonable contractual expectations.” *Id.* at 1324 (quoting *Centurion Air Cargo, Inc. v. United Parcel Serv. Co.*, 420 F.3d 1146, 1151 (11th Cir. 2005)).

¹⁴⁶ *Pruco Life Ins. Co. v. Brasner*, No. 10-8084-CIV-COHN (S.D. Fla. Nov. 14, 2011) (unpublished).

¹⁴⁷ *AXA Equitable Life Ins. Co. v. Infinity Fin. Group, LLC*, 608 F. Supp. 2d 1349 (S.D. Fla. 2009).

¹⁴⁸ *Sciaretta*, 899 F. Supp. 2d at 1324-25. Similarly, the Southern District of Florida held in a prior case, *AXA Equitable Life Ins. Co.*, that while “Florida permits the assignment of life insurance policies to persons without an insurable interest in the life of the insured,” that “this rule extends only to assignments made in good faith, and not to sham assignments made simply to circumvent the law’s prohibition on ‘wagering contracts.’” *AXA Equitable Life Ins. Co.*, 608 F. Supp. 2d at 1356.

¹⁴⁹ *Sciaretta*, 899 F. Supp. 2d at 1325.

insurable interest at inception.¹⁵⁰ Subsequently, at trial, a jury found that it was not intended, at the time of procurement, that the policy would later be assigned or transferred to someone with no insurable interest.¹⁵¹

2. Prohibit insurable interest challenges after the two-year contestable period.

Fortress's second proposed legislative change was to prohibit insurable interest challenges after the two-year contestable period. In Fortress's view, it has been long settled that life insurance companies are afforded the two-year window of time to complete underwriting, identify red flags, and determine if a policy has been issued based on misrepresentations.¹⁵² Fortress contended that insurance companies have attempted to contravene this two-year period by fixating on insurable interest, and the resulting uncertainty diminishes the value of policies and threatens to eliminate or significantly curtail the market.¹⁵³ The case law is unsettled as to this issue.¹⁵⁴

ILMA similarly asserted that “[a]ny question as to whether or not a policy’s validity can be challenged ad infinitum adds prohibitive uncertainty in the market for the sale of life insurance policies, depriving the consumer of the maximum value of her asset.”¹⁵⁵ At the hearing, ILMA asserted that the inability to challenge the lack of insurable interest after the two-year contestable period will not open the door to fraud. IMLA stated that a New York case many years ago held that a policy cannot be challenged on any basis after the end of the contestable period, and it did not lead to a rampant increase in fraud in New York.¹⁵⁶ There are red flags; the

¹⁵⁰ *Id.* at 1325-26.

¹⁵¹ *Sciaretta v. Lincoln Nat'l Life Ins. Co.*, 9:11-CV-80427-DMM, 2012 WL 5192610, at *1 (S.D. Fla. 2012).

¹⁵² Transcript at 38.

¹⁵³ Fortress Written Submission, *supra* note 72, at 13.

¹⁵⁴ Transcript at 38-39.

¹⁵⁵ ILMA Submission, *supra* note 119, at 3.

¹⁵⁶ Transcript at 129.

insurance companies know what they are, but sometimes choose to ignore them. ILMA argued that the balance of equities has to happen on a more global scale rather than with individual policies.¹⁵⁷

ACLI responded that most states in the country have rejected the principle that there cannot be any insurable interest challenge after the contestable period, reasoning that the public policy behind insurable interest is too important to be subject to a two-year bar. Restricting insurable interest challenges to the two-year contestable period would mean that an illegal contract would not be illegal based on a provision contained in the illegal contract. According to ACLI, such a rule would have unintended consequences. For example, in Florida, there was a case where the insured found out that someone she did not know had forged applications and taken out nine different life insurance policies on her life. If she had found out after the two-year period, there would be nothing that she or anyone else could do to address the situation.¹⁵⁸

A review of the case law reveals that the courts are divided on the issue of whether an incontestability clause applies to bar a claim that a contract is void *ab initio*. The majority view allows insurable interest challenges after the two-year contestable period. As summarized by a recent decision from a Florida federal district court in *Pruco Life Insurance Co. v. Brasner*¹⁵⁹:

Courts following the majority view hold that incontestability clauses have no effect where a policy is void *ab initio* for lack of an insurable interest. Such courts will allow an insurance company to raise a void *ab initio* claim even after the incontestability period has expired. In contrast, courts following the minority view hold that incontestability clauses bar insurance companies' claims regarding the validity of insurance policies.

Florida law embraces both the public policy that prohibits an insurance company from contesting the policy after the contestability period expires and the public policy that an insurable interest is necessary for an insurance policy to be valid in the first place. *See* Fla. Stat. § 627.404(1); Fla. Stat. § 627.455. Neither

¹⁵⁷ Transcript at 133-34, 136.

¹⁵⁸ Transcript at 70-71.

¹⁵⁹ *Pruco Life Ins. Co. v. Brasner*, 10-80804-CIV-COHN, 2011 WL 134056 (S.D. Fla. Jan. 7, 2011) (unpublished).

party cites binding caselaw requiring this Court to reconcile one policy over the other. However, at least one other court in the Southern District of Florida has conformed to the majority view in the face of a challenge regarding lack of insurable interest after a contestability period had expired. *See Rubenstein*, No. 09–21741–CIV–UNGARO. In *Rubenstein*, Judge Ungaro held that “if the Policy is void *ab initio* because an insurable interest is tacking, the incontestability clause would be of no effect.” *Rubenstein*, No. 09–21741–CIV–UNGARO, DE 28 at 5, 5 n. 4. Furthermore, the minority view decisions are distinguishable from this case . . . as the Florida legislature has promulgated statutes regarding both policies. *See Fla. Stat. § 627.404(1); Fla. Stat § 627.455.*^{160]}

The court in that case reasoned that although a compelling policy argument was presented that the minority view encourages insurance companies to timely investigate policies, protects policyowners, and prevents insurance companies from later receiving a windfall, “there is a compelling countervailing view that allowing an incontestability period to bar a lack of insurable interest claim actually encourages fraud.”¹⁶¹ “[U]nder the minority view, ‘if bad actors can disguise their fraud for two years, their hands; are washed clean . . . and they are free to collect on their ill-gotten gains.’ ”¹⁶²

A subsequent Florida federal district court in *Pruco Life Insurance Co. v. U.S. Bank*¹⁶³ agreed with the minority view. The court reasoned that in Florida, an insurance company may not challenge a policy based on fraud outside the contestable period and, in the STOLI context, a lack of insurable interest may not be divided from the fraud that created it: “[W]hether the fraud renders the policy voidable or void *ab initio* is inconsequential; this holds especially true in this case, where [the] lack of insurable interest claim is ultimately traceable to fraud.”¹⁶⁴

3. Require a notice of validity from the insurance company within 90 days of inquiry. Fortress’s third proposed legislative change was to require insurance companies to,

¹⁶⁰ *Id.* at *5-6 (citations and footnotes omitted).

¹⁶¹ *Id.* at *6.

¹⁶² *Id.* (quoting *Settlement Funding, LLC v. AXA Equitable Life Ins. Co.*, 06 CV 5743(HB), 2010 WL 3825735, at *5 (S.D.N.Y. Sept. 30, 2010)).

¹⁶³ *Pruco Life Ins. Co. v. U.S. Bank*, 12-24441-CIV-MORENO, 2013 WL 4496506 (S.D. Fla. Aug. 20, 2013).

¹⁶⁴ *Id.* at *5.

upon inquiry by an investor, provide a notice as to a policy's validity within ninety days.¹⁶⁵ Fortress argued that this requirement would provide increased security in the marketplace because, "[r]ather than be permitted to rebuff good faith efforts to receive assurances of a policy's validity . . . , insurance companies should be required to offer a definitive response. For now, insurance companies are content offering no information and forcing their policyowners to continue making premium payments."¹⁶⁶ ILMA added that "[i]f, after two years of policy issuance the insurer has any question as to the validity of a policy, it should be prepared to make those concerns known when asked to do so by a purchaser of a policy," which would provide stability to the market.¹⁶⁷

ACLI countered that this legislative change would essentially privatize the public policy of insurable interest and take it out of the hands of the courts. The life insurance company, however, does not have access to subpoena powers, information from third parties, or even really access to the insured at that point. Instead, the insurance company would be forced to make an insurable interest determination based on information it already had in its possession when it underwrote the policy. The investors, on the other hand, have unfettered access to the insured.¹⁶⁸

The Florida Insurance Council (FIC) also opposed this legislative change. FIC asserted that when an insurance company receives a verification of coverage request, it is a question of whether the policy is in force and whether the premiums are paid. FIC argued that it is unlikely that any substantial underwriting is going to take place at that time, so to use it as a vehicle to cut off any questions about insurable interest seems to be way far afield.

¹⁶⁵ Transcript at 39.

¹⁶⁶ Fortress Written Submission, *supra* note 72, at 13.

¹⁶⁷ ILMA Submission, *supra* note 119, at 3.

¹⁶⁸ Transcript at 72-73.

4. Require return of premiums if a policy is voided. Fortress’s fourth proposed legislative change was to require, even when a life insurance policy is deemed void, that the insurance company return the premium payments.¹⁶⁹ Fortress asserted that despite the straightforward principle of law that when a party rescinds an agreement, the opposing party must be put back in the position it occupied when the agreement was entered, some insurance companies have successfully convinced courts that they should be entitled to the premiums paid under the policy. Fortress argued that not only does such reasoning conflict with well-settled law, but “it creates one of the most perverse incentives imaginable” and is chilling the market.¹⁷⁰ Fortress argued that the proper remedy should not be to undercut the law of rescission, but rather to execute on remedies against those that are actually complicit in the fraud.¹⁷¹ In Alabama¹⁷² and Georgia,¹⁷³ the insurable interest statutes require the return of premium payments without interest in the event a contract is void.

LISA also supported premium-return legislation and suggested specific wording for a proposed amendment in its written submission.¹⁷⁴ LISA argued that although the law has required premium-return for over 150 years, insurance companies “are issuing policies that violate insurable interest laws, failing to take the proper steps to prevent or detect such improperly issued policies, refusing to respond to requests from owners to verify the validity of

¹⁶⁹ During the 2012 legislative session, an amendment was proposed to House Bill 1101 to require the refund of premiums, plus interest, if a life insurance policy is terminated or deemed to be void (including for lack of insurance interest). The amendment was withdrawn.

¹⁷⁰ Fortress Written Submission, *supra* note 72, at 14.

¹⁷¹ Transcript at 47.

¹⁷² See § 27-14-3(f), Ala. Code (2013) (“In the case of a void contract, the insurer shall not be liable on the contract but shall be liable to repay to the person, or persons, who have paid the premiums, all premium payments without interest.”). This provision was added in 1994. See ch. 94-576, Ala. Laws.

¹⁷³ See § 33-24-3(i), Georgia Code (2013) (“In the case of a void contract, the insurer shall not be liable on the contract but shall be liable to repay to the person or persons who have paid the premiums all premium payments without interest.”). This provision was added prior to 2003.

¹⁷⁴ See LISA Submission, *supra* note 26, at 7.

the policies, and then, after collecting the premium for years and years, attempting to keep those premiums.” LISA asserted that the amendment would not require premium return for STOLI policies, but rather for regulated viatical settlement contracts. Because these policies and the subsequent regulated viatical settlement transactions are the subject of “rigorous vetting,” insurance companies should be required to return premiums even when a policy is rescinded. LISA argued that this amendment would “ensure uniform public policy,” would “remove unjust enrichment by any party” and would “ensure the property rights and market value of life insurance for owners of life policies, including investors, who pay premiums and have not violated insurable interest laws.”¹⁷⁵

ILMA likewise asserted that if the insurance company is not enjoined from keeping the premiums if a policy is determined to be invalid after the contestable period, “this would provide an incentive for the insurer to be lax in its underwriting and its further examination as to the validity of the policy, because if it was later determined that the policy was invalid, it gets to keep the premiums that were paid in good faith by the purchaser.”¹⁷⁶

In opposition to this proposed change, ACLI submitted a letter from Valmark Securities, an early entrant to the life settlement brokerage business that stated that it “favors a well-organized and regulated secondary market for life insurance” and that “see[s] the benefit of helping a select group of older clients get true market value for their policies.”¹⁷⁷ In that letter, Valmark Securities argued against a premium-return requirement. Specifically, Valmark Securities contended that Fortress knew it was purchasing policies with the indicia of STOLI and is now seeking premium-return legislation in order to profit from these policies it bought on the

¹⁷⁵ *Id.* at 7-8.

¹⁷⁶ ILMA Submission, *supra* note 119, at 4.

¹⁷⁷ Valmark Securities, Letter to Commissioner McCarty, at 1-2 (Oct. 14, 2013), *available at* <http://www.floir.com/siteDocuments/ACLIMcCartyCommLetter10142013.pdf>.

secondary market at a deep discount.¹⁷⁸ Valmark Securities disagreed that such a legislative change is necessary in order to provide stability to the current market:

It is patently false, as the investors' interests assert, that unless certain states enact legislation requiring the return of premium upon rescission, the availability of funding for seasoned life insurance policies (those originally purchased to protect families or businesses as opposed to being purchased for speculation) will be ruined. We can tell from the policies being purchased today, that the market has adjusted and smart investors have adjusted their buying parameters to buy only seasoned policies excluding policies conceived in fraud. In fact, by rewarding investment in speculative pools of policies based on fraud several years ago might, draw capital away from pools of seasoned policies now being assembled that are from client[s] who purchased these policies to protect their families or business.^[179]

Valmark Securities stated that “[i]n those cases where the [insurance] companies have prevailed, fraud was rampant and those who assisted its commission had full knowledge of what was occurring in providing the funds. . . . [W]hen fraud is proven in a court of law, the speculators should not profit from having their premiums returned.”¹⁸⁰

At the hearing, ACLI contended that, contrary to Fortress’s assertion that premium refund is a bedrock principle, rescission is an equitable remedy and the court is allowed to weigh the equities and evaluate the facts of each case. Some courts have ruled that the public policy behind insurance fraud is so strong that they were not going to force a life insurance company to give back premiums to the entity that defrauded it, because doing so would make life insurance fraud a low-risk, high-reward proposition. Other courts have ordered premium return, but have allowed the life insurance company to offset against those premiums damages that it suffered separate and apart from the mere issuance of the policy. Finally, courts, including a Florida court, have ruled that if a life insurance company knew or should have known that there was an

¹⁷⁸ *Id.* at 2.

¹⁷⁹ *Id.* at 2-3.

¹⁸⁰ *Id.* at 3.

insurable interest concern, it is not entitled to retain premiums. Courts across the country have simply applied the three legal certainties of the law to reach equitable resolutions.¹⁸¹

The FIC also opposed this legislative change, arguing that in order to dispense equity in these cases, it is necessary to ensure that the parties who participated in the wrongdoing are punished to some extent, and those who did not are not punished. The only way such an individualized assessment can happen is through the courts. Requiring a return of premiums in every one of these circumstances may guarantee a large return on a risky investment that was bought with the knowledge of what was being bought.¹⁸²

A review of the case law in Florida reveals that rescission “is an equitable remedy where the primary obligation is to undo the original transaction and restore the former status of the parties.”¹⁸³ As a general rule, restoring the former status of the parties would require the life insurance company to return the premiums paid. However, at least one case from the Fifth District of Florida has distinguished contracts that are void *ab initio*, holding that “as a general rule, contracts that are void as contrary to public policy will not be enforced by the courts and the parties will be left as the court found them. We see no reason to depart from the general rule where, as in the instant case, the party seeking to enforce the contract is the only party who engaged in deceptive and misleading conduct at the time the contract was entered into.”¹⁸⁴ Accordingly, the Fifth District refused to order the refund of the premiums paid to the insurance company.¹⁸⁵ A federal district judge, however, in *Pruco Life Insurance Co. v. Brasner*, considered departing from this rule when evidence arose that the life insurance company may

¹⁸¹ Transcript at 67-69.

¹⁸² Transcript at 145.

¹⁸³ *TTSI Irrevocable Trust*, 60 So. 3d at 1150.

¹⁸⁴ *Id.*

¹⁸⁵ *Id.*

have been on notice of fraud and turned a blind eye to red flags that if timely and properly investigated would have led the insurance company to rescind or seek to void the policy before it was sold to a purchaser on the secondary market.¹⁸⁶

5. Require monitoring of any cost-of-insurance rate increases. Fortress's fifth, and final, legislative proposal was to require the Office to monitor cost-of-insurance rate increases to prevent insurance companies from discriminatorily targeting policyowners that are investors. Investor-owned policies can be identified because when an investor buys a permanent life insurance policy, it does not put extra premium into the product to accumulate value, but rather just enough to keep the policy in force. Fortress asserted that Phoenix identified these policies and targeted them for a discriminatory rate increase in an apparent attempt to force the investors to decide to allow the policy to lapse because of the rate increase.¹⁸⁷

Fortress contended that “[i]f investors on the secondary market must accept that any policy they purchase may be arbitrarily subject to premium increases, it decreases the worth of these policies. Accordingly, like many other states, Florida should protect its seniors by scrupulously monitoring and investigating any suspicious cost of insurance rate increases.”¹⁸⁸ ILMA stated that “[r]ate increases should only occur in accordance with the provisions of the policy. To arbitrarily and discriminatorily impose premium increases because of the status of the owner of the policy would unnecessarily and illegally reduce the value of the policy to the consumer.”¹⁸⁹ Fortress stated that if a policy has been in force for a number of years,

¹⁸⁶ *Pruco Life Ins. Co. v. Brasner*, 10-80804-CIV, 2012 WL 4364613, at *4 (S.D. Fla. 2012) (unpublished).

¹⁸⁷ Transcript at 48.

¹⁸⁸ Fortress Written Submission, *supra* note 72, at 14-15.

¹⁸⁹ ILMA Submission, *supra* note 119, at 4.

preapproval of a rate increase should be required, which would simply require that the insurance company explain to the Office the reason behind the rate increase.¹⁹⁰

ACLI responded that cost-of-insurance increases are heavily regulated by any state, and the language that is included in life insurance policies with respect to cost-of-insurance increases is usually specifically approved by state regulators. ACLI argued that in the rare circumstances that life insurance companies do not follow the language in the policies, the proper remedy is to either complain to the regulators or to the court. In ACLI's view, the notion that legislation is needed in order to deal with these issues is unfounded.¹⁹¹

D. Legislative Issues Asserted by LISA

In addition to supporting a premium-return amendment, which is discussed above, LISA identified five other issues that, in its view, should be addressed or corrected via legislation.¹⁹² Those issues are set forth below.

1. Nonpayment of interest on death claims. According to LISA, life insurance companies often fail to pay statutorily and contractually required interest on death benefits, depriving beneficiaries of the total proceeds due.¹⁹³ LISA asserted that no interest was paid on 3.4 percent of 1,003 viaticated policies. In 70% of those cases, the insurance company paid the interest once notified of the deficiency.¹⁹⁴ Viatical settlement providers or institutional investors in the secondary market know how to remedy the situation. However, if the beneficiary is unaware of the entitlement to interest, such as may be the case with seniors, the interest remains

¹⁹⁰ Transcript at 51.

¹⁹¹ Transcript at 75-76.

¹⁹² See LISA Submission, *supra* note 26, at 3-6; Transcript at 95-98, 105.

¹⁹³ Florida law requires payment of interest on death benefits. See § 627.4615, Fla. Stat. (“When a policy provides for payment of its proceeds in a lump sum upon the death of the insured, the payment must include interest, at an annual rate equal to or greater than the Moody's Corporate Bond Yield Average-Monthly Average Corporate as of the day the claim was received, from the date the insurer receives written due proof of death of the insured.”).

¹⁹⁴ LISA Submission, *supra* note 26, at 3.

unpaid. LISA recommended that the issue be examined and laws be enacted in order to ensure that life insurance beneficiaries receive all of the benefits due from a death claim.¹⁹⁵

2. Unauthorized changes of ownership data by insurance companies. LISA asserted that from November 2009 through July 2012, insurance companies made 944 unauthorized changes to ownership data on policies without authorization or knowledge of the policyowner. Although such changes may not be deliberate, they are detrimental—more than 35% of these changes could lead to a loss of coverage. Thus, LISA recommended examining the issue of unauthorized changes to ownership data and enacting laws to ensure that ownership data for life insurance policyowners is protected from unauthorized changes.¹⁹⁶

3. Obstruction in obtaining verification of coverage. LISA asserted that a number of insurance companies obstruct policyowners and life settlement providers and brokers from obtaining verifications of coverage. In LISA's view, these actions impair the market for seniors, and in some cases, the process becomes so complicated or lengthy that the transaction is not completed or the value paid for the policies is negatively affected. LISA also asserted that insurance companies refuse to honor the investor owners' requests for policy information. Thus, LISA requested legislation to ensure that the insurance companies provide a verification of coverage and policy information.¹⁹⁷

4. Preventing life insurance producers or agents from advising or being involved in viatical settlement transactions. The next issue asserted by LISA was that insurance companies are prohibiting licensed life insurance producers from advising and assisting policyowners with life settlements via the use of false information, threats of economic

¹⁹⁵ *Id.* at 3; *see also* Transcript at 96.

¹⁹⁶ LISA Submission, *supra* note 26, at 3-4; Transcript at 96-97.

¹⁹⁷ LISA Submission, *supra* note 26, at 4; Transcript at 97.

sanctions, and termination. Seniors consider their agents to be a source of financial advice and counsel and, consequently, this prohibition creates a negative impression of a viatical settlement transaction. Accordingly, LISA suggested examining insurance companies for violations of the Viatical Settlement Act and the Unfair Insurance Trade Practices Act and enacting laws to ensure that insurance companies do not impair insurance producers from being able to advise and assist their clients with viatical settlements.¹⁹⁸

5. Life expectancy provider registration requirement. Finally, LISA argued that certain provisions of the Viatical Settlement Act are outdated, fail to provide consumer protection, and impair the functioning of the viatical settlement market for seniors. In LISA's view, not only is the requirement ineffective and improperly viewed as a validation of registered life expectancy providers, it is impairing the functioning of the market. The requirement does not allow for viatical settlement providers to use expectancies generated in-house. Thus, LISA suggested that the Legislature repeal all provisions pertaining to life expectancy providers, including the prohibition on a viatical settlement provider or broker from being an owner or office, director, or employee of a life expectancy provider.¹⁹⁹

IV. CONCLUSION

Based on the materials submitted and testimony provided, there appear to be adequate protections for purchasers of life insurance policies in the secondary life insurance market to ensure that the market continues to exist. The five legislative changes proposed by Fortress, and supported by ILMA, appear to be proposed in order to address what Fortress asserted is only a "small handful,"²⁰⁰ or "2 percent,"²⁰¹ of insurance companies seeking to, in Fortress's view,

¹⁹⁸ LISA Submission, *supra* note 26, at 5-6; Transcript at 98.

