2013 Life Insurance Legislation- STOLI

• Bill requires life insurers to return all premiums, plus interest, anytime policy is rescinded, voided, or terminated in accordance with law because the insurance policy was procured by a person not having an insurable interest as required in s. 627.404.

• The requirement does not apply to the owner of a life insurance policy who directly engaged in a violation of this section.

• The requirement applies to all life insurance policies in effect or issued after the effective date of the law.

Stated purpose of the bill: Provide protection for innocent investors who purchased life insurance policies on the secondary market that were securitized in portfolios created and sold by life settlement companies, which appears to be perfectly reasonable.

Actual purposes of the bill: (1) Protect the investment by hedge funds and other investors in life insurance policy portfolios known to be "very aggressively created" with policies lacking insurable interest or "pretty much all STOLI, manufactured-type policies" mainly based on overly optimistic life expectancy evaluations on multi-million dollar policies, including multiple huge policies taken out on the same individuals.* (2) Avoid the insurable interest law, which would legitimize Stranger Originated Life Insurance policies, because requiring the refund of premiums eliminates the risk of loss to investors without "clean hands". A policy can only be rescinded or voided by a Court order.

Rather than pick the winner in these factual dispute, The Legislature should allow the Courts to make such decisions based on the facts of each case, which it has done evenly and fairly. The US Federal, Court Southern District of Florida, in two recent cases has ruled that S. 627.404 contains a "good faith" requirement for all parties, which will determine whether benefits are payable or a return of premiums is appropriate.

In *Pruco v. Brasner,* the court ruled that an insurance broker failed to exercise good faith in manufacturing the Stranger Originated Life Insurance policy ("STOLI") at issue and held that the insurer was not required to refund the premiums paid on the policy, because to do so would be an invitation to fraud. The court stated that the investor should seek relief from the parties that sold them the STOLI policies, as Fortress is doing.

In *Sciaretti v. Lincoln National Life Insurance Company,* the court ruled that the plaintiff was entitled to the benefits of a STOLI policy, because the insurer did not exhibit good faith in challenging the *Sciaretta* policy after accepting other policies with similar arrangements and not challenging any of those policies.

In *Sciaretti v. Lincoln National Life Insurance Company,* the court ruled that the plaintiff was entitled to the benefits of a STOLI policy, because the insurer did not exhibit good faith in challenging the *Sciaretta* policy after accepting other policies with similar arrangements and not challenging any of those policies.

If legislation passes eliminating the "insurable interest" requirement for the issuance of a life insurance policy, Florida's senior citizens will become prey to unscrupulous agents and brokers offering free insurance and large sums of money to agree to participate in STOLI arrangements, without full knowledge of the tax implications and possible fraud.

The most basic principle of life insurance is the requirement that a policy be issued with the owner or beneficiary having an "insurable interest" in the life of the insured—it has always been accepted wisdom that society does not want one citizen to have a direct economic incentive to hasten the early demise of another citizen. Nevertheless, unscrupulous parties are incenting seniors to participate in schemes where a life policy is issued only for the purpose of sale to a third party investor, whereby the policy becomes a security. These are known as Stranger Originated Life Insurance or STOLI and violate the Florida insurable interest law.

The bill will eliminate the ability of life insurers to contest whether an insurable interest in the insured was present at the time the policy was issued. The STOLI schemes involve very intricate and complicated non-recourse premium financing arrangements and utilize one or more life insurance trusts to hide the true facts surrounding the purchase of the life insurance policy, which is actually a wagering policy prohibited by the laws of Florida and every other state. Florida's insurable interest statute was updated by amendment recently to cover every possible legitimate situation. The proposed bill does nothing to help any Florida consumer and its sole purpose is to remove the last protection against STOLI for Florida Senior Citizens.