¹⁹⁹ LISA Submission, *supra* note 26, at 6.

²⁰⁰ Transcript at 20.

improperly invalidate policies. The current legal structure provides an avenue of relief, and the courts are addressing these issues by applying equitable principles based on the fact-specific circumstances of each case.

There is a significant concern that enacting these legislative changes may have the unintended consequence of encouraging STOLI and fraud. An attendant problem to the existence of STOLI schemes is that individuals are encouraged at the outset to procure more life insurance than would be needed if being purchased for legitimate insurance purposes. This treatment of life insurance solely as a commodity from inception is at odds with the purpose of life insurance and may have negative ramifications for the industry, to the detriment of Florida consumers, life insurance companies, and the legitimate viatical settlement industry.

As a result of the hearing and its review of the materials submitted, the Office has identified issues that may merit further investigation administratively, but has no recommendations for legislative action at this time.

²⁰¹ Transcript at 33.

APPENDIX A

**TRANSCRIPT OF SECONDARY LIFE INSURANCE
MARKET PUBLIC HEARING ON OCTOBER 25, 2013**

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STATE OF FLORIDA
OFFICE OF INSURANCE REGULATION

IN RE: SECONDARY LIFE
INSURANCE MARKET

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PUBLIC MEETING

October 25, 2013

10:00 a.m. - 1:35 p.m.

Knott Building, Room 412
The Capitol Complex
404 South Monroe Street
Tallahassee, Florida

Reported by:

LISA A. BABCOCK, Court Reporter
For the Record Reporting, Inc.
1500 Mahan Drive - Suite 140
Tallahassee, Florida, 32308

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P R E S E N T

BELINDA MILLER, ESQUIRE

TOMA WILKERSON

JAN DAVIS

WENCESLAO TRONCOSCO

ALYSSA LATHROP, ESQUIRE

BRUCE CULPEPPER, ESQUIRE

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P R O C E E D I N G S

MS. MILLER: Thank you all for coming today. My name is Belinda Miller and I will be refereeing today.

I do appreciate everyone coming, and also for your submissions, for everything that you've given to us. If they're not already on our website, they will be. We will post everything that is submitted so that those who didn't have a chance to review it prior to this hearing will have a chance to go to the website and access the materials. So welcome to the hearing.

Good morning. My name is Belinda Miller. I'm the general counsel for the Office of Insurance Regulation. I will be presiding at the public hearing today. I'd like to take this opportunity to welcome you to this informational hearing on the secondary life insurance market in the state of Florida.

For the record, today's date is October the 25th, 2013. We are conducting this hearing in the Knott Building, Room 412, the Capitol Complex, Tallahassee, Florida. Notice was published in the *Florida Administrative Register*. The hearing is being broadcast thanks to the Florida Channel and

1 will be available for viewers on our website at
2 www.floir.com.

3 Interested parties, and anyone, may offer
4 materials and comments by sending an e-mail to the
5 Office at secondarylife@floir.com no later than
6 October the 30th. Material received on this
7 matter will be available to the public and posted
8 on the Office's website.

9 I'd like to take a moment and introduce my
10 colleagues. To my left is Wenceslao Troncosco,
11 who is the deputy commissioner for life and health
12 insurance. To his left, Alyssa Lathrop, who is
13 our lead attorney on this case; Bruce Culpepper,
14 also our senior attorney.

15 Toma Wilkerson is on my right. She is the
16 director of Life and Health Financial Oversight
17 responsible for the solvency of life and health
18 insurers; and Jan Davis in Market Investigations,
19 who is our resident expert on secondary life and
20 viaticals and life settlements. And that's not in
21 the script so -- I'll find my way.

22 We would like to allow time for everyone to
23 have the opportunity to address the issues raised
24 in this public hearing. Therefore, we ask that
25 everyone be respectful of the time and allow

1 everybody else to be heard.

2 That being said, this hearing starts at
3 10:00, and we did not put an end time on the
4 agenda, so we will have ample time for those who
5 want to speak to put everything they want to into
6 the record.

7 The Office is recording this proceeding.
8 Therefore, to help clarify the record, please
9 state your name prior to making comments and speak
10 one at a time.

11 The agenda is fairly simple. We are going to
12 have representatives of Fortress speak first, and
13 then representatives of the life insurers and the
14 life settlement companies, and anyone else who
15 wishes to speak.

16 If you haven't already filled out a speaker
17 card and you would like to make comments, please
18 see Eddie in the back of the room. He's got
19 speaker cards and will be glad to help you.

20 Before we begin, I'd like to go over the
21 issues involved. The Office was given a specific
22 task by the Florida Legislature to review Florida
23 law and regulations to determine whether there are
24 adequate protections for purchasers of life
25 insurance policies in the secondary life insurance

1 market and to ensure that this market continues to
2 exist for Florida seniors.

3 Our purpose today is to solicit different
4 viewpoints -- and we know that there are a variety
5 of viewpoints that have some conflict in them so
6 it won't be boring -- and look into legal
7 arrangements and implications of the secondary
8 life insurance market.

9 The Office will also inquire how consumers
10 benefit or are harmed by these arrangements. We
11 would welcome any thoughts on the role that the
12 Office should play with regard to any new products
13 that might be coming into the marketplace.

14 I know that some of the participants will
15 have specific legislative recommendations and not
16 sure whether the Office will or not at this point.
17 We'll wait and see what happens. So if anyone
18 wishes to speak, again, see Eddie in the back of
19 the room for a speaker card.

20 With that, I will recognize our first
21 speaker, Jerry Kroll -- well, I will recognize
22 Fortress and you can introduce yourselves. I
23 think Mr. Welsh will be our first speaker.

24 MR. WELSH: Thank you, Ms. Miller.

25 My name is Tom Welsh -- there we go. Is that

1 good?

2 Good morning and thank you very much. My
3 name is Tom Welsh.

4 (Brief interruption.)

5 MR. WELSH: Thank you. My name is Tom Welsh
6 from Orrick, Herrington & Sutcliffe. We're an
7 international law firm that -- I'll try to make
8 myself shorter so you can hear me.

9 MS. MILLER: Yeah, I don't know that that's
10 going to work.

11 MR. WELSH: We are an international law firm
12 specializing in complex finance, complex
13 litigation and regulatory, specifically insurance
14 regulatory, matters. And I'm here to speak on
15 behalf of Fortress Investment Group, which is a
16 large investor in the secondary market in the life
17 insurance space.

18 We -- first, I want to let you know how much
19 we appreciate the time and energy and resources
20 that OIR and the Commissioner have put into this
21 issue. It's really an important issue. It can be
22 a very emotionally-charged issue, and we really
23 appreciate the fact that the Commissioner and his
24 senior staff is taking it very seriously.

25 Briefly, let me -- let me give you a quick

1 overview on my comments, which I'll try to keep as
2 brief as possible. But being a lawyer, you know,
3 I can only do so much. We're problematic when it
4 comes to --

5 MS. MILLER: Well, if we're going to go past
6 lunch, we will take a break for lunch, so take
7 your time.

8 MR. WELSH: I promise not to take up the
9 whole morning. What I want to do first is provide
10 a brief overview of the life and -- the life
11 settlements market, primarily just identify who
12 the major stakeholders are, because I think that's
13 important as we look at what your charge is and
14 the primary focus being on the role of the
15 secondary market investors and keeping that market
16 alive, well functioning and available for seniors.

17 And next, I'll move on and I'll talk about
18 that secondary market investors' perspective on
19 the market. After that, I'll talk about some very
20 serious problems that have emerged in the market
21 that have had a negative impact on actually many
22 different stakeholders within the market, most
23 notably consumers, who are the ultimate concern
24 for OIR and a lot of the players in the
25 marketplace.

1 Finally, what we've done in our submission on
2 behalf of Fortress is identify potentially five
3 legislative and/or regulatory corrections that can
4 be made to address some of these serious problems
5 that we've seen in the marketplace. And by all
6 means, while I'm talking, feel free to interrupt
7 me with any questions that you have.

8 As you mentioned, you've referred to yourself
9 as a referee today. I've been involved in the
10 life settlements market advising clients at
11 different levels for a long, long time, for many,
12 many years; and there's no question that probably
13 everyone in this room has really seen the fur fly
14 when we talk about these issues, because it is --
15 it's an emotional and can be a challenging space
16 to talk about.

17 And I think OIR's role as a referee of this
18 discussion will really assist everyone in allowing
19 you to focus on the real public policy drivers of
20 how this -- how this market can be and should be
21 regulated in a way that really keeps it safe and
22 sane.

23 So first, about Fortress, some of you
24 are familiar with Fortress, but let me briefly
25 describe them. Fortress is an asset management

1 firm that makes and manages investments for public
2 and private pension funds, unions, university
3 endowments, nonprofits.

4 Their investor client base, the people they
5 manage money for, are people like fire fighters,
6 police officers, teachers, nursers and other
7 public employees, as well as corporate pensioners
8 from all walks of life.

9 Fundamentally, they are an investment
10 manager. Their job is to find good investments
11 that are well-priced, manage them carefully, if
12 necessary, manage them aggressively so that their
13 underlying clients receive the returns that they
14 deserve.

15 Fortress has about 11,000 employees here in
16 the state of California (sic) through
17 its portfolio businesses and the industries that
18 it's involved in, and it regularly invests
19 hundreds of millions of dollars on behalf of its
20 pensioners and universities and foundations right
21 here in Florida. They're a significant player
22 here in your community and in your state.

23 We believe this is actually a relatively
24 typical profile for the type of investors who are
25 involved in the secondary market for life

1 insurance.

2 Another good example out where I'm from --
3 I'm from California -- and the California Public
4 Employees Retirement System is also a significant
5 large investor that has seen many of the same
6 problems that Fortress has seen in its
7 marketplace. So this -- you know, the type of
8 people who are looking for this particular asset
9 class is relatively similar, and Fortress is just
10 one example of many.

11 One of the -- as I mentioned and I think
12 you're all aware, one of the major investments
13 that Fortress made for its clients in the midst of
14 the recession was the purchase of nearly 1500
15 permanent life insurance policies that previously
16 had been owned by major financial institutions,
17 national and international banks that had provided
18 financing of one sort or another, and found
19 themselves owning these very large portfolios but
20 being unable to maintain them and service them,
21 because when you own these things, you have to
22 continue to pay premium on the policies and keep
23 them in force.

24 Obviously, the recession created a very, very
25 significant dislocation in the credit markets, and

1 these major financial institutions simply couldn't
2 afford to keep and maintain a portfolio of this
3 size all the way through to maturity.

4 Fortress saw the opportunity to buy up the
5 policies and did. And from that time, it spent
6 the ensuing years very aggressively and
7 assertively managing the rights that existed under
8 the policies and working -- attempting to work
9 cooperatively with the life insurers that had
10 issued those policies, talking to them about how
11 the policies were performing and establishing the
12 long-term relationships that you would expect and
13 want to see between a large policy owner and the
14 life insurance company underwriters that were
15 involved.

16 As a result of that, they really, I think,
17 became experts in the management of this
18 particular asset class. They have a very deep
19 staff, and I think they're particularly well
20 situated to assist OIR as it carries out its
21 charge of looking at the secondary market, seeing
22 what problems exist there, what potential
23 protections may be needed there to make sure that
24 the entire market stays alive and is available for
25 Florida seniors.

1 Let me -- let me give you a real brief
2 overview of the market and really only for the
3 purpose, since I know the staff is very well
4 acquainted with the life settlements market,
5 particularly here in Florida, but I want to sort
6 of identify who the real key stakeholders are,
7 and why they're important, and why each one of
8 them requires notice and consideration.

9 The first and foremost, obviously, is the
10 consumers, the Florida seniors who have acquired
11 life insurance, and at some point down the road,
12 may decide, for whatever reason, that they need to
13 access the life settlements market and convert
14 those life insurance properties into cash.

15 And, you know, ultimately, the reasons why a
16 senior might choose to access the life settlements
17 market is about as varied as life itself.
18 Everybody has different reasons for looking to
19 that market.

20 The key is that, regardless of the reason,
21 it's longstanding law throughout the United States
22 that that's a piece of property that they own and
23 have the right to sell if, for whatever reason,
24 they decide that that's a move that they want or
25 need to make.

1 So it's an important market from their
2 perspective, and as we work through today,
3 Fortress obviously keeps its eye on its role in
4 the marketplace and ultimately how that drives
5 towards benefiting seniors by keeping the market
6 available.

7 The next biggest stakeholder and constituency
8 obviously is the life insurance industry, those
9 people who have underwritten the policies
10 and undertaken contractual commitments to, first,
11 the original policy owner, and then subsequently,
12 to investors who may have to step in, or do step
13 in, to the ownership of those -- of those
14 policies. So those contractual obligations that
15 the life industry undertakes are flowing to
16 whomever ends up owning the policy.

17 The next constituent that we don't speak on
18 behalf of are those originators who are out in the
19 marketplace, the Coventries and others; the agents
20 and brokers who are on the front lines with the
21 consumers explaining the risks and benefits of
22 accessing the life settlement market; and next,
23 and from our -- from Fortress's perspective,
24 importantly, is the set of investors who
25 ultimately provide the liquidity to the market.

1 Obviously, the originators, for the most
2 part, are not there to buy and to hold to
3 maturity. They frequently are looking to transact
4 and move those policies into a secondary market.
5 That's the way our financial system in the United
6 States works.

7 And they need that access to good, solvent,
8 well-managed secondary market players who can
9 allow them to continue to outreach to consumers
10 who want to access the market and have the capital
11 necessary to acquire the policies.

12 Now, during the -- I'll pause for a second
13 and say that, you know, during the course of the
14 hearing and through submissions, I imagine
15 that there will be a certain amount of --
16 "invective" may be the wrong word, but we have
17 seen in these kinds of public hearings
18 and legislative hearings that there's often an
19 attempt to vilify the investors as vultures and
20 as people who are simply there to make a buck
21 without regard to anything else.

22 And I will acknowledge that Fortress's job,
23 and the other -- and the job of CalPERS and the
24 others, is actually to take investments, invest in
25 an asset class and try to make a healthy positive

1 return for the underlying investment clients that
2 they work for. There is -- there is actually no
3 shame in that, and Fortress is very, very good at
4 it.

5 But I think the focus -- you know, your job
6 today as referee is to try to cut through some of
7 that hyperbole and invective and an attempt to
8 divert your attention away from the key issues.
9 You're going to hear it, no doubt, because we hear
10 it all the time, but the secondary market space is
11 much bigger than just Fortress, and it needs to
12 be, in our view, protected so that the entire
13 market holds together.

14 There's not a market if you don't have the
15 investors who feel comfortable putting their
16 clients' money into the asset class with some
17 degree of predictability and knowledge of how that
18 asset class and how that space is going to work,
19 from a regulatory standpoint in particular.

20 So the last big stakeholder is you all. The
21 regulatory community in the United States is
22 vitally important to the functioning of this
23 market. We have here in the U.S., as you know, a
24 50-state -- well, 50-plus-state insurance
25 regulatory system where the regulators are able to

1 focus on the business of insurance that happens
2 within their borders, and they coordinate with
3 other states.

4 But you will see that some life insurers, one
5 in particular that we'll talk about, has really
6 tried to take advantage of and game that a little
7 bit at the expense of all the players, in our
8 view, in the market. That's one of the problems
9 that we'll identify.

10 But your regulatory role here is incredibly
11 important and plays a big part in what we see as
12 appropriate remedies to help deal with the
13 problems that we're seeing in the marketplace
14 right now. So those are the major stakeholders in
15 the market.

16 The -- let me -- let me turn to the
17 investors' perspective and essentially ask the
18 question why investors, like CalPERS, Fortress's
19 clients, find this asset class of life settlements
20 attractive, and it really is relatively simple.

21 In theory, in a well regulated market, this
22 asset class is not correlated to or vulnerable to
23 the wild fluctuations that can happen in the stock
24 market and in other equities indices. The asset
25 class shouldn't have to worry about a eurozone

1 crisis. It shouldn't have to worry about the
2 shutdown of the United States Government and the
3 volatility that happens from those things.

4 In a well regulated system, the investors are
5 essentially looking at mortality curves, and the
6 risk that they're taking is essentially a
7 mortality risk. They're going to pay fair value
8 at the outset for policies, and pay the premiums
9 through the maturity date.

10 And the return, in a large enough portfolio,
11 ultimately should be driven by mortality trends.
12 It should stay predictable and insulated from the
13 fluctuations that happen in other markets. So
14 it's that non-correlated market feature that has
15 largely made this asset class, especially during
16 the recession, attractive to secondary market
17 investors.

18 It's just a way to balance a portfolio and
19 identify assets that have a particular risk that
20 you can look at, like what mortality experience is
21 going to do and develop over time. That's
22 something that you can get your arms around. You
23 can predict, you can price, provided that the
24 market is well regulated and is not subject to
25 unpredictable behavior on the part of, frankly,

1 any of the stakeholders who are involved in the
2 marketplace.

3 So what do secondary market investors really
4 want and need to feel comfortable continuing to
5 fund the market? They really want predictability
6 and certainty. And not certainty as to investment
7 return: How much money am I going to make,
8 guaranteeing that I'll make a profit? That's not
9 the kind of certainty we're talking about.

10 We're really just talking about
11 predictability as to the behaviors of the key
12 players, and most importantly, the behaviors of
13 the life insurance companies who have underwritten
14 the policies. That's probably the single most
15 important element of it; but also, you know, the
16 predictability of the originator behaviors and the
17 consumer behaviors.

18 Because there's no question that if problems
19 occur and aren't well regulated at that level, if
20 we allow any consumer to commit fraud, if we allow
21 originators to not originate life settlements in a
22 way that's consistent with consumer interests and
23 consistent with the law, that creates an
24 unpredictable environment for investments in the
25 secondary market. And that's ultimately what

1 secondary market investors are looking for is a
2 well regulated market that is predictable
3 and isn't exposed to, let's say, irrational or
4 inappropriate behavior.

5 So that's a good segue into what some of the
6 current problems are in the market. There really,
7 right now, is a real threat to the life
8 settlements market, we believe, that will
9 ultimately reduce, for Florida seniors, their
10 ability to access the market and achieve the
11 values that they should get in a well regulated
12 market.

13 And the specific problem that we -- that
14 Fortress has seen is an effort by a small handful
15 of insurers to refuse in one way or another to
16 honor those policies after they've collected
17 premiums for years and years, sometimes a decade
18 or more on the policies.

19 I want to stress at the outset that by no
20 means is this an indictment of the entire life
21 insurance industry. This actually may be a good
22 example of that, you know, 90/10 rule, maybe even
23 98/2 rule, where, you know, regulators and
24 regulation often don't need to be there for the
25 90-plus percent of companies and market

1 participants who are behaving well.

2 Really, you have to be there to have the
3 tools to address that minority of companies who
4 don't behave well, who, for whatever reason, have
5 decided to try to game the system and avoid paying
6 their obligations when and as they come due.

7 And so Fortress doesn't want its comments and
8 its submissions to be seen as a broadside across
9 the life insurance industry, because in many
10 respects, the life insurance industry is the
11 partner of the secondary market investors. You
12 don't have this asset class, candidly, if you
13 don't have solvent, reputable life insurers in the
14 marketplace.

15 So let me focus on the problems of the
16 minority. What the biggest issue the secondary
17 investors are seeing is that after collecting
18 premium, and frequently long after the two-year
19 contestability period in California, a couple of
20 carriers are making aggressive moves to try to
21 invalidate the policies that are now held and
22 owned by secondary market investors.

23 And they're asking the courts to invalidate
24 the policies from inception by asserting, again,
25 long after the running of the contestability

1 period, that the policy was void from inception
2 because it lacked an insurable interest. In
3 short, they're trying to end around the
4 contestability period and go back and invalidate a
5 policy based on an argument that essentially it
6 was STOLI at its inception.

7 And the argument that they're making is that,
8 in legal jargon, it's -- the contract is *void ab*
9 *initio* -- lawyers can never get through any kind
10 of remark without throwing in a Latin phrase;
11 right -- so void from the very inception.

12 This is ultimately just a rescission remedy,
13 the kind of rescission remedy that you frequently
14 see in the life insurance industry in the first
15 two years. If a policy matures and an insured
16 dies within the first two years, the life
17 insurance company legally can and should
18 investigate the claim, investigate the
19 application, see if there was fraud.

20 And if there was, if there was material
21 misrepresentations in the application, they have
22 the right to rescind that policy. It happens on a
23 fairly regular basis, and it's not necessarily an
24 unusual remedy within the contestability period.

25 What makes this particular problem so serious

1 are two facts: One is that these kinds of
2 challenges are being made well outside the
3 two-year contestability period; and two, the
4 insurers have doubled down and said, "Not only do
5 we want to rescind, but we want to be able to keep
6 all of the premium that's been paid to us as
7 damages, because we were damaged by the fraud."

8 And they actually have now been successful
9 in picking out cases with particularly bad facts.
10 And as -- you know, our other favorite saying as
11 lawyers is bad facts can make for bad law. And
12 we're actually seeing that here in Florida where
13 the really bad facts of a particularly egregious
14 STOLI case where a consumer and an unscrupulous
15 agent of the life insurance company commits fraud,
16 they lie to the company in the application about
17 their net worth and their sources of income that
18 they have to get bigger policies, and those cases
19 have a tendency to cause judges to look for
20 remedies.

21 They don't want to reward an original insured
22 or anyone else who just happens, through the
23 secondary market to have ended up owning that
24 policy, to reward that bad behavior.

25 So we've seen clear examples, and we've

1 provided them in our submissions, of judges
2 essentially being misled by bad facts and allowing
3 a situation where an insurance company, long after
4 the contestable period, which is that window for
5 them to really complete underwriting and make sure
6 that they've got a policy that was applied for
7 appropriately, being able to rescind and create a
8 windfall for the life insurance company. And I'll
9 talk about that in a little bit more.

10 But just to give you a sense of how big this
11 problem is -- again, it depends on the insurer,
12 but this process of resisting claims, especially
13 with one particular insurer -- the members of the
14 Phoenix Group of companies which are headquartered
15 in -- their business headquarters are in
16 Connecticut. The parent company, Phoenix Life, is
17 domiciled in New York. The largest underwriting
18 company is PHL Variable. It's domiciled in
19 Connecticut.

20 We have statistics that are in our
21 submission, and these are from Phoenix's own sworn
22 statutory financial statements filed with OIR and
23 all the regulators in all the states where they're
24 licensed to write business, but you saw this trend
25 start prior to 2008. They were resisting or

1 denying less than 1 percent of their aggregate
2 death claims.

3 In 2009, that grew to 12.37 percent. By
4 2010, it had grown to 16.2 percent. And by 2011,
5 Phoenix was resisting or denying 20.87, almost
6 21 percent, of its incurred death benefit claims.
7 So the math tells us that over that three-year
8 period, that's a 1900 percent increase in the
9 amount of claim resistances and denials.

10 Now, Phoenix quibbles with these numbers, and
11 they point out accurately that the number is based
12 on the aggregate death claims, not the claim count
13 that comes in. And that is an important
14 distinction.

15 But the statement and the data is -- it can't
16 be refuted that during this period of time, there
17 has been a demonstrable, empirically identifiable
18 trend at Phoenix and a few other companies
19 to increase the extent to which they're denying
20 claims.

21 Now, the national industry average for
22 resisting and denying claims is about one half of
23 1 percent. So you look at a 21 percent ratio for
24 a particular company that has a big place in this
25 particular market for reasons I'll explain in a

1 minute having that level of resistance rate is
2 striking. It's something that we believe
3 regulators should note, because it's a serious
4 problem for secondary investors if it continues
5 and is allowed to go unchecked.

6 So, you know, when we look -- again, since
7 your charge is to look at the interests of the
8 secondary market and how that impacts Florida
9 consumers, there really -- the tie-in is pretty
10 obvious.

11 The simple fact is investors are simply not
12 going to buy policies in a state where that kind
13 of law exists and they have to worry about the
14 possibility that they can buy a policy long after
15 the contestable period, pay premium for 10, 15, 20
16 years until maturity, and then find that they have
17 an insurer who has rights under, what we think is,
18 anomalous Florida law that allow the insurance
19 company to not pay anything.

20 MS. MILLER: Let me interrupt you for just a
21 minute. Would it be that bad -- I mean, I know
22 this is a loaded question -- but would it be that
23 bad if, as a result of this case law, investors
24 said, "Well, you know what, I'm not going to buy a
25 Phoenix policy anymore"?

1 How does that harm the average consumer or
2 the average person who might be considering
3 selling their policy or maybe not? I mean, is
4 that going to hurt the people in the state of
5 Florida?

6 MR. WELSH: I think it does for a couple of
7 reasons: One, there's consumers and then there's
8 actually Fortress consumers -- or Phoenix
9 consumers. So if you stop and, you know, if
10 you're looking at it broadly, there are
11 significant negative impacts.

12 But stop and think about what Phoenix has
13 accomplished. And you're absolutely right. As we
14 pointed out in our -- in our submission, there
15 already is, in the secondary market, a "no Phoenix
16 paper" standard.

17 When investors identify for the originators
18 the types of policies and the profiles that
19 they're looking at purchasing and investing in --
20 they want an issue age of X and a death benefit of
21 a million-plus -- whatever those criteria, just
22 general criteria, are, they'll list them for the
23 originators so the originators know that there's
24 going to be a market for them.

25 And now, many investors are simply putting a

1 bullet in there that says "no Phoenix paper."
2 They just -- they don't want it. Now, if you
3 happen to be, say, a -- an 80-year-old Phoenix
4 policyholder in Florida, what Phoenix's behavior
5 has now done is taken the market value of your
6 policy and destroyed it or dramatically diminished
7 it.

8 And now you really have those classic just
9 two choices: You can either let that policy lapse
10 if you find yourself unable to afford it at 80, or
11 you don't need it anymore, you can let it lapse;
12 or you can see if you can surrender it for some
13 relatively modest cash surrender value, which, of
14 course, you know, was originally your money paid
15 in.

16 MS. MILLER: Well, was it? Because my
17 understanding was that these policies were what we
18 refer to as STOLI policies. So for people
19 watching at home, that is a stranger-originated
20 life policy where I, my understanding -- you can
21 correct me if I'm wrong -- is someone goes to a
22 consumer and says, you know, "You're not using
23 your asset, which is the capacity to buy more life
24 insurance. I've got a good deal for you.

25 "All you have to do is fill out an

1 application form, and you don't have to pay money.
2 I'll pay the premium for the first two years. And
3 then at the end of that period of time, you can
4 decide, do you want to keep the policy and repay
5 my loan, or do you want to sell me the policy?"

6 So if the policy is in the first two years,
7 have the consumers actually paid anything? Or is
8 this a -- an issue among investors and the life
9 insurers?

10 MR. WELSH: Well, first, we have no
11 information that suggests that the only business
12 that Phoenix was writing was STOLI, and you'll
13 hear a presentation shortly that will demonstrate
14 to you that Phoenix was actually out in the
15 marketplace looking for premium-financed life
16 insurance with high dollar values.

17 That was a market niche that they had
18 identified and really aggressively went after,
19 knowing at the outset that there was a high
20 likelihood that that policy, over time, would end
21 up in the hands of investors and would be less
22 likely to lapse. So, you know, that's one issue.

23 But, you know, right now, Phoenix has created
24 a situation where there may be people who went
25 ahead and acquired their insurance in that way,

1 borrowed some money to pay the premium for the
2 first couple of years, and then maybe because of
3 an adverse health event or an estate planning
4 reason decided to pay off that loan and keep the
5 policy for their beneficiaries.

6 I don't know exactly. I don't have Phoenix's
7 customer list here in Florida. Phoenix would be
8 the one who would have to tell you if they have
9 any policies that are still in the hands of the
10 original insurers. I have to believe that that's
11 the case but --

12 MS. MILLER: Would they know?

13 MR. WELSH: I would think that they should.

14 MS. MILLER: I don't want to jump ahead, but,
15 you know, in preparation for this hearing, one of
16 the things we did was we sent a questionnaire to
17 the life insurance companies.

18 We already get an annual report from all of
19 the life settlement companies about how many
20 policies have been, for lack of a better word,
21 viaticated; and the life insurers reported to us
22 their estimate of how much they think their book
23 is subject to a contract of viatication, and the
24 numbers are dramatically different.

25 I mean, the viatical settlement companies

1 have identified a tremendous number of viaticated
2 policies that I think the life insurers may be
3 unaware of. They may not know that's been
4 viaticated.

5 They may not -- it could be that they just
6 don't track it. It could be the ownership hasn't
7 actually changed yet. You know, I'm not sure.
8 They should have gotten notice. You know, if it's
9 in that two-year period, they may not have notice
10 yet.

11 MR. WELSH: That is -- that is true. And
12 actually, you know, if we take a step back,
13 really, what the secondary market investors are
14 looking for is a regulated market that is agnostic
15 as to who owns the policy.

16 And the reason we were talking about this was
17 identifying, you know, what's the adverse
18 consequence if Phoenix continues on this path and
19 other insurers start to replicate that because now
20 you're generating case law that lets other
21 insurers know that they could potentially avoid
22 the two-year contestable period if they missed
23 something by claiming that there was a lack of
24 insurable interest at the outset?

25 So there is this contagion risk that exists

1 when bad facts make bad law, and suddenly it's not
2 just Phoenix. It could be other companies that
3 feel as though they've been wronged, perhaps
4 correctly, but they missed the contestability
5 period, their window under your law to figure that
6 out.

7 And they will start to take advantage of
8 that. That's the overarching concern and problem
9 that will exist in the marketplace. And it's not
10 just a problem for life and set -- life
11 settlements investors. It's a problem for
12 original insureds.

13 Somebody who, you know, smokes 12 cigars a
14 year or 10 cigars a year or whatever insurance
15 companies will typically allow -- I don't smoke
16 that many but you can -- you can do that and still
17 be a nonsmoker and apply for a nonsmoker-rated
18 policy.

19 And if suddenly you unfortunately pass away
20 for totally unrelated reasons, three years later
21 and the insurance company comes back and says,
22 "Hey, we want to invalidate that policy," there's
23 now jurisprudence, there's case law that will
24 support invalidating that policy even afterwards.

25 Now, my example wasn't a good one because I

1 haven't settled the policy. But if a policy gets
2 settled and you have that kind of a circumstance,
3 that case law is going to be there for any life
4 insurance company to take advantage of it.

5 And that's the contagion risk that Fortress
6 sees coming out of bad behavior by that 2 percent
7 of companies that are looking for ways, right or
8 wrong, to avoid their policy obligation. Does
9 that answer your question?

10 MS. MILLER: Yes. Thank you. I know your
11 colleague has more to say about all of that.

12 MR. WELSH: And again, you know, we --
13 investors, I think, would like to see a market
14 that doesn't make distinctions between life
15 settlement companies or investors as owners of the
16 policies and the original purchasers.

17 So let me -- let me turn, having identified
18 some of those problems, what are -- what are some
19 of the potential fixes? In Fortress's submission,
20 we identified five potential legislative fixes
21 that could help clarify the marketplace.

22 The first one I'll go over briefly is a
23 possible reform that would try to clarify and
24 create certainty and end a lot of this needless
25 litigation by establishing that the subjective

1 intent of the original insured who may, you know,
2 by the time of the challenge, have died, isn't
3 relevant to determining whether there was an
4 insurable interest at the inception of the policy
5 on day one.

6 Insurable interest, just for the record
7 and for the audience, just refers to the interest,
8 either personal or financial, that the beneficiary
9 has in the life of the person who is being
10 insured.

11 I think as everyone is aware, the insurable
12 interest requirement is there to avoid that moral
13 hazard of having a stranger take out a life
14 insurance company (sic) on you and then, you know,
15 running you over with a car, which actually is a
16 real example from Los Angeles.

17 And, you know, that insurable interest
18 requirement is essential. It has to be preserved.
19 The issue is that under Florida law and under most
20 state laws, the insurable interest requirement
21 applies to the initiation of the policy. At the
22 time the policy is issued, there has to be an
23 insurable interest.

24 After that point, consistent with the notion
25 that a policy is a piece of property that can be

1 sold if the owner wants to, it has to be freely
2 transferable, even to someone who doesn't have an
3 insurable interest in the life that's being
4 insured. I mean, that's the fundamental principle
5 in the life settlements market.

6 And what we're seeing, unfortunately, is that
7 some of the companies have begun to challenge the
8 policies claiming that they're void for lack of an
9 insurable interest by focusing on what the
10 consumer, the applicant's, original intent was
11 when they took out the policy.

12 And that is absolutely chilling the market,
13 and, you know, they're keeping a lot of lawyers
14 busy. But the real problem is if you use that
15 kind of an intent standard to determine -- let
16 me -- let me back up for a second.

17 The argument they make is that if, at the
18 time of application, they intended to sell the
19 policy, that, by definition, there was no
20 insurable interest. The policy can be voided,
21 right.

22 There's a lot of devil in the details of
23 establishing or applying an intent standard. You
24 know, we ask the rhetorical question in our
25 submission, is it enough that they thought maybe

1 there is a 50/50 chance that they might settle the
2 policy and sell the policy in the future, is that
3 enough to establish that they had an intent to
4 settle, and therefore, the policy was void?

5 What if they just entertained the prospect of
6 doing it? What if they were simply aware of the
7 fact that policies are property, and down the
8 road, I can sell them if I want to? Is that
9 enough to demonstrate an intent to settle the
10 policy such that years, maybe decades later, the
11 insurance company can go back and void that policy
12 and try to hold onto the premiums as a form of
13 damage?

14 And ultimately, you know, should it matter
15 whether a policy is actually sold? Even if you
16 have someone who has the intent to settle the
17 policy, takes it out but then, you know, in all
18 likelihood, I'm going to -- I'm going to settle
19 this policy and get rid of it, but then they
20 don't.

21 I mean, that's a real case from here in
22 Florida involving Mr. Cotton and -- where the case
23 wasn't settled -- or the policy wasn't settled,
24 and the insurance company nonetheless was able to
25 find intent that he wanted to settle the policy

1 when he applied for it, and they argued that there
2 was no insurable interest and the policy was void
3 and they didn't want to pay the death benefit.

4 What's -- the judge in that case, I think,
5 did a very good job of identifying what really the
6 underlying problem is with an intent standard.
7 The quote from the case is, the judge said, "In
8 this case, discovering the intent of Mr. Cotton at
9 the time he procured the policy is complicated by
10 the fact that he is dead."

11 You know, our view is that an appropriate fix
12 would be a legislative change that establishes
13 that intent of the policyholder is not relevant to
14 an analysis of whether there is an insurable
15 interest that exists at the time of the policy
16 inception.

17 Without that, you get into this contagion
18 risk that insurance companies, as this kind of
19 jurisprudence continues to arise, will start to
20 think that the contestable period is discretionary
21 and optional. And that's not good for seniors,
22 whether they settle or not.

23 The second potential legislative option
24 is clarifying that these types of insurable
25 interest challenges can't be made after the

1 contestable period. You know, it has been long
2 settled that life insurance companies are afforded
3 this window of time, two years, to complete the
4 underwriting and identify red flags and follow up
5 on those red flags to see if they've issued a
6 policy that was issued based
7 on misrepresentations.

8 And we think, you know, candidly, it makes a
9 lot more sense to conduct that inquiry about
10 insurable interests while the original insured,
11 the applicant, is still among the living and can
12 tell the insurer and a court what he or she was
13 thinking at the time they bought the policy.

14 So if you are going to -- if the law is going
15 to evolve in a way that allows intent to remain
16 relevant that, at a minimum, those kinds of
17 challenges need to be put back where they belong
18 under the contestable period so that the market
19 understands that, after that window, the investors
20 have the certainty they need to dump money into
21 the market and provide higher values for those
22 seniors who actually want to sell a policy.

23 I can -- in our submission, I'll point out
24 that we've provided some case law to illustrate
25 some of these. Actually, a Florida federal judge

1 agrees with the investor community that the better
2 rule is that those kind of challenges need to
3 happen within the contestable period, but there
4 has been case law to the contrary that opens up
5 this uncertainty that is so problematic.

6 The third option is notices of validity, is
7 just ensuring that when an investor decides they
8 want to buy a policy, allow them to be able
9 to contact and obligate the insurance company to
10 respond with an affirmative indication that the
11 policy is valid, it was validly issued. And as
12 long as the premium remains -- is paid, the policy
13 will remain in force and the death benefit will be
14 paid.

15 The fourth option is a legislative change
16 that establishes that these kinds of challenges
17 will remain subject to the traditional rule of
18 rescission, which is that you have to give back
19 the premium.

20 So if you're an insurance company, and within
21 the contestable period, your insured dies and you
22 realize there's been fraud in the application and
23 you rescind, the law of rescission says that the
24 parties have to be put back into their original
25 position. The policy is ripped up. You don't get

1 the death benefit, but we're going to give you
2 back all of the premium that you paid into the
3 policy.

4 The litigation that I mentioned has had a
5 number of insurers asserting claims that they
6 should be able to rescind but not put the policy
7 owner back into the position of getting all their
8 premium back. They want to retain that as a form
9 of damages.

10 Their theories vary but, you know, the
11 biggest driver of this is that life insurance is a
12 very high commission business, and the life
13 insurance company gets the premium and they turn
14 around and pay very, very large commissions to
15 their life insurance agents. That's their
16 business model. That's the way they've chosen to
17 do business.

18 And the insurance companies don't want to
19 spend the time and effort to go after bad agents
20 who put a bad policy into their book, one, because
21 it's easier for them to just ask the judge to let
22 them keep the premium and they can -- they can
23 recover that damage, if it is damage, rather than
24 having to go --

25 MR. TRONCOSO: Can I interrupt you for a

1 second? You bring up a good point. So this goes
2 back to Option A. And I mean, really, what you're
3 getting to is, you know, fraud, because you kind
4 of opened the door a little bit to fraud when you
5 -- you know, what about the public policy
6 implications when you're talking about, you know,
7 closing off the door to the intent of the consumer
8 when they purchased the policy?

9 You know, when you're talking about doing
10 that, you obviously could open the door to
11 fraudulent situations. And have you thought
12 through what impact it could have on the
13 marketplace?

14 And then also, you know, have you thought --
15 is this legislative fix that you're seeing, are
16 you thinking to direct this specifically towards
17 the life insurance industry, or are you thinking
18 in a more general sense? Because, you know,
19 insurable interest obviously has rather large
20 impact across several markets.

21 MR. WELSH: It does. First, our thought was
22 focusing just on the life insurance, because this
23 is -- this is, by definition, a life settlements
24 context that we're talking about. But -- and most
25 of the moral hazard actually exists with respect

1 to life insurance.

2 It does -- lack of insurable interest does
3 raise moral hazards in property and casualty as
4 well. If you buy a homeowner's policy on your
5 neighbor and then burn their house down and
6 collect the premiums -- the damages, that's the
7 same type of moral hazard.

8 But really, the focus of moving away from
9 intent is to say to the life insurance industry,
10 "You have to underwrite. You have to police your
11 own agents. These are your agents. You file an
12 appointment saying that this person is authorized
13 to act on your behalf to work with consumers, to
14 solicit applications for life insurance. Police
15 those people."

16 And if they do their underwriting, if they do
17 their selection of agents and training of agents
18 properly and invest in that the way they should,
19 the way you as regulators would want them to,
20 that's where fraud abatement -- that's where
21 the fraud prevention is most easily addressed at
22 that front end agent selection and underwriting
23 process, and not allow insurance companies to
24 essentially just turn a blind eye to that fraud,
25 because they know that if they can prove it ten

1 years down the road, they can claim that there was
2 no insurable interest, get out from underneath the
3 policy and keep all the premiums.

4 MR. TRONCOSCO: So you bring up a good point.
5 So the other thing that's going through my head
6 when I heard your options is, what effort on your
7 part do you do to underwrite the policies that
8 you're investing in?

9 Because obviously, you know, if you're
10 concerned about that situation happening, so what
11 effort do you take on your own underwriting to
12 prevent that for yourself and your own investors?

13 MR. WELSH: As much as they can, given the
14 access to information that they -- that investors
15 in the secondary market have.

16 So the investors in the secondary market can
17 do things like, you know, find the address of
18 the underlying insured on the policy and figure
19 out if they actually live in a trailer park, or,
20 you know, do they live in a country club gated
21 property that actually suggests that they should
22 have a 2 to \$3-million-dollar policy on their
23 life? If they live in a trailer park, it's a
24 problem.

25 So there are certain types of information

1 that investors can have access to and do look at
2 as they do their own diligence. But frankly, it's
3 a more limited data set. They can't always go
4 directly to the consumer and sit down
5 and interview them about what their original
6 intent was. That wouldn't be a functional
7 finance-driven market.

8 But they do, by all means, as much diligence
9 as they can and try to avoid situations where they
10 buy a portfolio that has some
11 fraudulently-procured STOLI policies in it.
12 Sometimes that's unavoidable when you buy large
13 portfolios and you're a secondary investor, but,
14 you know, you can do as much as you can.

15 But that's the wrong time, in our view, to be
16 looking at fraud abatement. The right time to be
17 looking at fraud abatement is long before an
18 investor ever comes on the scene. This gets back
19 to the need for predictability and certainty that
20 investors want. They want a marketplace that's
21 free of STOLI and free of fraud.

22 Because the last thing they -- they didn't
23 buy portfolios to become involved in the business
24 of litigation with life insurance companies. That
25 was never anyone's expectation. Sometimes it

1 happens and you have to just face up to the fact
2 that you're going to have to litigate with some
3 insurance carriers who clearly don't want to honor
4 their contracts.

5 But the right place to police fraud is the
6 life insurance underwriting, agent select period.
7 That's what Fortress believes is the best
8 marketplace where the secondary market's investors
9 can provide the liquidity to the market, not
10 having to worry that bad behavior has happened, at
11 that end.

12 And, you know, frankly, some companies are
13 really, really good at taking care of their
14 policies, doing the underwriting at the front end,
15 selecting really good agents. Just by way of
16 example, you never see a -- or you rarely see a
17 Northwestern Mutual life insurance policy in the
18 secondary market, because they take care of their
19 customers. It's a mutual company.

20 And that's an example of the -- maybe the
21 majority of life insurance companies that are
22 doing the right thing, that are doing really good
23 underwriting at the front end. And the more of
24 that that happens, the more stable the life
25 settlements market can be, the higher value

1 consumers can get because the secondary market
2 investors are willing to invest at higher levels
3 in that market, because they don't have to price
4 for the kinds of risks that you're identifying
5 that emanate ultimately from fraud or the
6 appearance of fraud.

7 So the intent standard is really designed to
8 drive fraud abatement back to where it belongs,
9 which is at the insurance company level.

10 MR. TRONCOSO: Thank you for clarifying
11 that.

12 MR. WELSH: So we talked about premium
13 return, not essentially giving the insurance
14 industry a potential windfall and easy recovery.
15 What -- what's particularly problematic about
16 allowing them to recover or retain premium based
17 on a claim that they're damaged because they had
18 to pay a bunch of commissions to their own agent
19 and that agent may have been fired or may be long
20 gone, they don't want to go through the effort,
21 the secondary investor who now -- secondary market
22 investor who owned that policy, payed the premium
23 for years and years and now has been denied
24 recovery of the death benefit based on this kind
25 of litigation challenge has no privity of

1 contract, no direct right to go back after the
2 agent and recover some of the premium that lines
3 the pocket of that agent.