The scheme works like this: (1) seniors age 55-75 are told that they can get free life insurance for 2 years; (2) the senior is told he can keep the policy after 2 years by repaying the premiums paid on his behalf; or, (3) the senior can transfer or sell the policy to another entity with no further obligations and often receives a large cash payment in exchange for the transfer. The unknowing senior is then exposed to federal tax liability for any cash payment received and the value of the 2 years of premiums paid for the policy on his behalf and often will be unable to qualify for additional life insurance needed or desired for legitimate purposes.

***Taken from the Life Settlement Report website:**

Fortress Alleges Fraud in $50M Lawsuit Against Pacifica Group, KBC Bank

By **Donna Horowitz**
February 10, 2012 5:52 AM PST

Fortress Investment Group has sued **Pacifica Group** and **KBC Bank NV** alleging fraud in its purchase of the $6.2 billion KBC portfolio and is seeking $50 million in damages, plus 9% interest.

The two-page summons, filed Oct. 20, in the Supreme Court of New York in Manhattan gives some of the details, but not a full accounting because the lawsuit has been sealed.

Essentially, a Fortress entity named **Lima LS PLC** is alleging that Pacifica Group, a defunct premium-finance firm and KBC Bank defrauded it in the sale of the KBC portfolio in October 2010.

The summons said Fortress is suing for breaches of the purchase agreement between Lima and Pacifica that includes, but is "not limited to breaches of representations, warranties and covenants contained in the Purchase Agreement, for which KBC is the guarantor of Pacifica's obligations pursuant to the KBC Guaranty."

Fortress also is alleging negligent misrepresentation, fraud and fraudulent inducement in the sale. Allan Arffa, an attorney with **Paul, Weiss Rifkind, Wharton & Garrison** in New York whose firm is representing Fortress, declined to comment. Gordon Runte, a spokesman for Fortress, also declined to comment.

Lisa Fuller, general counsel for **NorthStar Life Services**, an Irvine, Calif., servicing firm who is the former general counsel for Pacifica, also declined to comment.

Fortress beat out **Apollo Global Management** and provider **Coventry First** for the portfolio of just less than 1,000 policies by paying just more than $300 million for it, people with knowledge of the matter previously told *The Life Settlements Report*.

Market players described the portfolio as either "very aggressively created" with policies lacking insurable interest or "pretty much all STOLI, manufactured-type policies" mainly based on overly optimistic **21st Services** life expectancy evaluations on multi-million dollar policies, including multiple huge policies taken out on the same individuals.

In November 2009, KBC, a Belgium bank that was getting government funding due to the economic crisis, said it had decided to concentrate on its core business. That meant that it had to jettison its $6.2 billion life settlement portfolio. **KBC Financial Products**, which was based in New York, stopped originating new premium-finance loans and acquiring life settlement assets in September 2008, the company previously said. The firm had started its life settlement business in 2005.

This is not the first time Fortress has gotten into a tussle after the purchase of a portfolio. In August, Fortress acquired the **SageCrest** portfolio for $27.6 million, a reduction from the previous price of $35 million.

Fortress had tried to back out of the April deal for that portfolio after it claimed that certain life expectancy reports were not provided by the debtor, according to a filing in U.S. Bankruptcy Court in Bridgeport, Conn.

Ultimately, the two parties reached an agreement and Fortress got a price reduction for each policy of 21.6% for the 106-policy portfolio with $514 million in face value.

Himelsein Mandel Fund Management, manager of the **HM Ruby Fund**, hired the **Steptoe & Johnson** law firm on contingency to pursue any potential lawsuit against Fortress for lender-liability fraud and misrepresentation, *The Life Settlements Report* reported in November. The allegation results from an alleged verbal promise by Fortress to expand a $65 million line of credit by $35 million to allow HM Ruby to pay premiums. Fortress ended up taking over a 195-policy portion of the portfolio with $1.36 billion in face value after a June 2 auction. HM Ruby had defaulted on its loan from Fortress.
Source: Fortress Lawsuit

<u>VOTE NO on Hedge Fund Insurable interest Amendment on HB 1101</u>

The Current Dispute Resolution System is Working Well

The U.S. Federal Court, Southern District of Florida, has issued two consistent decisions on insurable interest within the last five months based upon the premise that the insurable interest statute, s. 627.404, contains a "good faith" requirement for all parties.