4 The only one who is in a position really to
5 do that is the company that has a selling
6 agreement with them, who appointed them as their
7 agent. And that's where, you know, if the
8 agent -- I'm sorry, if the company has, in fact,
9 been defrauded, their remedy is not to undercut
10 the law of rescission, which says that both
11 parties are put back in their original position --
12 rip up the contract, give you back your premium --
13 but rather, you know, let them execute on remedies
14 that they have against the people who were
15 actually complicit in the fraud. And frankly,
16 sometimes that's people within the insurance
17 company as we'll hear a little bit later.

18 The final option -- there's one other tactic
19 that Phoenix has deployed in this marketplace that
20 has destabilized the life settlements market,
21 particularly for Phoenix policies; and that is,
22 after the recession, they lost a lot of money in
23 their investment portfolio.

24 One way they have tried to recover from that
25 is look at policies that they believe were

1 investor-owned because of the way they're
2 behaving. And generally, when an investor buys a
3 permanent product, they don't put a bunch of extra
4 premium into the product to accumulate value.
5 They put in enough premium to keep the policy in
6 force through maturity and they retain the rest.

7 And so what Phoenix was doing was identifying
8 those policies within their book that appeared to
9 be owned by investors, and those policies were
10 targeted for a discriminatory cost of insurance
11 rate increase.

12 The appearance was that the desire was to try
13 to gut the economics of the policy and force the
14 investors who owned those policies to make the
15 hard decision of allowing the policy to lapse
16 because the rates were going up and could go up to
17 such an extent that they would end up paying more
18 premium through maturity than they would get back
19 in death benefits. And that's a losing investment
20 and that's something that all secondary market
21 investors are trying to avoid.

22 MS. MILLER: So are you suggesting that the
23 Florida Legislature should require life insurance
24 companies to have their rates regulated, to go
25 through the Office? And I've just got to watch

1 the reaction.

2 MR. WELSH: I actually -- I actually think
3 that an appropriate fix might be not necessarily
4 rate regulation at the front end. The open rating
5 market actually works. It's a very competitive
6 marketplace.

7 And most of the companies are very good at
8 setting fair rates for consumers, and there's
9 enough competition that the environment -- that
10 environment seems to work. But when you get into
11 in-force business and cost of insurance
12 adjustments, that's actually a very rare thing in
13 the life insurance industry.

14 There's a lot of reputational risk that
15 happens when an insurance company kind of mid-term
16 decides, uh-oh, "We have to confess to all of our
17 policyholders that we goofed up on the pricing and
18 now we have to increase your rates, excuse me,
19 beyond what we originally illustrated to you at
20 the inception of the policy."

21 That's not something that happens lightly
22 within the insurance industry. So you could
23 actually impose a prior approval rate regulation
24 regime over those kind of post-issuance cost of
25 insurance adjustments. And 90, 95, maybe even 98

1 percent of the life insurance companies wouldn't
2 mind, because they'd only be working -- well, I'll
3 let them --

4 MS. MILLER: That will be hilarious. We'll
5 wait for them to respond to that. But -- so
6 you're suggesting the legislature -- that the rate
7 regulation doesn't need to occur at the outset;
8 that there's enough competition in the market;
9 that if you're writing new life insurance policy,
10 you don't need to have that prereg -- preapproved.

11 But if you've had a policy in force for ten
12 years and a life insurance company is going to
13 increase your rate, at that point, that would have
14 to be preapproved?

15 MR. WELSH: I think that is a good
16 suggestion. I'm glad you made it.

17 MS. MILLER: Okay. Well, these are -- these
18 are definitely not our suggestions, but I just
19 want to make sure that we're clear on what the
20 recommendation is. So that's the five
21 recommendations to the legislature that --

22 MR. WELSH: Correct.

23 MS. MILLER: Are these alternatives, or do
24 you want all of these things at the same time?

25 MR. WELSH: Any one and -- or a combination

1 of them would, I think, achieve the objective of
2 helping create the kind of certainty that
3 investors want to see in the life settlements
4 market so that they will continue to invest and
5 pour money into the marketplace ultimately for the
6 benefit of those seniors who decide they need or
7 want to tap into that market.

8 And let me -- I will go back and -- with
9 respect to prior approval of COI increases post
10 issuance, if you actually do have a company that
11 is needing to do that, all prior approval requires
12 is that they come and talk to you about it and
13 explain what is happening within the back office
14 of their company that is driving them to need to
15 make these kind of mid-term rate adjustments.

16 And from a regulatory standpoint, that's
17 probably the time you want to be spending more
18 time with those companies. If they've got a big
19 book of business out there that they've priced
20 incorrectly, this gives you as regulators an
21 opportunity to get a little bit closer to that and
22 really have an opportunity to understand that.

23 So those are -- those are Fortress's
24 comments. We are happy to continue the process of
25 helping analyze these issues, and we'll answer any

1 questions or do whatever you need us to do to help
2 you complete the report.

3 MS. MILLER: Thank you very much.

4 MR. WELSH: And at the risk of appearing to
5 try to control or dictate the order of things --

6 MS. MILLER: No. Mr. Kroll is next. That's
7 fine.

8 MR. WELSH: Okay. I didn't want to be
9 presumptuous. But Jerry Kroll, an attorney, has a
10 presentation that he would like to show
11 that provides a little more color on some of the
12 issues that I've touched on briefly.

13 MS. MILLER: Thank you.

14 MR. WELSH: Is there -- is there someone who
15 can help boot that up for those of us who are
16 technology challenged?

17 MS. MILLER: We don't have a remote control
18 so we're going to come around.

19 (A pause in the proceeding.)

20 MR. KROLL: Good morning. My name is Jerry
21 Kroll. I'm an attorney from a small fishing
22 village in California.

23 MS. MILLER: Small fishing village?

24 MR. KROLL: Yes. It's called Santa Barbara.

25 And I handled a case on the opposite side from PHL

1 Variable Insurance Company and Phoenix Life
2 Insurance Company on behalf of two life settlement
3 funds, one of which was called XLI, and the other,
4 Olive Tree.

5 And they purchased a number of beneficial
6 interests in trusts that owned 32 policies, and
7 collectively, I'll call them Phoenix policies,
8 totaling approximately \$300 million in face. Each
9 policy was held by life insurance trust, and at
10 some point, each of these funds purchased that
11 beneficial interest.

12 Since the policies were freely transferable
13 after approximately one-and-a-half years, XLI
14 wrote to Phoenix asking to change ownership of the
15 policies from the trust to the fund, and thereby,
16 be able to dispense with the trust and the expense
17 of that.

18 About four months later, Phoenix responded by
19 letter. What did they say? "We'd like some
20 documents from you," and there were requests for
21 over 20 categories of documents, everything from
22 lists of your financial advisors to documents
23 substantiating net worth, annual income, life
24 expectancy evaluations and so on.

25 And the threat, if the information wasn't

1 provided in 14 days, Phoenix would consider all of
2 its legal options, including potential rescission.
3 This is when I was involved. I was hired and we
4 sued Phoenix.

5 It seemed like a rather simple case at first:
6 Request to transfer ownership, failure to change
7 the ownership. Well, what transpired was
8 something that was beyond what I knew at the
9 outset, but it was a great education. I have come
10 here today to share some of this education with
11 you, because I think it may be helpful to some of
12 the issues that you're addressing here today.

13 Phoenix cross complained, and in essence, it
14 became a battle about some of the things that have
15 already been mentioned here this morning. Phoenix
16 wanted to void the policies and keep the money,
17 and that's the battle.

18 In this case, we took approximately 200
19 depositions all across the United States. For a
20 time, I felt like I was living in New York,
21 Pennsylvania, got to know the great state of
22 Florida very well. Many of the insureds lived in
23 South Florida, and that's why obviously this is
24 very important, what we're doing here today.

25 And as you'll see in a moment, the

1 deposition -- I brought some clips here for you to
2 see. These are excerpts from Phoenix personnel
3 who testified in this case. For me, this was a
4 great education. The case, we'll talk about it in
5 a moment, but this is -- this reminds me -- so
6 many times, it was like Forest Gump. You never
7 know what you're going to get.

8 So if I may, I would like to share with you
9 these deposition experts.

10 MS. MILLER: Okay.

11 (Whereupon, a video was played.)

12 MR. KROLL: That is the education that I got
13 during the course of the case and --

14 MS. MILLER: Can you get closer to the mic?

15 MR. KROLL: Sorry? Oh, I'm so sorry. I was
16 trying to say that that is the education I
17 received during the course of the case, the *Fenton*
18 *vs. Phoenix* case, and that has now gone on to
19 become evidence that has been used in a variety of
20 cases around the United States that are pending as
21 we speak.

22 And I will tell you that just generally,
23 what's out there -- you probably know -- that
24 there was so many policies put on the books during
25 these years, that was coming. Maybe one day,

1 there is going to be a tsunami of death claims
2 that are going to have to be dealt with, and these
3 issues will be dealt with.

4 But I thank you for letting me share this
5 with you, because it was an education for me and I
6 hope for you as well.

7 MS. MILLER: Thank you.

8 MR. KROLL: Thank you.

9 MS. MILLER: At this time, I think what we
10 need to do is take a ten-minute break, and if that
11 concludes Fortress's presentation -- does it?

12 MR. WELSH: Yes, it does.

13 MS. MILLER: Okay. Then when we come back, I
14 believe the ACLI has one or more witnesses, and we
15 will -- we will hear from them.

16 So thank you. We'll be back in ten minutes.

17 (Whereupon, a recess was had in the
18 proceeding.)

19 MS. MILLER: Okay. We're ready to go back on
20 the record.

21 At this point, I will allow you to make your
22 introductions and tell us who you are and who you
23 represent.

24 MR. MCDOWELL: Thank you, Ms. Miller.

25 My name is David McDowell. I'm a lawyer from

1 Edison, McDowell & Hetherington in Houston, Texas,
2 and I'm pleased to be here today on behalf of the
3 American Council of Life Insurers. As I'm sure
4 you know, the American Council of Life Insurers is
5 an organization dedicated to protect the interests
6 of life insurance companies and their
7 policyholders.

8 What we're really talking about here today is
9 the tale of two markets. On the one hand, you
10 have the legitimate life settlement marketplace, a
11 marketplace that has existed for a very long time
12 that is designed to allow Florida citizens and
13 other policyholders around the country to sell
14 their policies if they no longer need or want the
15 insurance coverage they had.

16 When they bought the insurance coverage, they
17 were buying it to address legitimate insurance
18 need. Their needs changed over time, and they now
19 wish to sell it onto the secondary market. As
20 evidenced by the information that's been provided
21 by others to this panel, that market is doing just
22 fine.

23 There has been information provided to the
24 Office indicating that that market is still
25 viable. It's still available. It still allows

1 insureds to sell unwanted or unneeded policies
2 into the marketplace as long as that insurance was
3 originally purchased to address legitimate
4 insurance needs.

5 I highly doubt that this office has been
6 flooded with calls from Florida seniors saying
7 they can't sell their policies on the secondary
8 market. What we're talking about today isn't
9 really addressing that market.

10 What we're talking about today is addressing
11 a very different market, a market of
12 stranger-originated life insurance. The Office
13 knows what stranger-originated life insurance is.
14 Stranger-originated life insurance is not life
15 insurance at all.

16 Life insurance is purchased to address the
17 financial consequences of the insured's death.
18 Those buying stranger-originated life insurance
19 suffer no financial consequences when the insureds
20 die. Instead, they want the insureds to die as
21 fast as possible. The quicker the insured dies,
22 the greater the profit margin that they're able to
23 lock in over time.

24 Obviously, this creates a very dramatic
25 difference than what typically goes on in the

1 traditional life insurance marketplace. A life
2 insurance company is not going to issue a life
3 insurance policy if it believes that the person
4 purchasing that policy is doing so for reasons
5 other than legitimate life insurance purposes.

6 For that reason, people had to disguise these
7 policies, disguise these applications when they
8 originally sought to buy them so that they would
9 look like legitimate life insurance transactions.
10 That's how they induced the life insurance
11 companies to issue these policies.

12 This whole notion that the life insurance
13 companies wanted to turn a blind eye to the
14 obvious risks that were presented on paper are
15 belied by the fact that so often in these
16 transactions, the individual seeking to buy the
17 policies had to lie in order to get them.

18 If the life insurance companies didn't care,
19 why lie? Why do you have to -- why do you have to
20 tell a lie on an application? Why do you have to
21 lie about a person's financial means, about their
22 net worth, about the reason they're purchasing the
23 insurance if the life insurance industry didn't
24 care about them?

25 When regulators and life insurance companies

1 became aware of the STOLI threat in 2006 and 2007,
2 they both immediately reacted. State legislatures
3 around the country passed anti-STOLI legislation.
4 They firmed up their insurable interest laws to
5 rededicate the notion behind the public policy
6 behind insurable interest.

7 Life insurance companies went into court to
8 seek rescission of these policies that were
9 procured by fraud, and they were largely
10 successful. Because of the combination of these
11 legal and regulatory forces, the value of these
12 toxic assets on the secondary market was
13 absolutely crushed.

14 They were unable to sell on the legitimate
15 life insurance -- on the legitimate secondary
16 market, because the legitimate secondary market
17 didn't want to have anything to do with these
18 assets. And so the hedge funds, they smelled a
19 bargain.

20 And as Mr. Welsh indicated, I'm not here to
21 vilify Fortress for smelling a bargain, but I am
22 here to set the record straight that the reason
23 why Fortress and other companies got involved and
24 bought these blocks of policies was because they
25 were able to do so for pennies on the premium

1 dollars already paid.

2 And in doing so, in seeking investors, in
3 seeking funds to buy these -- buy these toxic
4 assets, they issued notices to the investing
5 public. And in these notices to the investing
6 public, they told the investing public that they
7 were looking to buy assets that might lack an
8 insurable interest, that might have been procured
9 by fraud, that were subject to litigation and
10 regulatory risk and that might be outright
11 illegal.

12 And they told the investing public that if
13 any of those factors came to pass, if any of those
14 things were actually true, it would have a
15 significant and profound effect on the value and
16 the liquidity of the policies in the portfolio
17 they were looking to purchase.

18 So with these dire warnings and with the
19 characteristics of these policies, is it any
20 wonder that they've had difficulty selling those
21 policies in the legitimate secondary life
22 insurance marketplace?

23 I would offer to the Office that the
24 legitimate secondary life insurance marketplace's
25 hesitancy, unwillingness to purchase these

1 policies is actually a very healthy vital sign of
2 a thriving marketplace and not an indication of a
3 weakness that needs to be addressed through
4 legislation.

5 What life insurance companies did when they
6 learned about the stranger-originated life
7 insurance threat is the only thing they could do,
8 which was to resort to court. And when they
9 resorted to court, they seek to affirm the three
10 certainties that have long existed with respect to
11 life insurance:

12 Number one, it is a legal certainty that if
13 you lie on a life insurance application, the life
14 insurance company can rescind that policy within
15 two years of policy issuance; number two, it is a
16 legal certainty that if the life insurance policy
17 is issued without an adequate insurable interest,
18 that the policy is *void ab initio*. It is
19 terminated. It is an illegal contract because it
20 violates the public policy of insurable interest;
21 and number three, it is a legal certainty that if
22 a life insurance company knew or should have known
23 of problems on the application or problems
24 associated with insurable interest, that the life
25 insurance company has to bear the consequence of

1 that knowledge.

2 And nothing that has happened in the courts
3 over the last five or six years has changed those
4 legal certainties. Those are the legal
5 certainties that have governed the insurance
6 marketplace for decades. Those are the legal
7 certainties that exist today, and those legal
8 certainty certainties don't need additional
9 legislation to firm them up at all.

10 When life insurance companies went into
11 courts, they found judges who were willing to
12 listen, who were willing to balance the equities.
13 These are complicated cases. And whether or not a
14 particular policy can be rescinded, whether or not
15 premiums should be given back in a certain
16 situation, whether or not an insurable interest
17 exists will come down to the facts of each
18 individual case.

19 So for example, if a life insurance company
20 issues a policy to a person claiming to be worth
21 \$40 million and they are really a taxi cab driver
22 or a blackjack dealer or an indigent person, well,
23 what did the life insurance company do during
24 underwriting?

25 If the life insurance company requested tax

1 returns and received falsified tax returns, is the
2 life insurance company at fault? If the life
3 insurance company asks to speak to a CPA and was
4 presented with an impostor, a fake CPA, is the
5 life insurance company at fault?

6 If the life insurance company asked for
7 appraisals of significant assets making up a
8 person's net worth and false fake appraisals were
9 provided, is that the life insurance companies
10 fault?

11 When these matters are brought before the
12 courts, the courts have an opportunity to look at
13 the individualized facts and make a decision
14 whether, under that particular circumstance, the
15 life insurance policy in that situation should be
16 rescinded, and if it is rescinded, who should get
17 the premiums on the -- on the policies?

18 And I would submit to the Office that it
19 would be very, very difficult, despite the
20 collective talent of the legislature and this
21 Office, to craft legislation that would adequately
22 address the potential equitable issues that could
23 crop up in any individual case, and that's why no
24 state has tried to do so.

25 This is not a new effort by the Fortresses of

1 the world, by the hedge funds that now own the
2 policies that get legislation passed. We've been
3 in South Dakota. We've been in Minnesota. We've
4 been in Delaware.

5 No state has decided to go down that road,
6 and I think in part, it's because it would be very
7 difficult to legislate fairness, to provide
8 legislation that would adequately address each
9 individual situation.

10 The life insurance industry has been very
11 successful in courts. Mr. Welsh said it was
12 because they've been able to mislead judges based
13 on bad facts. I have a greater faith in the
14 judiciary than I guess Mr. Welsh does.

15 I don't think judges have been misled. I
16 don't think the First Circuit Court of Appeals of
17 the United States, the Sixth Circuit, the Eighth
18 Circuit, federal district courts and state courts
19 across the country, I don't think they've been
20 misled by the facts when they've addressed the
21 situations. I think they've been guided by the
22 equitable principles and the three legal
23 certainties that I spoke about at the outset in
24 arriving at their decision.

25 We just heard a lot about Phoenix Life

1 Insurance Company, and I would suggest to the
2 Office that it look at Phoenix's filings. And
3 I should say that I appreciate Mr. Kroll beeping
4 out all of my curse words during the course of
5 those depositions.

6 I represented Phoenix in that lawsuit. I was
7 in most of those depositions, and I can tell you
8 that those depositions -- he's right. We took 200
9 depositions and you saw about ten minutes of clips
10 in those depositions. And if those depositions
11 presented an accurate reflection of what Phoenix
12 was actually doing at the time, Phoenix would not
13 have been successful as it has been in court.

14 Phoenix tried a case in front of a Los
15 Angeles, California, jury earlier this year
16 against a hedge fund and won. Phoenix tried a
17 case in Minnesota, in a Minnesota federal court
18 earlier this year and won. The First Circuit and
19 Eighth Circuit Court of Appeals have ruled in
20 favor of Phoenix on these type of issues.

21 Federal courts around the country have done
22 the same thing. And they've done so because
23 Phoenix, like a lot of other companies that were
24 duped into issuing these policies, have credible
25 issues they have brought before the court, and

1 courts were able to look at the equitable
2 consideration and reach a reasoned decision.

3 I do want to note, and I do again ask the
4 Office to look at Phoenix's regulatory findings.
5 Mr. Welsh indicated that Phoenix is denying about
6 20 percent of the claims submitted to it, and it's
7 been on an upward spike since then.

8 When you look at the blue book that's filed
9 by Phoenix with the Office, you're going to see
10 that for the last four calendar years, Phoenix has
11 paid 66,527 claims out of 66,535 claims submitted.
12 They've contested eight claims in the last four
13 calendar years.

14 That's a payment rate of 99.98 percent,
15 hardly an indication of a company gone wild, of a
16 rogue company that is simply flouting the
17 regulations that Florida and other states have put
18 in place to govern their conduct and their
19 activity.

20 As it relates to litigation, the one last
21 thing I want to mention is this idea of premium
22 refunds. Mr. Welsh and Mr. Kroll, I believe,
23 indicated the premium refund has been a bedrock
24 principle of rescission, that you always get your
25 premium back when you refund a policy, and that

1 simply isn't the case.

2 Rescission is an equitable remedy. And when
3 a court -- when a court provides equitable
4 remedies, it is allowed to weigh the equities, and
5 it is allowed to determine in what situation it's
6 going to allow return of premiums.

7 Some courts have said that the public policy
8 behind insurance fraud is so strong that we are
9 not going to force a life insurance company to
10 give back to the entity that defrauded it the
11 premiums that were paid, because then you're
12 making life insurance fraud a very low-risk,
13 high-reward proposition.

14 Other courts have said yes, in a situation of
15 rescission, we're going to require the life
16 insurance company to give the premiums back, but
17 the life insurance company can seek to offset
18 against those premiums the damages that it
19 suffered separate and apart from the mere issuance
20 of the policy, which only seems fair.

21 And finally, courts, including a court right
22 here in Florida, has said, you know what, if a
23 life insurance company knew or should have known
24 that there was an insurable interest concern, they
25 did have some obligation to initiate legal action,

1 and they couldn't sit back and simply collect the
2 premiums and then claim later, well, we don't have
3 to pay any back.

4 What that Florida court said is when there is
5 evidence that the company knew or should have
6 known, that those premiums that were received
7 after that point in time are in play, and that a
8 life insurance company has to be accountable for
9 its conduct.

10 So when it comes to litigation, litigation --
11 the courts across the country have simply applied
12 the three certainties of law that have existed for
13 decades to reach equitable resolutions in the
14 context of individual life insurance policies.

15 This notion that there is a lack of certainty
16 simply isn't true. What is true is that the
17 outcome of a particular policy, of a particular
18 case, is going to depend on the facts, facts that
19 shouldn't be neutralized simply by the passage of
20 black-or-white legislation.

21 Mr. Welsh offers to the Office five possible
22 legislative alternatives to address whatever the
23 problem was that he suggests exists. The first
24 one is that the subjective intent of the insured
25 should not matter when it comes to determining

1 whether or not an insurable interest exists.

2 I would submit to the panel that the
3 subjective intent rarely does matter to a
4 determination of whether insurable interest
5 exists. The highest court in the land to speak of
6 the issue, the Delaware Supreme Court, said it
7 doesn't matter.