In *Pruco v. Brasner,* the court ruled that an insurance broker failed to exercise good faith in manufacturing the Stranger Originated Life Insurance policy ("STOLI") at issue and held that the insurer was not required to refund the premiums paid on the policy, because to do so would be an invitation to fraud.

In *Sciaretti v. Lincoln National Life Insurance Company,* the court ruled that the plaintiff was entitled to the benefits of a STOLI policy, because the insurer did not exhibit good faith in challenging the Sciaretta policy after accepting other policies with similar arrangements and not challenging any of those policies.

The current method for resolving disputes provides an appropriate remedy for the insurer and the insured when an insurable interest issue cannot be resolved. The Legislature should not change insurance law in a manner that essentially eliminates the insurable interest requirement for life insurance policies, because any such action will eliminate the basic premise upon which life insurance is based.

The Amendment to HB 1101/SB 1620 places a life insurer in a position where insurable interest is eliminated as an issue, because the limited time and availability of information preclude an adequate investigation of the circumstances resulting in issuance of the policy. **Please Vote No on the amendment!**

Legislative Action by Hedge Funds and Life Settlements

The life insurance industry knows all too well the story of the development of viaticals, which morphed into life settlements which then led to the manufacture of STOLI policies. Now – with billions of dollars in face value of life insurance policies having been transferred to third party investors, these deep-pocked, politically influential institutional owners have a new-found interest in the life insurance business. They are not content with the arbitrage that undermines insurers' underwriting and pricing, but seek to challenge the basic principles of the life insurance business and protect the fraud involved in STOLI activity.

It would appear that ownership of settled life policies by hedge funds and other third parties has reached some sort of critical mass – with investors now owning so many life insurance policies that they feel the need to try to change state insurance laws to protect their investments. To that end, they have teamed up with some life settlement providers and retained local lobbyists in multiple states to find sponsors for bills advantageous to their interests.

This activity may be a reaction to recent court rulings that permit insurers to retain premiums when a policy is found to be void at issue. In Pruco Life Insurance Company v. Steven Brasner[1], (a subsidiary of Prudential Financial), Prudential contested an in force policy (insured still living, past the 2 year contestable period), for STOLI related fraud. The federal judge, Southern District of Florida, declared the policy void at issue and allowed Prudential to keep all premiums paid. Delaware courts had similar rulings, and a Minnesota judge opined when he ruled that insurers should retain premiums, "a contrary rule would be an invitation to commit fraud."

The result of these decisions is that the settlement and hedge fund owners now risk losing not only the death benefits from a STOLI policy, but also their "hedge" of, at least, a return of premiums. Since these rulings, firms such as Fortress Investment Group and Coventry First have embarked on a campaign to change state insurance laws to limit insurers' ability to challenge unlawful policies and/or retain premiums.

In Florida, the "Innocent Investors Protection Act"[2] was introduced. If enacted, an insurer would have had 90 days to contest an in force policy once it received a Verification of Coverage (VOC) notice. If it did not contest within that time frame, it would be barred from any future challenge – regardless of a lack of insurable interest, violation of state insurance law or any other facts that might come to light at a future time. If the insurer did successfully challenge and even if the policy were found to be void from inception - the insurer would be obligated to return the premiums, with interest.

Interestingly, just as the debate in Florida was heating up there was a story in The *Life Settlement Report* about Fortress filing a $50M lawsuit alleging fraud in its purchase of a $6.2 billion portfolio of life settlements.[3] The portfolio was described as "very aggressively created" with policies lacking insurable interest or "pretty much all STOLI, manufactured-type policies." Given the distressed prices that Fortress paid, they apparently had a hedge in mind of a pay back of, at a minimum, the premiums. Decisions such as the Brasner case obviously threatened that plan and probably motivated this attempt to immunize potentially toxic assets.