8 What the Delaware Supreme Court said and what
9 other courts have followed suit in doing is
10 looking at the factual circumstances of the policy
11 issuance and deciding, based on that set of facts,
12 whether there was an insurable interest.

13 What the courts are trying to do is to make
14 sure that we're not elevating form over substance
15 and allowing STOLI promoters and hedge funds to
16 simply paper around the important public policy of
17 insurable interest.

18 The second thing that he suggested is that
19 there cannot be any insurable interest challenge
20 after the contestability period. Most states in
21 the country have rejected that principle. Most
22 states in the country have said that the public
23 policy behind insurable interest is too important
24 to simply subject it to a two-year bar.

25 If you subject it to the contestability

1 period, what you're essentially doing is saying
2 that an illegal contract is not illegal because of
3 a provision contained in the illegal contract.
4 And let me tell you -- let me -- let me talk to
5 you about an unintended consequence of that kind
6 of legislation.

7 I had a case many years ago right here in
8 Florida involved an insured down in the Miami area
9 who woke up one day and found out that somebody,
10 unbeknownst to her, had taken out nine different
11 life insurance policies totaling about \$3 million
12 of death benefit on her life.

13 Those applications had obviously been forged.
14 But if insurable interest was subject to the
15 contestability period and she found out two years
16 after the policy issuance, there would be nothing
17 she could do about it. There would be nothing
18 that she or anybody else could do to address that
19 situation. That doesn't seem to be sound
20 legislation.

21 Mr. Welsh suggested that there be
22 verification of coverage legislation, that if a
23 life insurance company is asked by a policyholder
24 whether or not a policy has an insurable interest,
25 a life insurance company should be forced to take

1 a position, yes or no.

2 What that legislation is essentially trying
3 to do and why no state in the country has passed
4 that kind of legislation is to privatize the
5 public policy of insurable interest, to take out
6 of the hands of the courts and of judges whether
7 or not insurable interest exists in that kind --
8 in life insurance policies.

9 If the onus is on the life insurance company,
10 subject to penalty and potential judicial
11 sanction, to make a statement as to whether or not
12 a policy has or doesn't have insurable interest,
13 what incentive does the life insurance company
14 really have to go ahead and fight the fight?

15 The life insurance company doesn't have
16 access to subpoena powers. It doesn't have access
17 to information from third parties. It doesn't
18 even really have access to the insured anymore to
19 gather the information.

20 It has to make the insurable interest
21 determination based on the information that it
22 already had in its possession when it underwrote
23 the policy. There would be no reason to do that
24 and it would privatize the issue of insurable
25 interest.

1 And at this point, I do want to make one
2 comment on something Mr. Welsh said, and it was in
3 response to, Mr. Troncosco, your question on what
4 burden is on the hedge funds when they buy these
5 policies to assess whether or not these are toxic
6 assets or whether they were legitimately-issued
7 policies.

8 And he said, "Well, we have limited access to
9 information." I think if the Office does research
10 into this area, it will find, generally speaking,
11 that hedge funds that buy large blocks of policies
12 have unfettered access to the insureds; that
13 often, the insureds have an ongoing contractual
14 obligation to provide information to these hedge
15 funds; that these hedge funds are very, very
16 particular about how they value their assets, and
17 they frequently are in touch with the insureds to
18 assess their health.

19 So this notion that we're going to blindly
20 buy a block of policies for hundreds of millions
21 of dollars without actually knowing the risk that
22 we're taking on I don't believe withstands common
23 sense and general knowledge of the life settlement
24 marketplace.

25 The fourth item that he suggested is return

1 of premium legislation; basically what we've
2 already talked about, that if a policy is
3 rescinded or declared void, that a life insurance
4 company has to return the premium.

5 For all of the equitable reasons we've
6 already talked about, that legislation doesn't
7 make sense. That legislation would take out of
8 the hands of the court the right to do equity, the
9 right to rescind policies and then decide whether
10 or not, under the circumstances, the insurance
11 company gets to keep some of the premium, has to
12 give all of the premium back, gets to keep all the
13 premium.

14 There is no reason to have legislation that
15 deals with that direct issue. And again, let me
16 tell you one unintended consequence, or perhaps an
17 intended consequence, of that kind of
18 litigation -- legislation.

19 If you have legislation that says if a policy
20 is declared *void ab initio* for lack of insurable
21 interest, these hedge funds that own blocks,
22 hundreds and hundreds of policies, they know what
23 the mortality horizon is on their particular
24 insureds. They know which policies are going to
25 require premium payments far into the future, far

1 longer than they want to pay.

2 They're going to gather those policies.
3 They're going to sell them to an entity, if
4 Florida is the one that passes the legislation,
5 domiciled here in Florida, and then they're going
6 to declare the lack of insurable interest
7 themselves.

8 They're going to declare that the policies
9 lack an insurable interest and demand that the
10 insurance company return all of the premiums paid
11 for those policies, even the premiums that were
12 paid long before the hedge fund ever took
13 ownership of the policy.

14 And finally, Fortress suggested a change to
15 how Florida deals with COI, cost of insurance,
16 increases. Cost of insurance increases are
17 heavily regulated by any state. The language that
18 is included in life insurance policies with
19 respect to COI increases are usually specifically
20 approved by state departments of insurance.

21 Life insurance companies are required and
22 obligated to follow that language. And in the
23 very rare circumstance where they don't, there is
24 remedy either to complain to departments of
25 insurance or to court. The notion that, again, we

1 have to address legislation to deal with these
2 issues is simply unfounded.

3 Finally, about an hour of the presentation by
4 Fortress and by others, by Mr. Kroll, focused on
5 Phoenix. I would submit to the Office that if
6 this is really a one-company issue, there's no
7 reason for legislation. There may be reason for
8 review, regulation, et cetera, but there's no
9 reason for legislation to deal with the supposed
10 sins of simply one company.

11 At the end of the day, life insurance
12 litigation has been around for a long time, and
13 the certainty that has been derived over time is
14 no more tenuous today than it was five to ten
15 years ago before STOLI litigation came to pass.

16 If what the Office is interested in
17 protecting is the legitimate life settlement
18 marketplace, I think a review of the materials
19 provided to the Office will show that that
20 marketplace is just fine.

21 If the Office wants to open up that
22 marketplace to these toxic assets, that's a --
23 that's an entirely different situation and one
24 that, based on everything we just talked about,
25 simply is not justified by the passage of

1 legislation.

2 I'm happy to take any questions the Office
3 might have.

4 MS. MILLER: Thank you. I have a question
5 and my colleagues may have some, too. First of
6 all, some of us have purchased life insurance
7 before. I've never tried to buy a 2 or 3 or 4 or
8 \$5 million-dollar policy.

9 But if I did, I would expect the life
10 insurance company to ask me a few questions, and I
11 might not get past the first one. But the notion
12 that people can buy a policy for those types of
13 amounts and the life insurance company then does
14 not even know if the policy is sold or not, it
15 just blows my mind.

16 Can you discuss that and tell me why an
17 insurance company would not be aware -- because
18 under Florida law, as you said, the traditional
19 life settlement market notifies, they are required
20 to notify, the company that the policy has been
21 purchased.

22 So how does this get so far down the road
23 without the insurance company having a very good
24 idea of why the policy was purchased, and who owns
25 it, and how it was transferred?

1 MR. MCDOWELL: Sure. And thank you for the
2 question. During the application process, the
3 application will specifically ask questions about
4 a person's net income, about their net worth,
5 about the reasons why they're purchasing the
6 policy, about other policies that might be in
7 force.

8 Most companies have gone to some form of
9 what's called a statement of client intent where
10 they seek to find out from this particular
11 insured, why are you buying this? Is it for
12 legitimate life insurance purposes, estate
13 planning, et cetera; or is it really with an eye
14 towards selling it?

15 Are you paying for it yourself? Are you
16 premium financing? Is somebody else giving you a
17 cash inducement or a promise of payment down the
18 road if take out these policies? The insurance
19 company is trying to get out in front of this
20 issue, because they don't want these policies.

21 The reason we have all this litigation is
22 because the industry doesn't want these policies
23 so they ask those questions. Once the policy is
24 issued, these policies, again, as I said at the
25 outset, are disguised to look like normal life

1 insurance transactions so --

2 MS. MILLER: Let me stop you for just a
3 minute. Okay. When I buy a life insurance
4 policy, they're going to get a check from me, and
5 it has my name on the check and my address. Is
6 that what they get, or are they getting a check
7 from somebody else?

8 MR. MCDOWELL: So when a policy is purchased
9 by an elderly person for estate tax planning
10 purposes, it is almost always purchased by an
11 irrevocable life insurance trust. The irrevocable
12 life insurance trust is, legally speaking, a
13 separate third party. It has a separate trustee,
14 and that trust has a beneficiary.

15 The way they disguise the transaction is they
16 allow the trust to purchase the policy, and then
17 the trustee, which on paper, looks like somebody
18 that has an insurable interest of the insured, say
19 it's a spouse or a husband -- a spouse or a son or
20 a daughter, that person will then sell their
21 beneficial interest in the trust, often hours
22 after policy issuance, to the third party
23 financier, to the STOLI promoter.

24 So there's been an effective change of
25 ownership, but the person -- the entity in charge,

1 the entity that owns the policy and from whom the
2 company is going to receive the checks, hasn't
3 changed. The company never knows about the
4 transfer of the beneficial interest.

5 MR. TRONCOSO: I think you brought up a good
6 point. And just for -- we're using a whole lot of
7 acronyms today, and for people that are watching
8 us and trying to understand through the acronyms,
9 and also, the legalese and insurance-ese and
10 everything like that, and a comment that was made
11 during the break to point out -- and you briefly
12 touched on it, I think -- it would be helpful for
13 everyone to understand this issue a little bit
14 more the difference between the traditional
15 secondary market and the secondary secondary
16 market, that is -- that is what Fortress was
17 talking about. If you could explain upon that a
18 little bit further so people could understand, I
19 think it would be beneficial.

20 MR. MCDOWELL: The history lesson, as all of
21 you know, is that the secondary market essentially
22 rose out of the AIDS epidemic. Individuals that
23 had AIDS back in the '80s essentially had death
24 sentence.

25 They had these life insurance policies that

1 were guaranteed to pay off because, at the time,
2 they were going to die, but they had no use for
3 those policies. What they really had the use for
4 was the expensive medicine that was needed to
5 treat their symptoms.

6 And so the secondary market arose out of that
7 crisis, and these individuals were able to sell
8 their policies on the secondary market for much
9 needed cash, and it expanded from there. People
10 with terminable diseases were able to sell it
11 later on.

12 And then traditional -- simply insureds,
13 people that had life insurance, they may have
14 bought a large policy when they were 45 or 50
15 years old. It's 15, 20 years later, their kids
16 are all successful. They don't have to pay for
17 college any more. They have no need for the life
18 insurance policy.

19 They essentially had under -- without the
20 secondary market, the option of either letting it
21 lapse or simply taking the cash surrender value
22 that was in the policy.

23 What the secondary market did was give them a
24 third option. It allowed them to shop their
25 current mortality, which could have been worse

1 than the mortality that existed at the time the
2 policy was issued, they could shop their current
3 mortality and the value of that policy to
4 secondary investors who would purchase the
5 policies as part of a transaction.

6 The fundamental distinction between that, the
7 legitimate life insurance and life settlement
8 transaction, and STOLI is that everybody was still
9 on the same page at the time the policy was
10 issued. Everybody wanted the insured to live as
11 long as possible.

12 The insured wanted to live as long as
13 possible. The life insurance company certainly
14 wanted the insured to live as long as possible.
15 And if the concept of insurable interest means
16 anything, the beneficiary wanted the insured to
17 live as long as possible.

18 That's not the case with STOLI. STOLI, there
19 is no financial consequence to the person
20 procuring the policy. They want to the insured to
21 die as soon as possible, and that really creates a
22 moral hazard and a risk that we as a society have
23 largely said we don't want to deal with.

24 MS. MILLER: Well, now, if a policy is
25 viaticated, if it's sold to investors the first

1 time, in other words, not in the hedge fund
2 scenario, but say I have a policy that I've had
3 for ten years and I go to a life settlement
4 company and I say, "I'd really just like to spend
5 the money and go to Europe," you know, and so they
6 pay me a percentage of the face value of my policy
7 and they take ownership of my policy.

8 Not to imply that they would ever do anything
9 wrong with that, but they do have a financial
10 interest in my early demise. They're better off
11 if they don't have to pay premiums for a long
12 period of time after that transaction, so that
13 interest exists the first time the policy is sold.

14 The second time it's sold, when that life
15 settlement company bundles their policies and
16 sells to an institutional investor, that's still
17 in place. There's still an investor out there
18 with an interest in my early demise, which I would
19 find a rather uncomfortable situation. But in
20 either event, you have that, and people still do
21 it because, as you said, that's the only way they
22 get the liquidity out of their policy in the first
23 place.

24 The life insurance companies offer
25 accelerated benefits if I'm dying, if the

1 situation is I have AIDS and I need the money for
2 medicine. But why doesn't the life insurance
3 company, to get ahead of this, offer people the
4 opportunity to buy back their policy directly
5 instead of allowing middle men to get involved who
6 really do have -- they have, by nature, they have
7 an interest in the insured dieing sooner rather
8 than later?

9 MR. MCDOWELL: Sure. The life insurance
10 industry is selling death benefit coverage.
11 They're selling peace of mind that the financial
12 consequences of the insured dead are going to be
13 covered should it come to pass. It's insurance.

14 They're not selling a car. They're not
15 selling a house or a building. So the way the
16 product is designed, especially permanent
17 products, whole life and universal products, is
18 that those products can have a cash value.

19 Depending on the premiums paid over time by
20 the insured, the election made by the insured to
21 pay premium, that cash value could grow to be
22 quite sizable. And at that point in time, a
23 person who doesn't want to sell it to the
24 secondary market can simply take the cash value of
25 the policy.

1 There's nothing wrong with doing that, and
2 they're not necessarily selling themselves short
3 by simply taking what the policy offers, the cash
4 value of the policy.

5 If they don't have the concerns that you just
6 raised about having a disinterested third party
7 own the policy -- that's sort of the tension with
8 life insurance is that on the one hand, it's an
9 insurance product. The issue of insurable
10 interest is important.

11 On the other hand, it is generally considered
12 an asset that can be, after issuance, sold freely
13 on the market. If a person wants to, they have
14 the option of then selling it on the market, but
15 they do have the option.

16 They're not -- it's not a situation where the
17 only way they could possibly get value out of this
18 policy is to take the cash value or to let it
19 lapse and lose all of the premiums paid. If they
20 want the cash value, they can take it. If they
21 want to shop it on the secondary market, they can
22 do so.

23 MS. MILLER: Can you, for people that are
24 watching this, give an example or just, I mean,
25 not a -- not a technically-calculated average,

1 just a ballpark, how much -- if I had a
2 \$100,000-dollar policy and I took the cash value,
3 how much would that likely be? And how much would
4 it be if I viaticated, and how much would it be
5 the secondary investor would pay? Just, you know,
6 the --

7 MR. MCDOWELL: Yeah. I wish I could.

8 The problem with doing that is you have to know
9 certain assumptions. You have to know how much
10 premium has been paid in the past. Have you paid
11 along the premium schedule? Have you sometimes
12 paid a little more? Have you sometimes paid a
13 little less on the policy? Have you taken any
14 loans against the policy? What's your health?

15 When you go shop your policy on the secondary
16 market, in the legitimate secondary market --
17 marketplace, they can assess your mortality risk
18 at the time you're selling it. So the healthier
19 you are -- the more unhealthy you are, the greater
20 value your policy is.

21 So just to say a hypothetical example,
22 somebody has a policy, \$100,000, what could they
23 get versus the cash value? It would be impossible
24 to, at least with my limited knowledge, to give
25 you an answer to that question.

1 MS. MILLER: Well, but comparatively, you
2 know, if I have a -- if I'm 65 or 70 years old and
3 I've had the policy for a number of years, I might
4 get, what, 20 percent or something in cash value,
5 maybe not even that?

6 MR. MCDOWELL: Yeah. Again, I wish I could
7 answer your question. I'm afraid if I did so, it
8 would be pure speculation.

9 MS. MILLER: I'll ask the life settlement
10 folks because they would know those numbers.

11 MR. MCDOWELL: There you go.

12 MS. MILLER: Okay. Does anybody else on the
13 panel have questions? Jan?

14 Okay. I have a couple of questions. Do life
15 insurance companies police their agents
16 adequately, or is there some criticism, legitimate
17 criticism, of that that might have led to some of
18 these issues?

19 MR. MCDOWELL: I think the life insurance
20 companies do police their agents and their
21 producers adequately. There are bad apples in
22 every group, and those bad apples can lead to bad
23 consequences.

24 I think that if a, quote, life insurance
25 agent is actually conspiring with a third party to

1 defraud a life insurance company and induce it to
2 issue a life insurance policy it wouldn't do so
3 had it known the truth, that person is no longer
4 an agent, legally, agent principal, agent of the
5 life insurance company. It's working with a --
6 with a third party.

7 The life insurance industry polices its
8 agents. It wants to make sure that it doesn't
9 have any bad apples out there, and I think that it
10 does do so adequately.

11 MS. MILLER: The implication of some of those
12 videos was that the company encouraged that
13 behavior, that they were looking for the premium
14 and it was increasing their premiums dramatically,
15 and it was increasing their agents' incomes, agent
16 commissions dramatically to write as many STOLI
17 policies as possible. What's the incentive of a
18 company to do that?

19 MR. MCDOWELL: To do -- I'm sorry, to do
20 what?

21 MS. MILLER: To try to encourage their agents
22 to sell STOLI policies. Or is there any?

23 MR. MCDOWELL: Well, I think that you would
24 talk to companies that have been involved in
25 litigation, and they would tell you that they

1 haven't been making money hand over fist by paying
2 the lawyers.

3 To purchase policies or to allow the issuance
4 of policies that shouldn't be issued to only then
5 seek their rescission doesn't make good economic
6 sense. Where Phoenix, for example -- using
7 Phoenix as the example because that's what was in
8 the videos -- Phoenix, for example, most of the
9 litigation that Phoenix has filed has not been
10 with respect to death claims.

11 Again, given the numbers I gave you, they
12 have only contested eight death claims over the
13 last four full calendar years. Their contest has
14 been on policies that are still in force where the
15 insured is still alive.

16 So if the notion was, well, the insurance
17 companies are just going to sit back and collect
18 all the premium on all these bad policies until
19 the insured dies, that really hasn't been borne
20 out by market conduct, not only by Phoenix but by
21 other life insurance companies.

22 Life insurance companies don't want the stuff
23 because it's fraught with fraud. Because it's
24 fraught with fraud, they don't understand or
25 necessarily appreciate, on a particular policy

1 basis, the risk they're actually undertaking.

2 I'll give you an example. We had a case a
3 while ago in which a person claimed on an
4 application to be worth \$23 million. This was an
5 elderly woman about 72 years old. During a review
6 of the policy as part of litigation, we found
7 a subsequent medical record, and the medical
8 record indicated that the insured came into an
9 emergency room with a cut on her head that she
10 received walking along the railroad tracks home
11 from work at midnight.

12 Now, is it possible that somebody worth
13 \$23 million at the age of 72 is required to work
14 at a job that has her walking along the railroad
15 tracks at midnight home? I guess it's possible.
16 Is it likely? No.

17 So life insurance companies, they don't have
18 any interest in issuing these policies because
19 they really don't understand the risk that they're
20 being asked to assume. And, again, I think the
21 best evidence of that idea, that notion, is that
22 life insurance companies have generally been
23 filing what we call live rescissions, rescissions
24 while the insured is alive. They haven't been
25 sitting back and just collecting premium.

1 MS. MILLER: I can't imagine that they
2 couldn't have found that out the day the policy
3 was issued.

4 MR. MCDOWELL: Well, so as, again, you look
5 at --

6 MS. MILLER: Or before.

7 MR. MCDOWELL: Sure. So as I indicated, you
8 look at the underwriting process. And look, I'm
9 not going to stand here and tell you that the
10 insurance company is 100 percent perfect in every
11 situation. You know, even Sinatra cleared his
12 throat every now and then.

13 But what life insurance companies do
14 typically as it relates to a policy is they'll ask
15 for information. And if they continually ask for
16 information time and again, and they get
17 fraudulent information in return, at some point,
18 it's no longer the fault of the life insurance
19 company.

20 They're being conned by crooks and we have to
21 place the responsibility on the crooks and on the
22 con men and not on the life insurance company if
23 the life insurance company asks the right
24 questions.

25 And that's why I said one of the legal

1 certainties that has long governed life insurance
2 litigation is if the company knew or should have
3 known about the issue, they have to bear the
4 consequence of that.

5 What the STOLI promoters have been unable to
6 do time and again in this litigation is to show
7 that the life insurance company knew or should
8 have known. Because, again, when the life
9 insurance company would ask the questions, they
10 would get fraudulent information in return.

11 MS. MILLER: Should the legislature consider
12 a law that says that life insurance is not freely
13 tradeable, that after -- maybe you've had the
14 policy for five or ten years -- you can sell it
15 one time but you can't trade it on the secondary
16 market?

17 MR. MCDOWELL: I don't think so. I think
18 that, again, the legitimate secondary life
19 insurance marketplace provides a third option to
20 insureds who originally procured their policy to
21 address legitimate insurance needs.

22 And that marketplace, I think, is important
23 to regulators, because it does give a third option
24 to citizens. So I don't think legislation is
25 needed that was recommended by Mr. Welsh. I

1 frankly don't think that that legislation would be
2 necessary either.

3 MS. MILLER: Thank you.

4 Anything else?

5 Thank you very much.

6 MR. MCDOWELL: Thank you. Thank you for your
7 time.

8 MS. MILLER: Mr. Freedman, you want to -- you
9 can go next. It's very dark in that part of the
10 room. I thought -- I thought you were sitting
11 there but --

12 UNIDENTIFIED SPEAKER: It's very light for
13 you.

14 MS. MILLER: Yeah, I know it is.

15 UNIDENTIFIED SPEAKER: Does it make a
16 difference if we sit and testify or do we --

17 MS. MILLER: Take your choice. We can do it
18 either way.

19 MR. BAYSTON: My name is Darwin Bayston and I
20 am the president and CEO of the Life Insurance
21 Settlement Association, and I would like to thank
22 you for the opportunity to be here today to
23 provide some comments and some recommendations for
24 this hearing.

25 We are submitting -- we have submitted formal

1 comments, so I'll let those stand, and I'm just
2 going to make brief comments relative to a couple
3 of the issues in there.

4 For the past 20 years, the life settlement
5 market has evolved from largely an unregulated
6 marketplace where viatical policies were sold to
7 today's well regulated market in 42 states and
8 covers about 90 percent of the population that
9 would qualify for a life settlement transaction.

10 This market has provided billions of dollars
11 to tens of thousands of policyholders who
12 otherwise would not have been able to access the
13 financial value and resources of their life
14 insurance policy.

15 Today's market is one that's including a lot
16 more lower-to-middle income policyholders who are
17 in bad need of financial resources for retirement,
18 even to the extent that several states are
19 considering the use of life insurance policies for
20 long-term care, and even in cases of people
21 qualifying for Medicaid.

22 So basically, the life settlement market
23 exists to allow seniors, as was stated earlier, to
24 sell the policy that is personal property in the
25 marketplace if they no longer need it, want it or

1 perhaps can afford it.

2 Even so, the market evolves. There have been
3 challenges to the ability of seniors to make that
4 life settlement transaction, and I'm going to talk
5 about those -- some of those in a second. But as
6 a preface, I think it's already been distinguished
7 by some of the speakers earlier the difference
8 between the secondary market, which is the larger,
9 broader market; the life settlement market, which
10 is the transaction, the sale of the policy; and
11 STOLI, stranger-originated life insurance.

12 And I think the definitions of STOLI have
13 been made clear. It is -- it becomes a STOLI
14 policy at the time of issue. I am talking about
15 life settlements, which are not STOLI. STOLI is
16 not a life settlement. Life settlement is the
17 sale and transfer of that policy.

18 So -- but I would like to focus some comments
19 on some conduct matters that relate to the
20 difficulty in the sale or transfer of life
21 insurance policies by these seniors that may
22 impact transaction happening or may impact the
23 value that the seniors get when they sell those
24 policies.

25 And the first, of course, is the nonpayment

1 of interest. I think there's an awareness among
2 the market participants that when interest is not
3 paid and it's generally corrected, and in most all
4 cases, once it's brought to the attention of the
5 companies that the interest is not paid, it is
6 then paid.

7 But I think that there is a broader
8 issue here on the broader audience of individual
9 seniors who may not be aware of whether or not
10 interest is paid or whether or not they have
11 rights to interest. And so that's why it becomes
12 an important issue for you all to address to make
13 sure that all seniors are getting all of the
14 benefits they're supposed to get from the sale of
15 that policy including any unpaid interests.

16 There have been interest -- instances in the
17 past that we have discussed about unauthorized
18 changes in ownership data by the insureds, whether
19 it's addresses, whether it's telephone numbers or
20 other information, that really is important to the
21 ownership of that policy.

22 These may be inadvertent, and certainly,
23 don't believe that they're done deliberately. It
24 may result from simply from, you know,
25 administrative matters, or Lord knows we know the

1 last few days of difficulties in computer programs
2 and what they cause. So these may not be done on
3 purpose at all, but they could, they could, cause
4 a loss of coverage if the policies lapse as a
5 result of nonpayment of the death benefit.

6 There is a third issue in the obstruction in
7 obtaining verification of coverage.

8 Those instances seem to be more prevalent, and
9 clearly, the difficulty in providing verification
10 of coverage simply is an action that's taken that
11 significantly slows down the process of whether or
12 not that policy can be transferred.

13 And in some cases, it becomes so complicated
14 and so -- takes so long, that the transaction
15 simply doesn't get completed or, you know, people
16 throw their hands up and say, "Look, we're going
17 to go away from this."

18 So to that extent, any policies that are
19 prevented or delayed from being sold, it also
20 affects the value of the people who paid for those
21 policies. Therefore, that is an area where
22 seniors could be harmed through that action, and
23 we feel and recommend that that is addressed.

24 Another one that seem -- that has a broader
25 significance, I believe, is when insurers either

1 threaten or gaggle producers from advising or
2 being involved in life settlement transactions.
3 In other words, they tell their -- they tell their
4 agents they can't be involved in it. They can't
5 talk about it. They can't discuss it.

6 And when that happens, there's two things
7 that happen: Seniors are -- seniors consider
8 their agents a very important part of someone who
9 gives them financial advice and counsel. We get a
10 lot of calls from seniors that want help, need
11 help. Where should we go? Who should we talk to?

12 And the agents -- the agents, of course, and
13 producers are very, very much an important part of
14 the financial advice that these people get, that
15 they should get, and is impacted by. And when
16 carriers don't allow them to participate in the
17 life settlement market, they are really creating a
18 negative environment and a negative attitude by a
19 lot of the seniors of there must be something
20 wrong with this transaction, because my producer
21 is not able to talk about it. Those are serious
22 things, I think, that need to be addressed.

23 I'm going to let Michael give some comments,
24 but I would like to make one general comment from
25 the testimony and the conversations that have gone

1 on before. I spent 35 years in the investment
2 management profession, and I spent a lot of those
3 years with the (inaudible) institute as a charter
4 financial analyst.

5 And it bothers me when conversations go on
6 about an investor buying insurance policies and
7 then hoping that the person dies as quickly as
8 possible so I can make as much money as I can.
9 Now, look, most of these are bought by
10 institutional investors.

11 An institutional investor buys various types
12 of assets and puts them together in a portfolio to
13 accomplish some sort of a goal. And when you look
14 at, as an investor, buying 100 policies or 200 or
15 300 or however many, you're looking at that total
16 group of policies, and you're anticipating and
17 expecting a cash flow.

18 And you're trying to -- you try to evaluate
19 the return you're going to get based upon the cash
20 flows that you're going to get over time. And to
21 say that I'm sitting there every day as a
22 portfolio manager thinking, well, I sure hope this
23 person with a \$2 million-dollar policy dies
24 because I can make more money is ridiculous.

25 The other side of that that we don't ever

1 hear is life companies who sell annuities. And if
2 I give them \$500,000 in a lump sum and they're
3 going to pay me X amount of money each year until
4 I die, I don't believe they sit there and say,
5 "Well, I hope Darwin dies in a hurry so that we
6 can keep the money, therefore, we make more."

7 I don't hear the state pension fund saying,
8 "Gee, we have all these unfunded liabilities, and
9 you know one way that would take care of this is
10 if people die early. We wouldn't have to make the
11 minimum retirement payment." We don't hear that.

12 So I think we need to look at this in the
13 context of -- we could even go up to the next
14 level and talk about social security, you know, if
15 you want. But we need to say these policies are
16 bought by professional investors who are combining
17 those with other assets and they're trying to get
18 certain cash flows.

19 And it's really the predictability of that
20 cash flow that determines what they get as a
21 return or not. It's not individual ones. You
22 know, I don't buy 100 stocks and then look at one
23 stock and say, this is going to make me or break
24 me. That's ridiculous.

25 And I would like to see us not talk about it

1 in that manner. Talk about it in a larger context
2 of these are investments that they make in hopes
3 of earning an expected return, and that return is
4 determined by the cash flows and when they come.

5 MS. MILLER: Okay. So to be fair, the life
6 insurers are not sending me vitamins and
7 memberships to a gym and asking me to really take
8 care of myself, because they want me to live a
9 long time either. So I understand your point.

10 Do you think that -- do you think that it's
11 important for the State of Florida to maintain the
12 ability to buy a life insurance policy the second
13 time? In other words, I understand the consumer
14 need. If I have a policy, I've had it for ten
15 years, and I come to you and I say, "I need to get
16 the money out for whatever," and for me to sell it
17 to a life settlement company and be able to
18 liquidate that policy, that's important for me.

19 But is it important for the State of Florida
20 to then allow those companies to bundle their
21 portfolios and sell them again to hedge funds or
22 to whomever? Can you comment on that.

23 MR. BAYSTON: Any market needs liquidity, and
24 I think to not have that happen would deny
25 liquidity or the ability for these policies to be

1 sold somewhere else.

2 You're basically telling the investor that
3 buys it the first time, "You're buying it. It's
4 got to be locked up and you're not going to be
5 able to sell this."And when you -- when you don't
6 have any liquidity like that in the marketplace,
7 you basically have investors who are not
8 interested in locking their money up that long.

9 I don't know of an institutional investor who
10 is willing to say that I buy something today and
11 it's locked up for 10 years or 15 years and with
12 no ability to be able to get it. So a
13 secondary market -- I mean, a tertiary market is
14 very important to this marketplace, just that it's
15 done correctly is the important part.

16 MS. MILLER: Right. Is that the source of a
17 lot of the funding that is used today for life
18 settlements? In other words, I think when
19 viaticals first came out, there was a lot more
20 solicitation by viatical settlement companies of
21 individual investors.

22 For example, you know, put \$10,000 in and buy
23 a fraction of a life insurance policy. You don't
24 see that as much today. It's -- I don't think.
25 Maybe you can correct me if that's wrong. I think

1 more of the money is coming from institutional
2 investors. Is that correct?

3 MR. BAYSTON: That is correct. And that --
4 and that certainly is what we hope continues to
5 happen. And there is a greater recognition by a
6 broader group of institutional investors to put
7 money into this -- into this space.

8 For example, we introduced at our
9 conference -- at our conference last week a
10 Harvard Business School case study that's been
11 written on the industry, which is -- which is, for
12 certain, going to bring more recognition and
13 consideration by a high level of good
14 institutional investors who are looking to put
15 money into this as a legitimate asset class to go
16 along with all the other assets that they have,
17 types of investments they have, for the
18 diversification and for the noncorrelation
19 benefits and other benefits this particular asset
20 has.

21 MS. MILLER: Okay. Thank you.

22 MR. FREEDMAN: My name is Michael Freedman,
23 not Frank Sinatra clearing my throat. I am senior
24 vice president of Government Affairs for Coventry,
25 and I'm here representing LISA today as a member

1 of LISA and as a member of the External Affairs
2 Committee.

3 I want to reiterate just one thing that
4 Darwin was saying at the outset in his preface,
5 that there is a very clear and important
6 distinction between the broader secondary market
7 and between this thing called stranger-originated
8 life insurance.

9 And I think the only thing I could add is if
10 you look at the litigation that is being brought
11 by insurance companies, hundreds of cases, they
12 are not being brought against life settlement
13 companies. The issues that are being litigated do
14 not have to do with the assignment of a policy
15 through a life settlement transaction, a regulated
16 life settlement transaction.

17 There are some cases that involve policies
18 that were settled, of course, but that's the --
19 that's one of the issues at hand, which is if the
20 carriers are duped in the issuance of the policy.
21 There's been instances where life settlement
22 companies have not been aware, and in some
23 instances, deceived as to the true nature of the
24 origination of the policy.

25 The perpetrators of those schemes don't want

1 anyone to know what their true origins are. So
2 yeah, there have been some. But, again, the
3 litigation -- none of the litigation, none of the
4 litigation is aimed at life settlements and the
5 life settlement market and life settlement
6 participants.

7 And I think that's important, and very much
8 what Darwin was talking about, the issues about
9 the life settlement market and how that market is
10 important for seniors in Florida, and how there
11 are areas of concern that could be addressed
12 through stronger enforcement and stronger
13 legislation.

14 I'm just going to pick up on there and make a
15 few other additional brief comments that are
16 covered in our submission, and one deals with a,
17 more or less, regulatory issue that, going back
18 several years, the legislature adopted a
19 requirement that life expectancy providers be
20 registered under Florida law.

21 And that registration is different than a
22 licensing. It was simply basically telling the
23 state you're going to be in this business. The
24 qualifications were very few, if any really, and
25 there was no judgment, no standard by which the

1 department could say you are or not eligible to be
2 a life expectancy provider.

3 Earlier this year, the Office of Insurance
4 Regulation proposed legislation that would delete
5 the requirement of registration of life expectancy
6 providers. That legislation, which was included
7 in House Bill 635, was one that life insurance
8 settlement associations supported.

9 The life expectancy provider registration
10 requirements, at this point in time under that --
11 that law was passed only just about a decade
12 ago -- were ineffective. There was no
13 demonstrable consumer or investor protection.

14 They were anomalous in that no other state
15 provided such a registration requirement for life
16 expectancy providers, noting that Texas has a
17 requirement that LE providers register as brokers.
18 But, again, no distinction such as this.

19 And as the OIR has pointed out, it gives the
20 appearance of an endorsement or an imprimatur that
21 the life expectancy provider has some sort of
22 blessing from the state. But even today, it
23 impairs the market because the market has shifted,
24 as you've just recognized, Ms. Miller, and as we
25 know, that there's more institutional investors in

1 the market.

2 Investors are buying, using their own
3 underwriting, underwriting that is, because they
4 are themselves either an insurance company or
5 reinsurance company which represents some of the
6 investors in the market, or that differs, if you
7 will, from those registered LE providers. And
8 so -- and as part of that, providers buy for
9 themselves as investors and would use their own
10 underwriting.

11 But the way the law is written today, with
12 that in the law, we're not allowed. Those
13 investors are not allowed to utilize their own
14 underwriters or underwriters of their choice,
15 because they're restricted to using only
16 registered life expectancy providers.

17 So we would support, again, an effort to
18 repeal that provision in its entirety that would
19 include any remnant of the life expectancy
20 provider registration or any restriction on who an
21 investor can utilize for a life expectancy
22 provider.

23 I want to make one comment, though, now also,
24 switching gears a little bit, again, focusing
25 still on life settlements. The issue of return of

1 premiums does have an impact on our market even
2 though it's not, as I pointed out, subject in the
3 litigation and subject of a lot of this debate,
4 because investors are buying these life insurance
5 policies and we're going to really focus on just,
6 again, the life settlement policies.

7 When a life settlement occurs, the life
8 settlement provider is required to go back to the
9 insurance company and ask for the verification of
10 coverage. It asks the insurance -- it effectively
11 notifies the insurance company there's about to be
12 a potential sale of that policy.

13 And the questions are some very basic
14 information about the policy, but it signals to
15 the carrier. In states, many states, it requires
16 them to look back for fraud, misrepresentation in
17 the issuance of the policy.

18 So the insurance company is given another
19 notification. Hey, there is an opportunity here
20 for you to say this policy was issued properly or
21 improperly at its origination. If there are any
22 other questions about the validity of the policy
23 or things, that's an opportunity for the insurance
24 company.

25 Under Florida law and every law in the

1 country that I'm aware of -- I think I'm aware of
2 them all -- there's also a requirement that the
3 life settlement company, the provider, as part of
4 its antifraud plan, due its diligence to look for
5 elements of fraudulent settlement acts that
6 include the original underwriting of the policy,
7 where the premiums are coming from, insurable
8 interest, as well as any potential fraud or
9 misrepresentation in the sale of the policy.

10 So we're doing our due diligence at that
11 point in time. So the life insurance companies
12 had the opportunity to do due diligence at the
13 inception of the policy. They have an opportunity
14 at the time the verification of coverage is
15 submitted. We have that obligation, too. But yet
16 still, sometimes policies will get through and
17 sold that should have never probably been issued,
18 that would have been *void ab initio*.

19 So we believe that among the things that the
20 legislature should look at is strengthen the law
21 that doesn't impair the ability for an insurance
22 company to rescind a policy for lack of insurable
23 interest, or -- but that does provide the
24 opportunity or make clear that if the policy has
25 gone through a regulated life settlement

1 transaction, that if they find they're going to
2 rescind that policy for lack of insurable interest
3 and if that's granted, that the premiums be
4 returned to the investor of the life settlement
5 contract.

6 Because, again, we've gone through elements
7 of diligence that haven't -- that may not have
8 happened in other transactions, in other secondary
9 market transactions. But in a life settlement
10 transaction, there is that level of scrutiny.

11 But, again, still mistakes can happen.
12 Things can still get through, but we are clearly
13 not part of any transaction that's originating the
14 policy improperly, and those premiums should be
15 returned to the investors of life settlements.

16 And so we have provided you with it in our
17 testimony. We've provided you with some suggested
18 language that clarifies the return of premium
19 that -- just what I just said, that it be
20 clarified. Because, again, that gives confidence
21 to the investor, as well as to the life settlement
22 market so that the seniors can access the market.

23 MS. MILLER: What about the argument that we
24 heard earlier that you don't need new legislation
25 to accomplish that; that courts can already weigh

1 the equities of the situation? And in your
2 example, you have a legitimate licensed life
3 settlement company that has not engaged in any
4 fraud, has bought the policy. Why wouldn't you
5 already win that case?

6 MR. FREEDMAN: Again, we're talking about
7 this market, which is not the subject of that --

8 MS. MILLER: Right.

9 MR. FREEDMAN: -- that mess. What we are
10 talking about is there needs to be clarity and
11 there should be some level of certainty in this
12 market that provides tremendous value to
13 consumers.

14 And the idea, again -- I guess we -- there is
15 fallout from all this that is going to affect the
16 life settlement market. Investors become
17 potentially more wary about, well, you know, even
18 if there is a life settlement transaction, even if
19 you've done all this diligence -- as you know,
20 it's a very regulated transaction -- we can still
21 lose all of our investment in the premiums that
22 we've paid since we purchased it.

23 There should be some certainty. And, again,
24 as I pointed out with the level of scrutiny that's
25 involved with the carrier having to go back for

1 verification of coverage, the opportunity to look
2 back on that policy, as well as the life
3 settlement company, everyone has done their best
4 efforts, and yet still, there may be cases.

5 And if a carrier then says, "Well, now we've
6 discovered it," remember they had an opportunity
7 at inception. They had an opportunity throughout.
8 They had an opportunity prior to the sale. I
9 think at that point, there needs to be some
10 certainty and some comfort, clarity for this
11 market, for life settlements, the certainty that
12 the premiums that the investor, from the time they
13 bought the policy from a regulated life settlement
14 transaction, be comforted that they -- they be
15 restored to their original position, because they
16 were not part of it and they did their best
17 efforts as well through the provider.

18 MS. MILLER: Okay. I think I'm a little
19 lost. It may be just me. The law is already very
20 settled that after two years, the life company
21 can't contest the policy based on fraud, that they
22 can't -- the two-year contestability policy has
23 been in the law for years.

24 The only issue, I think, that's new, and it
25 may have come out of these cases, is the idea that

1 yeah, but you can still look at the insurable
2 interest at the time the policy was taken out. I
3 don't even see how they would affect you.

4 Because the life settlement is typically a
5 contract that is already in force before you see
6 it. I mean, you're not having people go out and
7 apply for insurance and then generate a new
8 contract, are you?

9 So is that really something that's hindering
10 investment in the products that you're involved
11 in, or is it just this STOLI issue that Phoenix
12 and Fortress are arguing about?

13 MR. FREEDMAN: I'm sorry if I haven't been
14 clear.

15 MS. MILLER: It's me.

16 MR. FREEDMAN: And I said it at one point in
17 what I have spoken here, but we've also made it
18 clear in our submission. We are focused only on
19 insurable interest issues, the issue of insurable
20 interest which carries beyond the contestable
21 period in most states.

22 In Florida, there is at least some question
23 now because of a recent court ruling as to whether
24 that's applicable. But we're talking about that
25 issue of insurable interest only, which can carry

1 beyond the two-year contestable period. And so
2 yes, it does have an impact on our market.

3 And more court-made law is establishing not
4 only is there the ability -- you know, good faith
5 standard or somewhat of a subjective intent
6 standard. If courts, as they are in Florida,
7 allowing carriers to retain premiums for policies
8 that are void for lack of insurable interest,
9 we're saying with respect to life settled policies
10 where there is this extra scrutiny, this extra
11 diligence that has to go on, they should be
12 protected so the investors in the secondary market
13 -- excuse me, in the life settlement market -- I
14 want to make that distinction -- are certain that
15 they're not -- their investments are not at risk
16 because there's been a failure through all of that
17 level of diligence to do that, to ensure the
18 policies didn't have a lack of insurable interest.

19 MS. MILLER: Anybody else on the panel have
20 any questions?

21 MS. DAVIS: I'm just not sure I understand.
22 If you've done your due diligence, there shouldn't
23 be a problem with the policy.

24 MR. FREEDMAN: That's correct.

25 MS. DAVIS: So why do you need legislation?

1 MR. FREEDMAN: But does it happen that
2 policies are issued for lack of insurable interest
3 and get through the carrier? Yes. Can they get
4 through the life settlement market? Yes.

5 MS. DAVIS: And the courts can take care of
6 the issue.

7 MR. FREEDMAN: Well, again, we're asking and
8 suggesting that the legislature be clear because
9 of the level of scrutiny that's involved in the
10 life settlement transactions that, again --
11 remember, the carrier gets another bite at the
12 apple, if you will, through the verification of
13 coverage to say, "Hey, this policy is subject to
14 potential life settlement." The carrier gets to
15 ask -- gets the opportunity to say, "Well, we
16 should make sure this policy is valid, whether it
17 should have been issued as well."

18 We base -- we, as a life settlement company,
19 under our antifraud plans, have to go back and
20 look, where did we get our information from on
21 whether or not the policy was issued accurately --
22 properly? From the insurance company. So, again,
23 there may be instances where cases are going to
24 get through.

25 MS. DAVIS: And so for those rare instances,

1 you want us to do legislation?

2 MR. FREEDMAN: Well, this is rare, but, you
3 know, again, we're representing our market. And,
4 you know, again, the courts are making the --
5 making court-made law today saying that carriers
6 can retain premium. We ought to be more clear.

7 They can retain premium where there was a
8 policy that was *void ab initio* if that's going to
9 be law. However, they can't do that with respect
10 to policies that have been through a regulated
11 life settlement transaction. I think, you know,
12 they have to return the premium to the owner, the
13 investor owner of the life settlement.

14 MS. MILLER: What do you think the insurance
15 company should do when they get a request of
16 verification of coverage to make sure that that
17 policy was issued properly?

18 MR. FREEDMAN: It's what they should do at
19 the inception of a policy, is do their best
20 efforts and do their diligence to make sure the
21 policy is issued properly. What are they going to
22 do if it's not a settled transaction?

23 MS. MILLER: I guess that's my question.
24 Maybe it's more appropriate to ask the life
25 insurers, and I'll ask them when they get back up.

1 But the -- I mean, having bought life insurance
2 before, they come and they, you know, they test
3 your blood. They meet you. They see where you
4 live. They see -- or at least they see where you
5 work if they're coming into the office.

6 Some life insurers actually do due diligence
7 and underwrite the policies. So if a year or two
8 later, they get a request for verification of
9 coverage, should they go back and do the
10 underwriting again?

11 Would you do that if you've got some
12 indication that -- I mean, it's too late after you
13 buy the policy. It's too -- it's not too late for
14 them until the two years, though, is what you're
15 saying.

16 MR. FREEDMAN: Again, our point is there's an
17 extra level -- there's several extra levels of
18 scrutiny that are going to take place when the
19 policy is being sold. The carrier is notified
20 it's going to be sold, and they have to do
21 verification of coverage. They have to look to
22 see whether there are issues related to the
23 policy.

24 It may not specifically involve insurable
25 interest inquiry but it can. And certainly, if

1 it's past the two-year contestable period on fraud
2 and misrepresentation, it may not be worth doing
3 but they -- but they have to -- they're being made
4 aware the policy is subject to settlement. And is
5 it valid? Is it a -- is it a valid policy.

6 The life settlement market has to also do it.
7 The life settlement company also has to do the
8 same thing through our antifraud plans. We look
9 back, take a look, see where premiums come from.
10 We have to look back at the origination of the
11 policy. We have to look back for specifically
12 insurable interest violations. We do our best
13 efforts.

14 These are regulated transactions. Again, I
15 made the point earlier, much of the STOLI
16 litigation involves policies that are not going
17 through a regulated transactions. Should there be
18 a benefit of having a regulated transaction, one
19 in which we've done our best efforts by law? And
20 the answer is yes.

21 There should be some comfort that if the
22 carrier then later finds out there was a scheme to
23 deceive the true insurable interest, the ownership
24 of that policy from inception -- we tried our
25 best. They tried their best. Now they found out

1 about it. That -- those premiums should not be
2 retained by an insurance company at that point for
3 the life settlement policy.

4 MS. MILLER: Okay. Thank you.

5 MS. DAVIS: You're saying most of the STOLI
6 policies have not gone through a regulated
7 viatical transaction. Are you saying that that's
8 because they're premium-financed policies that are
9 then sold off? Or what are -- what are you saying
10 that those policies are?

11 MR. FREEDMAN: Well, I think Mr. McDowell
12 pointed out as well that these -- it's the
13 beneficial interest in the -- in the trust that's
14 being sold, that the -- in the case of
15 premium-financed schemes, there was a
16 relinquishment or abandonment of the policy.

17 You know, they didn't even involve a life
18 settlement transaction, I can tell you that,
19 whatever those were. That's why there's a
20 difference between life settlements and
21 stranger-originated life insurance.

22 MS. MILLER: So we have 17 licensed -- 17 or
23 18 -- 17 --

24 MS. DAVIS: 17 in Florida.

25 MS. MILLER: -- licensed life settlement

1 providers, companies. And those entities are not
2 the entities that were involved in STOLI
3 transactions. Is that correct?

4 MR. FREEDMAN: That would be my assertion.
5 And I think, you know, I would ask you the same
6 question.

7 MS. MILLER: And so I think what we've been
8 presented with from time to time is the question
9 of, "If I do this transaction and I'm making a
10 loan, at the time I make the loan, I'm telling
11 people that in two years, you have a choice. You
12 can keep the policy and repay my loan, or you can
13 sell me the policy."

14 The people who are proposing to do that come
15 to us and say, "Do we have to be licensed as a --
16 as a viatical settlement company or a life
17 settlement company?"

18 And we say "Oh, yes, you do," because the law
19 requiring a life settlement provider license is
20 specific enough to cover that situation.

21 And they say "Okay. Never mind. Forget we
22 ever asked." They go off. They don't come
23 through us again and get licensed. They just go
24 to these trusts and buy a beneficial interest in
25 the trust, and they don't actually buy the policy.

1 Is that what they're doing?

2 MR. FREEDMAN: From the STOLI schemes that
3 we've seen --

4 MS. MILLER: That's what it is?

5 MR. FREEDMAN: -- that's what it is.

6 MS. MILLER: So when you say it's two
7 separate markets, it's separate players. It's not
8 even --

9 MR. FREEDMAN: You made the case for me. I
10 mean, when -- you know, if they thought that they
11 were going to get away with something and you said
12 it doesn't look like it's a life settlement to
13 us -- or it would be a life settlement, they don't
14 want to be regulated.

15 Again, when the scrutiny, when the lights are
16 on and the -- and the regulation requires the
17 level of scrutiny and diligence that we have to
18 provide, that's good for investors. But it's good
19 for the consumer and makes sure that there is a
20 healthy market.

21 MS. DAVIS: I have another question about
22 your verification of coverages. How many
23 verification of coverages are requested as
24 compared to how many policies are actually bought?

25 You're suggesting that the insurer should

1 reevaluate every policy they get a verification of
2 coverage on, but not every policy that they would
3 get a verification of coverage on would be a
4 policy that would be sold.

5 MR. FREEDMAN: Right. I'm sure that -- I
6 don't know the statistic. I don't know a number
7 that tells -- that answers your question as to how
8 many verification of coverages are received versus
9 how many are purchased.

10 But, again, the point is that the carrier is
11 notified of a potential sale of the policy. They
12 also are notified at the time of the assignment of
13 the policy, the transfer to the new owner. So
14 there's, again -- they do know at that time which
15 policies are actually sold.

16 MS. DAVIS: Does is specifically say this
17 policy is being viaticated or this policy is being
18 sold?

19 MR. FREEDMAN: Every carrier knows which ones
20 are being sold. It's not just a simple -- I mean,
21 this is part of what Darwin's testimony was, that
22 carriers are treating changes of ownership
23 differently for life settlements they change --
24 than they do for change of ownership for placing
25 it into a trust, a family trust, or from a

1 business, you know, to business. So carriers
2 track life settlements. They know which policies
3 are sold. They treat them differently at every
4 stage of the -- every stage.

5 Again, you know, we're just saying where we
6 know there is that additional level of attention,
7 additional level of scrutiny -- these are
8 regulated transactions. There's no one trying to
9 hide who owns it; and, again, the requirement of
10 the law that we have to notify the insured who
11 owns it if it changes ownership -- is that that's
12 a secure transaction for both the consumer and the
13 investor.

14 MR. BAYSTON: I would just make one comment
15 that I look at this as the simple part of this
16 transaction is that on one end of the spectrum, we
17 have seniors who have insurance policies they no
18 longer need, want or can afford. And they have
19 the right to sell them, and they're looking to
20 sell those in the marketplace.

21 And on the other end, you have an investor
22 who is making a decision on buying those policies
23 and providing that capital for those seniors. And
24 I think I -- one view that one could take is that
25 investors are pretty good at measuring the amount

1 of risk they have involved in the investment.

2 So anything that would be perceived as
3 increasing the risk that those investors have is
4 going to result in them paying, you know, a lesser
5 price to the consumer, to the senior who is trying
6 to sell that.

7 So actions that could be taken that will
8 reduce perception or the reality of risks that
9 those investors have, then the benefit of that
10 flows back to the seniors who are selling
11 policies.

12 MS. MILLER: Thank you for making that
13 connection. Is there anything else that you
14 wanted to add? No? Anybody else have questions?

15 Okay. We have -- thank you very much for
16 your testimony.

17 We have three more -- I think we have three
18 more speaker cards. So if everybody is on board,
19 hopefully, let's just push through instead of
20 breaking for lunch. It's 1:00 o'clock, and
21 hopefully, we can finish up pretty soon.

22 Thomas Weinberger is the next speaker card on
23 behalf of the Institutional Longevity Markets
24 Association.

25 MR. WEINBERGER: Good afternoon. My name is

1 Tom Weinberger. I'm a partner at Stroock, Stroock
2 & Lavan. We are a full-service law firm with
3 offices in Miami, New York, D.C. and Los Angeles,
4 and we serve as general counsel for the
5 Institutional Longevity Markets Association. I am
6 appearing today on their behalf.

7 ILMA was formed by institutional investors,
8 leading investment banks that were focused on
9 longevity and mortality markets and in life
10 settlements. Today, the members comprise Wells
11 Fargo, Wilmington Trust, Credit Suisse, Fortress,
12 Neo Partners and other investor groups, some of
13 whom are investors on behalf of pension funds, and
14 they are all institutional investors.

15 I appreciated and enjoyed Mr. McDowell's
16 remarks. I thought they were very passionate and
17 dramatic. I would submit that, as far as accuracy
18 goes, perhaps not as much. I don't think we're
19 talking today about STOLI. What we're talking
20 about is whether a true secondary market will
21 exist in the state of Florida.

22 The institutional investors that make up ILMA
23 participate in primarily what is called the
24 tertiary market. When you look at the life
25 settlement industry, you have the primary market,

1 which is the initial issuance of the policy by the
2 insurance company to the original policy owner;
3 the secondary market is when that policy first
4 gets settled to a life settlement company; and the
5 tertiary market is all the subsequent trading that
6 goes on in that policy.

7 This tertiary market is crucial for the life
8 settle -- the secondary market. Without the
9 tertiary market, the secondary market does not
10 exist because there needs to be liquidity. It's
11 the pension plans who can buy large blocks of
12 policies that provide the capital that ultimately
13 feeds this market.

14 And while Mr. McDowell was very passionate, I
15 also want to express a certain passion, because I
16 truly believe in the life settlement industry. It
17 is a product that provides a great service to
18 seniors. It's a product that provides a
19 reasonable return to institutional investors. And
20 if the insurance companies were honest about it, I
21 think it provides a lot of opportunities for them
22 as well in terms of product design and how they
23 work with their customers.

24 And I know Mr. McDowell went on and
25 constantly referred to the institutional investors

1 as hedge funds. I assume it was meant in a
2 pejorative way. The reality is we're really
3 talking about long-term investors with long-time
4 horizons for whom this type of product makes sense
5 because it matches their cash flow needs.

6 For pension plans that know that they have to
7 make payouts in the next 10, 20, 30 years, these
8 are perfect products, because they can invest
9 today in products that will provide cash flow
10 downstream. It's not people looking for outsized
11 returns.

12 And if you ask investors, I think they'll
13 tell you that the returns -- some of them have
14 lost money, some have made money, but I think
15 overall, the returns are respectable. It's not
16 someone trying to grab and make a ridiculous
17 return. That's not what the market is about. But
18 if all the participants act in the market
19 together, you can have a true and active secondary
20 market.

21 Now, the question is, why do the
22 institutional investors seek the protections that
23 they're asking for today? And the reason is when
24 we're buying blocks of policies, we actually have
25 limited access to information. We're provided

1 with some sale documentation that was provided at
2 the time of the life settlement. Typically, the
3 due diligence is limited to a review of the policy
4 at the application, the life settlement contract
5 and some supporting documents.

6 We, at Strook, are actively involved in
7 helping the companies do diligence on these
8 policies, and I can tell you we do not have access
9 to the insureds. It's true that when you buy a
10 policy, you get updated medical information, but
11 that's not the same thing as being able to sit
12 done and talk to the insured and ask them, why did
13 you take out this policy? Why did you sell it?
14 That doesn't happen.

15 You certainly can't do it when you buy a
16 block of 100 policies or so, which is really what
17 happens in the tertiary market. And it's not the
18 practice and there are, in fact, due to privacy
19 laws, significant limitations on who can actually
20 contact the insured and when. So to say that
21 there's access to the insured is not entirely
22 accurate.

23 Also, the concept that the law is well
24 settled and there are legal certainties is also
25 not true, and I think that's what's driving the

1 interest in seeking the reforms and the
2 legislation that the institutional investors want.

3 The concept of a -- being able to challenge a
4 policy after the end of the contestability is
5 something that's actually very much in flux. In
6 Florida itself, you have two courts that came out
7 with different decisions on the issue. So it's
8 not -- it's far from a legal certainty. It's
9 unknown.

10 There have been only a few courts that have
11 actually addressed the issue. And the concept
12 that if there were no ability to challenge for
13 lack of insurable interest after the end of the
14 contestability period, that you are now going to
15 open the door to fraud, I don't think that's going
16 to prove to be the case.

17 And I think it's not going to be the case for
18 several reasons: One, in New York, there was a
19 case many years ago, the *Caruso* decision by the
20 New York Court of Appeals, where they said that
21 you can not challenge a policy on any basis after
22 the end of the contestability period. That has
23 not led to a rampant increase in fraud in the
24 state of New York.

25 I think investors do a very good job of

1 identifying policies that were fraudulently
2 originated, and they don't -- and they don't buy
3 them when they can identify them. But the reality
4 is there's just the lack of information.

5 And when you couple the lack of information
6 and the limits on the diligence that can be done
7 at the time you're originating policies with the
8 legal uncertainties in this area, it makes it much
9 less attractive for investors to come in. And
10 without the investors in the market, you're not
11 going to have the liquidity that you need for a
12 secondary market.

13 And, you know, if you look at what's going on
14 in the United States today, the current economic
15 environment, you have many Baby Boomers who are
16 entering their retirement years. Following the
17 Great Recession, there has been significant
18 reduction in asset values.

19 A lot of them have needs for long-term care
20 that are far more expensive than anyone ever
21 imagined be the case, and there's a real need
22 today for people to be able to settle their
23 policies to either fund a comfortable retirement
24 or perhaps pay for long-term care needs.

25 And what we're talking about today is, will

1 there be a secondary market to provide that
2 service to them, to provide that option? And I do
3 think that if you look at the policy origination,
4 it's really the carriers who are in the best
5 position, at the time a policy is originated, to
6 do the proper diligence.

7 Yes, it's true that they ask questions and
8 you have to fill out a form. But should the
9 obligation of the carrier stop there? It's simple
10 enough in the two-year contestability period for
11 them to figure out what's going on with the
12 policy.

13 And we're not talking about doing this with
14 every policy. The issues are going to arise with
15 a certain block of policies. It's going to be
16 large face policies with older age issuances. All
17 they need to do is, six months down the road, call
18 up the insured and say, "Thank you for taking out
19 the policy. How is -- you know, is everything
20 okay? Do you need more information?"

21 You quickly find out if the insured sold the
22 policy. It's happened time and time again, but
23 the carriers didn't take that step and weren't
24 interested, quite frankly, weren't interested in
25 taking that step.

1 It's not something institutional investors
2 can do four or five years down the road. It's
3 certainly something that the companies can do
4 during the contestability period without too much
5 difficulty.

6 So I think just to quickly summarize --

7 MS. MILLER: Let me interrupt you. Do you
8 think that the reason they don't, or to the extent
9 that they don't, is just because that would be an
10 expensive thing to do?

11 MR. WEINBERGER: I don't think it's an
12 expensive thing to do. I think there have been
13 cases where it's been done. Again, we're talking
14 probably about a relatively small group of
15 policies. We're not talking about doing it with
16 someone who's 25 years old and took out a term
17 policy.

18 We're talking about sales of universal life
19 policies to people who are over the age of 65 and
20 face amounts over a million dollars. It's not --
21 it's not a big group. It's something that they
22 certainly can do during the contestability period.
23 I don't think there's a lot of cost or a lot of
24 effort involved in doing so.

25 MR. TRONCOSO: You lose me on the fraud

1 issue, and that's just because, you know, their
2 testimony was quick to point out that 98 percent
3 of, you know, the companies are not having this
4 issue, and it seems like most of their problems
5 came with one company.

6 And so, you know, if you make that issue -- I
7 understand it alleviates your client's issues, but
8 doesn't that perpetuate a fraud problem to just
9 push the fraud to another sector of the market? I
10 mean --

11 MR. WEINBERGER: No. I appreciate that. I
12 think that's a very good observation. I think the
13 answer is it will likely not, and here it comes
14 out to a question of balancing what's most
15 important here.

16 I think it would likely not lead to an
17 increase in fraud for several reasons: One, the
18 carriers that don't have the problems today
19 already take the steps and identify, at the time
20 of origination, the policies that are likely
21 fraudulent because there are steps you can take.

22 I do diligence on these policies, and even
23 with the limited information I have, I can find
24 fraudulently-originated policies from time to
25 time. There are certain red flags and the

1 carriers know what they are.

2 So I think it's possible to do it at the time
3 of origination; need to ask a few more questions,
4 need to add questions to the application. All of
5 this is being done, and it's easy to follow up and
6 easy to see inconsistencies in these policy
7 applications if you care to look for it.

8 I think what's going on is they would get in
9 information, which sometimes was fraudulent, but
10 they'd merely check the box and say, okay, we got
11 this, we got this, we got this. No one would
12 bother to look.

13 And, in fact, there's been quite a bit of
14 testimony that companies even realize after the
15 fact that there were red flags, and there are
16 memos to this, that they ignored the issues or
17 they didn't act on the red flags.

18 All we're saying is that the companies should
19 take a look and should act on it. And, again,
20 we're talking probably about a segment of the
21 market that is highly profitable for everyone
22 involved that probably deserves a little more
23 attention. And because other companies have been
24 able to handle the issue, I think the insurance
25 companies can handle the issue.

1 And the institutional investors don't want to
2 buy these policies either. I get paid to help
3 them find the fraudulent policies. But, again,
4 because of where we are in the chain, it's not
5 always possible to do so.

6 MR. TRONCOSCO: What concerns me, I guess,
7 is, you know, how many lawyers -- not the fact of
8 how many lawyers we have in the room, but I know
9 we have a lot of lawyers in the room. And what
10 concerns me is what we're talking about is
11 handcuffing the law of equity.

12 And, you know, for everyone that went to law
13 school, we understand that's the judge's power
14 to make sure that things are fair and balanced, to
15 put it in layman's terms. So that's the only
16 thing that concerns me. You know, every time you
17 do that, you do open the door to fraud, so that's
18 just my point.

19 MR. WEINBERGER: Again, fair point. But I do
20 think there is a significant value to making sure
21 that the institutional investors can act in this
22 space, and that you have to look at what the legal
23 uncertainty does to the ability of the investors
24 to be in this space, and whether you want the
25 investors in the space and you want a secondary

1 market. So there is some balancing of equities
2 that has to go on on a more global scale than just
3 on the individual policy issuances.

4 MS. MILLER: Do you know how big the
5 secondary and the tertiary markets are? We
6 haven't been able to figure that one out, to be
7 quite honest.

8 MR. WEINBERGER: There have been some
9 reports. I think there's some studies, and I
10 believe that in the submission that you received
11 from Fortress, they had some studies in there that
12 provided figures. Those are probably the most
13 accurate figures that you'll find. I don't have
14 independent information.

15 MS. MILLER: So is it in the billions, the
16 tertiary market?

17 MR. WEINBERGER: Probably, yeah. And it's
18 something that could grow. I mean, one thing that
19 a number of states, including Florida, has been
20 considering is whether, in order to fund Medicaid
21 long-term care costs, whether the states
22 themselves want to get into the business of life
23 settlements.

24 So it's a market that's poised to grow. It's
25 meeting a significant need. But in order to grow,

1 there does need to be a greater amount of legal
2 certainty around some of these issues.

3 MS. MILLER: I'm going to tell you it's been
4 a really long road, from my perspective. But
5 we don't have to digress into it, but we've had
6 quite a number of fraud cases and officers of
7 licensed viatical companies that we've had to go
8 through the process of, A, proving what was going
9 on, and then B, working with prosecutors to take
10 those cases and stop those people from
11 masquerading as legitimate viatical or life
12 settlement companies. And I'm not sure that we
13 got them all.

14 I mean, the -- what I'm hearing is that there
15 are a whole other group of people out here who, to
16 stay off the radar now, are buying -- or were
17 buying policies by buying the -- or by trading a
18 beneficiary interest.

19 I don't know what the next iteration is going
20 to be, but this group of issues is so convoluted,
21 I'm not sure that it isn't ripe for the courts
22 whether rather than trying to get involved in
23 these transactions, you know, with hard-and-fast
24 rules from the legislature.

25 MR. WEINBERGER: Well, I think actually,

1 there was a lot of time spent discussing
2 beneficial interest. Most states that have
3 adopted updated life settlement laws actually
4 expressly prohibit the sale of beneficial interest
5 in a trust during the contestability period.

6 That practice, as a result, has largely
7 disappeared from the market, if not entirely. I'm
8 not aware of any institutional investors that are
9 active in doing anything like that today.

10 MS. MILLER: So the STOLI issue is pretty
11 much an issue of the past, 2007/2008, other than
12 the fact that there's still policies out there
13 that were procured that way?

14 MR. WEINBERGER: I think a lot of the most
15 egregious practices probably are from that period.
16 And both the insurance companies have become much
17 better at identifying them and preventing them;
18 the institution investors are better at
19 identifying people that participate in those types
20 of activities and not purchase those policies.

21 But that doesn't obviate the need for more
22 legal certainty in the space, because there are a
23 lot of issues that are floating around, especially
24 in the courts in Florida. And I know for a fact
25 that -- I have a number of clients that, when we

1 review policies for them, they also ask us -- you
2 know, we look at policy design issues and other
3 factors and help them evaluate the policies.

4 Right now, they are actually handicapping any
5 policy that's issued in Florida because of the
6 legal uncertainty, which means that the prices
7 they're -- that they're willing to pay for Florida
8 policies are much lower than the rest of the
9 country.

10 MS. MILLER: Okay. Thank you.

11 MR. WEINBERGER: Thank you.

12 MS. MILLER: James Tollerton, Professional
13 Benefits, Inc. Thank you for sticking around and
14 not being first.

15 MR. TOLLERTON: Thank you for letting me get
16 up and circulate my blood. And for the record, I
17 am Jim Tollerton of CLU and CHFC, Professional
18 Benefits in Sarasota, Florida.

19 I was invited by representatives at the
20 National Association of Insurance and Financial
21 Advisors, Florida Chapter, to come and speak as a
22 typical Florida insurance agent today about my
23 experiences in this area.

24 It's actually been very instructive and I
25 appreciate the information that's been provided.

1 I'm intrigued by the questions you've asked. I do
2 not have a great deal of experience personally in
3 the settlement industry, except peripherally.

4 I do, in the interest of disclosure, want to
5 tell you that I did settle a policy, actually with
6 a friend and a client, about 15 years ago who had
7 developed cancer and was offered a settlement. He
8 accepted it and it was my only experience with it.

9 I became very uncomfortable with the process.
10 I would get calls every three to six months,
11 "How's he doing? What's going on," and so forth.
12 And as I sit here and listen to the colloquy we've
13 been going through, I -- it occurs to me that this
14 is that slippery slope.

15 The farther we get away from the essential
16 underpinnings of the insurance -- life insurance
17 industry of insurable interest, I think the
18 slipperier the slope is going to be. When you have
19 somebody else owning a life insurance policy on
20 you, you don't know who it is, you don't know
21 where it is, you don't know what's going to
22 happen, that is very uncomfortable.

23 This came to light to me -- an attorney -- a
24 couple attorneys have asked me to review these
25 sorts of policies because they didn't understand

1 what in the world is going on here. And I
2 remember one instance last year, a gentleman in
3 his, I believe, early 70s had a \$2 million-dollar
4 policy by a legitimate company, a name you'd all
5 know, not one we'd characterize ill in the
6 industry.

7 And he said, "Geez," to his attorney, "I'm
8 afraid I don't know who owns my policy anymore.
9 This agent came to me and offered me a loan so I
10 said sure. It wouldn't cost me anything really.
11 They bought me a nice dinner at a fancy steak
12 restaurant and so forth."

13 And now, at the end of two years, they say,
14 "Well, you don't really have to pay that loan
15 back."

16 And I -- of course, I interject
17 parenthetically, most of these seniors that deal
18 with this have no idea of the tax implications of
19 a loan forgiveness or boot or anything like that,
20 have no idea where this policy is going and what's
21 happening. All that's dangled out there is that
22 nice attractive dollar amount, and gee whiz and
23 it's painless and so forth.

24 And all of a sudden it dawned on this guy,
25 he's got \$2 million on his head. He has no idea

1 who owns it. That's not been disclosed at all.
2 It's long gone in tertiary four, five, six times.
3 Who knows where it's been sold to.

4 So I think the bottom line from an insurance
5 agent's perspective is that we're in the business
6 of, where there is insurable interest, insuring
7 lives for families, for businesses, for charities
8 in some instances.

9 And 99.9 percent of our agents in NAIFA and
10 the agents, legitimate agents in Florida, have no
11 interest in this market because of the ongoing
12 problems that just naturally happen if you can
13 sell it.

14 I think the analogy of the mortgage industry
15 where the mortgages were packaged together and
16 sold in the secondary, tertiary and down-the-road
17 market, and look at the trouble we got into. And
18 that's dealing with homes and objects. It's not
19 dealing with human lives, which is what we all
20 are, fortunately, by the grace of God, living
21 today.

22 So I summarize my remarks that way. I would
23 be glad to answer questions as a practical matter
24 from an insurance agent's point of view from a
25 small town in the back waters of Florida.

1 MS. MILLER: Well, I suppose one thing that
2 we had identified from the assignment from the
3 legislature is that it assumed that we want to
4 ensure that the tertiary market continues to exist
5 for Florida consumers and for Florida seniors.
6 And from what I'm hearing, it may be that that
7 market needs to exist for investors but not
8 necessarily for seniors. Is that your perspective
9 on it?

10 MR. TOLLERTON: Speaking only for myself, I'm
11 uncomfortable with the industry generally, to be
12 honest with you.

13 MS. MILLER: Thank you very much.

14 MR. TOLLERTON: Thank you.

15 MS. MILLER: Oh, my goodness, I can't believe
16 I gave Paul Sanford the last word unless there's
17 somebody else here that I don't have a speaker
18 card for.

19 MR. TRONCOSO: Do you waive your time?

20 MS. MILLER: No. Mr. Sanford is not going to
21 waive his time in support.

22 MR. SANFORD: Thank you. Paul Sanford
23 representing the Florida Insurance Council. I
24 just want to comment on a couple of things that
25 were said without taking too long, because

1 everybody is ready to go.

2 The issue of these verification of coverages
3 has come up two or three times. Basically, when
4 an insurer gets a verification of coverage, it's a
5 question of, is the policy in force, and are
6 premiums paid?

7 It's very unlikely that any substantial
8 re-underwriting of the contract is going to take
9 place at that time. And to try to use that as a
10 vehicle to cut off any questions about insurable
11 interest just seems to be way far afield from our
12 perspective.

13 I think the other issue that was brought up,
14 again, about the return of premiums, insurable
15 interest and that sort of thing, and I think if
16 there's one thing that you can really count on
17 today is every case, the facts are different.

18 If you're going to find equity in these
19 cases, which is what the courts are trying to do,
20 you must look at each case individually in order
21 to arrive at the right conclusion and see that the
22 parties who participated in the wrongdoing are
23 punished to some extent, and those who did not are
24 not punished.

25 And the only way that can happen is to go

1 through the courts. Anything that we may do to
2 guarantee that a return of premiums in every one
3 of these circumstances may well be guaranteeing a
4 large return on a risky investment that was bought
5 with knowledge of what they were buying. So from
6 our perspective, we don't really think any
7 legislation is necessary.

8 But if you wanted to consider some
9 legislation, it might be to look at the NAIC model
10 act on these STOLI transactions, especially the
11 five-year provision on nonrecourse premium
12 financing and the limitations on transferring
13 those policies, and combine that with the trust
14 provisions from the NCOIL Act that would get to
15 these issues where they're able to deceive the
16 insurers on what the contract really is.

17 Those two things might well forever remove
18 STOLI from the -- from this planet, and that
19 appears to be the only real hazard that this
20 secondary market is having.

21 MS. MILLER: I disagree that it's the only
22 hazard.

23 MR. SANFORD: Well, true. Perhaps a larger
24 one we discussed today.

25 MS. MILLER: That might be the hazard du jour

1 or maybe the hazard of 2007/2008; and there will
2 be a new hazard du jour in 2014.

3 And I would ask just a couple things. One
4 is, what have the life insurance companies done to
5 strengthen their underwriting and their ability to
6 identify policies that have been sold? And can
7 they, in fact, tell if there is a policy that is
8 owned by a trust that the beneficial ownership of
9 it has changed?

10 MR. SANFORD: Quite frankly, I think the
11 underwriting policies are about as strong as they
12 can get. I think we've seen situations where we
13 get an application. It's attached -- it's -- the
14 application may or may not be fraudulent, which
15 some of those things you can find.

16 We've received financial statements from CPAs
17 that didn't exist. The policy is purchased by a
18 trust that appears to be for the benefit of a
19 person who does have an insurable interest in the
20 applicant.

21 And other than having to go back and look
22 every day after that to see what happened, we
23 can't keep up with what that trust does. And
24 unless we want to expend huge sums of money and
25 large amounts of time, which will increase the

1 cost of insurance for everyone to try to ferret
2 this out, I don't really know what else they can
3 do.

4 MS. MILLER: Well, they can pick up the phone
5 and call the insured.

6 MR. SANFORD: Call who?

7 MS. MILLER: The insured.

8 MR. SANFORD: Yes.

9 MS. MILLER: They can call them and they can
10 say, you know, "Mr. Smith, I see that Joey Smith
11 is your beneficiary. Is Joey your son?"

12 "Yes."

13 "How old is Joey? Where did he grow up?
14 Where does he live now?" And those things, they
15 could verify on the internet.

16 So I'm not sure that there aren't things that
17 life insurance companies could do to kind of check
18 some of this out, and I think that they do do some
19 of that and maybe more now than they have done in
20 the past.

21 MR. SANFORD: And I think the larger the
22 policy, the more checking that goes on.

23 MS. MILLER: Probably so.

24 Anybody else have any questions?

25 MR. SANFORD: Thank you.

1 MS. MILLER: Thank you.

2 Okay. Does anybody else wish to
3 testify? Well, see, we got through this without
4 any bloodshed. Today, we have heard testimony
5 from interested parties on the secondary, or as it
6 may now be known, the tertiary life insurance
7 market in the state of Florida.

8 The Office will carefully review and consider
9 the testimony offered here today, as well as all
10 materials submitted to the Office before making
11 our report to the legislature. If anyone in the
12 audience wants to provide additional comments or
13 materials, please e-mail them to
14 secondarylife@floir.com no later than
15 October 30th, 2013.

16 Materials received on this matter will be
17 available to the public and posted on the Office's
18 website. Therefore, if any interested parties
19 believe they have comments or information that has
20 not already been expressed today, feel free to add
21 those.

22 Thank you for your participation. If there's
23 nothing further, this hearing is adjourned.

24 (Whereupon, the proceedings concluded at 1:35
25 p.m.)

1 CERTIFICATE OF REPORTER
2
3
4

5 I, LISA A. BABCOCK, do hereby certify that I
6 was authorized to and did report the foregoing
7 proceedings, and that the transcript, pages 3 through
8 148, is a true and correct record of my stenographic
9 notes.
10

11 Dated this 12th day of November, 2013 at
12 Tallahassee, Leon County, Florida.
13

14 

15 _____
LISA A. BABCOCK

16 Court Reporter
17
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APPENDIX B

SURVEY AND RESULTS

SECONDARY LIFE MARKET SURVEY QUESTIONS

- * 1. What is the total count of Florida in-force life policies as of June 30, 2013?
- * 2. What is the total sum of the face amount of Florida in-force life policies as of June 30, 2013?
- * 3. What is the count of Florida in-force life policies that were owned by a trust as of June 30, 2013?
- * 4. What is the sum of the face amount of Florida in-force life policies that were owned by a trust as of June 30, 2013?
- * 5. For the previous two responses, are your answers based on known or estimated information?
- * 6. What is the count of Florida in-force life policies that were owned by a bank or financial institution as of June 30, 2013?
- * 7. What is the sum of the face amount of Florida in-force life policies that were owned by a bank or financial institution as of June 30, 2013?
- * 8. For the previous two responses, are your answers based on known or estimated information?
- * 9. What is the count of Florida in-force life policies that were financed through a premium finance company or other structured loan program as of June 30, 2013 (do not include insurer-financed policies)?
- * 10. What is the sum of the face amount of Florida in-force life policies that were financed through a premium finance company or other structured loan program as of June 30, 2013 (do not include insurer-financed policies)?
- * 11. For the previous two responses, are your answers based on known or estimated information?
- * 12. What is the count of Florida in-force life policies that have been viaticated as of June 30, 2013?

- * 13. What is the sum of the face amount of Florida in-force life policies that have been viaticated as of June 30, 2013?
- * 14. For the previous two responses, are your answers based on known or estimated information?
- 15. Please provide any comments you have regarding the data that has been provided.
- * 16. Does your company have procedures in place to evaluate the impact of viaticated policies on the net-present-value of the life insurance book of business?
- 17. If you responded 'Yes' to the previous question, please provide an explanation of the procedures or include them in the Supporting Documentation component and respond 'Supporting Documentation' here. DO NOT INCLUDE 'TRADE SECRET' INFORMATION IN YOUR RESPONSE.
- * 18. Provide the name and title of the officer of the company who has reviewed the submission of this data and who would attest that the above information is true and accurate to the best of his or her knowledge.

* *Required field*

SUMMARY OF SURVEY RESULTS

393 of 425 companies completed the survey (92.4%).

The companies responding represent 92.3% of the face amount of Florida life insurance policies in-force as of December 31, 2012.

63 companies had no in-force policies in Florida as of June 30, 2013.

Three companies reported data solely related to credit life and term policies.

327 companies responding to the survey appear to have in-force Florida policies that could be subject to viatication.

319 companies did not have procedures in place to evaluate the impact of viaticated policies on the net-present-value of the life insurance book of business.

Trust-Owned, Bank-Owned, and Premium-Financed Policies:

186 companies (57%) relied on estimates to respond as they were not able to readily identify all trust owned, bank-owned, and premium financed policies

Based on either known or estimated data:

- **Trust-owned Policies:**
 - 175 companies identified 52,725 in-force life policies owned by a trust for \$72.348 billion.
 - 86 (49%) of these companies identified 11,476 trust-owned policies based on known data.
 - 89 (51%) of these companies identified 41,249 (78%) trust-owned policies based on estimates.
 - 85(49 %) of these companies identified \$14,044,453,841 (19%) trust-owned policies based on known data.
 - 90 (51%) of these companies identified \$58,303,266,059 (81%) trust-owned policies based on estimates.
 - 157 companies reported no policies on their books as trust-owned.
 - 95 (62.5%) of these companies responded based on known data.
 - 57 (37.5%) of these companies responded based on estimates.
- **Bank or Financial Institution Owned Policies:**
 - 89 companies identified 9,647 policies owned by a bank or financial institution, with a face value of \$6.280 billion.
 - 33 (37%) of these companies identified 4,500 bank-owned policies based on known data.
 - 56 (63%) of these companies identified 5,147 bank-owned policies based on estimates.

- 33 (37%) of these companies identified \$2,137,438,295 in bank-owned policies based on known data.
 - 56 (63%) of these companies identified \$4,142,757,582 in bank-owned policies based on estimates.
- 238 companies reported no policies bank-owned policies on their books
 - 138 (58%) of these companies responded based on known data.
 - 100 (42%) of these companies responded based on estimates.
- **Premium Financed Policies:**
 - 16 companies identified 8,134 policies financed through a premium finance company or via another structured loan program in the amount of \$1.340 billion in face value.
 - 9 (56%) of these companies identified 8,022 premium financed policies based on known data.
 - 7 (44%) of these companies identified 112 premium financed policies based on estimates.
 - 9 (56%) of these companies identified \$903,861,925 in premium financed policies based on known data.
 - 7 (44%) of these companies identified \$436,154,886 in premium financed policies based on estimates.
 - 311 companies reported no premium financed policies on their books
 - 150 (48%) of these companies responded based on known data.
 - 161(52%) companies responded based on estimates.

Viaticated Policies:

159 companies (49%) relied on estimates to respond as they were not able to readily identify all viaticated policies.

- 64 companies have identified, based on either known or estimated data: 1931 viaticated policies at a face value of \$1.500 billion in face value.
 - 24 (38%) of these companies identified 364 viaticated policies based on known data.
 - 40 (62%) of these companies identified 1567 viaticated policies based on estimates.
 - 24 (38%) of these companies identified \$474,392,147 viaticated policies based on known data.
 - 40 (62%) of these companies identified \$1,025,722,008 viaticated policies based on estimates.

263 companies (80%) have no knowledge of viaticated policies on their books. Of these 263 companies 257 have no procedures in place to evaluate the impact of viaticated policies on the net-present-value of the life insurance book of business.

2013 Life Policy Target Survey Results

Question #	Summary of Question	Company Totals (includes estimated data)	"Known" Totals (excludes estimated data)
1	Total Count of Florida in-force policies	6,628,892	6,628,892
2	Total Sum of Florida in-force policies	\$987,404,181,004	\$987,404,181,004
*Number of companies with Florida in-force policies: 327			
3	Number of policies owned by a trust	52,725	11,476
4	Face value of policies owned by trust	\$72,347,719,901	\$14,044,453,841
*Number of companies identifying trust-owned policies: 175			
6	Number of policies owned by bank or financial institution	9,647	4,500
7	Face value of policies owned by bank or financial institution	\$6,280,195,877	\$2,137,438,295
*Number of companies identifying bank owned policies: 89			
9	Number of premium-financed policies	8,134	8,022
10	Face value of premium-financed policies	\$1,340,016,811	\$903,861,925
*Number of companies identifying policies financed: 16			
12	Number of policies viaticated	1,931	364
13	Face value of policies viaticated	\$1,500,114,155	\$474,392,147
*Number of companies identifying viaticated policies: 64			

* Excludes companies that expressly indicated that they do not have life insurance business in Florida as of June 30, 2013, or write only the kinds of policies that would not be subject to viatication (e.g., credit life, group, term, or accidental death and dismemberment).

APPENDIX C

**FLORIDA REGULATORY AND ENFORCEMENT ACTIONS
PERTAINING TO VIATICAL SETTLEMENT PROVIDERS**

**FLORIDA REGULATORY AND ENFORCEMENT ACTIONS
SINCE OCTOBER 1, 1996**

The below information is current as of November 30, 2013

Administrative Complaints – (2)

- Accelerated Benefits Corporation
- Wm. Page & Associates, Inc. d/b/a the Lifeline Program

Orders to Show Cause – (3)

Includes Notice and Order to Show Cause

- Coventry First LLC
- Future First Financial Group, Inc.
- Mutual Benefits Corporation

Orders to Cease & Desist – (7)

- Findco, Inc.
- Future First Financial Group, Inc.
- GWG Life Settlements, LLC f/k/a Great West Growth, LLC
- Mutual Benefits Corporation
- Resource Funding Group, Inc. et al.
- Robin Hood International, Ltd et al.
- VESPERS, LLC

Orders – (10)

- Accelerated Benefits Corporation
- Amerifirst Funding Group, Inc.
- Future First Financial Group, Inc.
- GWG Life Settlements, LLC f/k/a Great West Growth, LLC
- Justus Viatical Group, LLC et al.
- Kelco, Inc.
- Neuma, Inc.
- Resource Funding Group, Inc., et al.
- Robin Hood International, Ltd et al.
- Wm. Page & Associates, Inc. d/b/a The Lifeline Program

Consent Orders – (2)

Excludes application-related consent orders

- Life Partners, Inc.
- Mutual Benefits Corporation

Examination/Investigation Related Consent Orders – (14)

- CMG Surety, LLC - \$23,000
- CMG Surety, LLC - \$15,500
- Coventry First, LLC - \$1,500,000
- GWG Life Settlements, LLC f/k/a Great West Growth, LLC - \$162,000
- Life Settlement Corp d/b/a Peachtree Life Settlements - \$50,000
- Life Equity LLC - \$35,000
- Maple Life LLC - \$28,000
- Magna Life Settlements, Inc. - \$13,000
- Mutual Benefits Corporation - \$10,000
- Q Capital Strategies, LLC - \$15,500
- Q Capital Strategies, LLC - \$18,000
- Proverian Capital, LLC - \$28,000
- VESPERS, LLC – \$85,000
- Wm. Page & Associates d/b/a The Lifeline Program - \$25,000

Licenses Revoked – (4)

- Accelerated Benefits Corporation – February 5, 2001
- Future First Financial Group, Inc. – May 17, 2002
- Kelco, Inc. – March 21, 2003
- Mutual Benefits Corporation – March 29, 2005

Licenses Surrendered – (9)

- Viaticare Capital, L.P. – December 31, 2002
- Viaticus, Inc. – December 31, 2002
- Life Settlements International, LLC – September 10, 2004
 - Note: later reapplied for licensure with new owners and approved
- Wm. Page & Associates, Inc. – March 15, 2005
 - Note: continues to report on a quarterly basis under a Final Order and will do so for the foreseeable future
- Living Benefits Financial Services, LLC – March 26, 2008
- Dedicated Resources, Inc. - March 9, 2011
- Life Settlement Corporation – September 9, 2011
- Life Settlement Solutions – October 7, 2013

Licenses Denied – (8)

- AmeriFirst Funding Group, Inc.
- Future First Financial Group, Inc.
 - Note: later reversed, subsequently revoked
- Imperial Life Settlements, LLC
 - Note: later reversed
- Justus Viatical Group

- Mutual Benefits Corporation
 - Note: later reversed, subsequently revoked
- Neuma, Inc. d/b/a Neuma, Inc. of Illinois
- Robinhood International, Ltd.
- ViatiCare Financial Services, LLC

Applications Filed and Withdrawn without further activity – (26)

- American Benefits Services, Inc.
- Axis Thought Capital, LLC
- Beneficial Assurance, Ltd.
- Cato Capital, LLC
- Centre Life Finance Ltd.
- Centre Life Finance Ltd. Trust
- Fairmarket Life Settlements Corp.
- Genesett Capital Corp., Jacksonville, FL
- Genesett Settlements Corp. (f/k/a Genesett Capital Corp.)
- Kelco Life, LLC
- Legacy Benefits Corporation
- Montage Financial Group, Inc.
- Natlis Capital, LLC
- Neuma, Inc.
- Neuma, Inc. d/b/a Neuma, Inc. of Illinois
- Portsmouth Settlement Co. Inc.
- Reliance Financial Group, Inc.
- Resource Funding Group, Inc.
- Spiritus Life, Inc.
- VESPERS, LLC
- Viatical & Elderly Settlement Providers, LLC
- Viatical Benefactors, LLC – Greensboro, NC
- Viatical Benefactors, LLC – Ft. Lauderdale, FL
- Abacus Settlements, LLC
- Spiritus Life, Inc.
- Viasource Funding Group, LLC

APPENDIX D

LICENSED VIATICAL SETTLEMENT PROVIDERS IN FLORIDA

LICENSED VIATICAL SETTLEMENT PROVIDERS IN FLORIDA

The below information is current as of November 30, 2013

CMG Surety, LLC

Date Licensed: 12/11/2003

Coventry First, LLC

Date Licensed: 4/26/2001

Credit Suisse Life Settlements, LLC

Date Licensed: 10/2/2008

EaGIL Life Settlements, LLC

Date Licensed: February 20, 1011

Econotree Capital, Inc.

Date Licensed: May 23, 2011

GWG Life Settlements, LLC

Date Licensed: March 15, 2013

Imperial Life Settlements, LLC

Date Licensed: 2/5/2009

Institutional Life Services (Florida), LLC

Date Licensed: 3/20/09

Life Equity, LLC

Date Licensed: 12/21/2001

Life Settlements International, LLC

Date Licensed: 11/26/2007

Lotus Life, LLC

Date Licensed: 5/18/2012

Magna Life Settlements, Inc.

(f/k/a Magna Administrative Services, Inc.)

Date Licensed: 2/12/2004

Maple Life Financial, Inc.

(f/k/a Stone Street Financial, Inc.)

Date Licensed: 4/26/2001

Peachtree Life Settlements, LLC

Date Licensed: 3/4/2008

Proverian Capital, LLC

Date Licensed: 11/22/06

Q Capital Strategies, LLC

Date Licensed: 11/16/04

Vespera Life, LLC

Date Licensed: 2/25/2011