The insurance industry did manage to stop the bill - but on the last day of session. If it had passed, a hedge fund could have flooded an insurer with a large volume of VOC's knowing full well it could not evaluate the need to contest during the 90 day period, thus taking away insurers' ability to challenge - even If fraud was present at the sale.

In California, a "placeholder" bill was filed by the Chair of the Senate Insurance Committee. Coventry and Fortress hired multiple lobbying firms in Sacramento in an effort to possibly "conflict the industry out." Bills similar to Florida were

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[1] Brasner v Pruco Life summary – Attachment 1
[2] Bill as initially introduced in Florida - Attachment 2
[3] Article in *Life Settlement Report* re Fortress lawsuit - Attachment 3

filed in Minnesota, Delaware and South Dakota. None of these bills passed, but Fortress has already retained lobbyists to resume the fight next session.

A different approach was tried in Connecticut, where a bill was introduced to require an insurer to forgo collecting any increase on Cost of Insurance (premium increases for certain policies with contracts that permit changes in premium) should a policyholder/investor object.[4] The bill provided that the requested increase would be held in abeyance until after a court hearing. If the court upheld the premium increase, the investor then had an option of rescinding the policy with the insurer required to refund all prior premium payments, at a high interest rate. This gave the hedge funds a free put option, while severely restricting the contractual rights of the entire in force life insurance business.

Insurers make every effort to identify lack of insurable interest, fraud and misrepresentation during the application process, but entities intent on "bad faith" transactions go to great lengths to deceive insurers. Life insurance application forms and processes are regulated by state insurance laws and rules. Insurers must work within those constraints; third party investors have no such limitations. They can negotiate sales agreements that include warranties and other protections that represent that the policy was issued with an insurable interest and without fraud. If such representations prove to be untrue, they can seek remedy in the courts from those who deceived them. In the Pruco Life v. Brasner case, the court opined that "nothing in this Court's Order prevents [defendant] from seeking reimbursement from an appropriate person or entity."

Marketers of financial products and services have a legal responsibility for due diligence, whether the product is securitized life insurance policies or sub-prime mortgages. Since these investments are sold and resold, frequently for retirement accounts, entities marketing the security must be held responsible for representations as to the integrity and value of the product. Rather than trying to change the law to give immunity to owners of potentially unlawful policies, the focus should be on compliance with requirements to perform the necessary due diligence to assure that they are marketing lawful products. And, if they are the victims of fraud, misrepresentation or other deceptive practices, they too are entitled to seek a remedy through the courts.

These hedge funds and settlement providers are looking for every option available to maximize their gain, taking advantage of product provisions that were intended for the retail market, and not a sophisticated owner who could anti-select in mass. For example, in a jurisdiction with high delayed claim interest rates, they could hold off on filing the death claim, thereby enjoying an above market return on the death proceeds. They will also likely pay all premiums at the minimum amount required and on the latest available day. Now, under the guise of investor protection, they are trying to change insurance law to protect the unlawful policies in their portfolios – estimated to be about $115 billion face value of STOLI policies in the secondary or tertiary market.

As the number of policies in the hands of owner/investors increases, the greater the likelihood that hedge funds and their allies will continue to manipulate the political process to advantage their interests. Further erosion of insurable interest requirements or laws that re-write insurers' contracts and protect insurance fraud will be very detrimental to the entire in force and future policyholders. Life insurance should not be just one more financial product subject to arbitrage, but remain an affordable and much needed financial protection for responsible citizens - an important benefit to society overall.

[4] Bill as introduced in CT – Attachment 4

PRUCO LIFE INSURANCE COMPANY V. STEVEN M. BRASNER

This case involved the fraudulent procurement of a life insurance policy from Pruco Life Insurance Company (a subsidiary of Prudential Financial) on the life of Arlene Berger.

Mrs. Berger learned in 2005 that she could obtain "free insurance" by following the guidance of settlement broker Steven Brasner. He assisted in the submission of an application and, through a series of misrepresentations, she received a $10 million life insurance policy, ostensibly for "estate planning" purposes. The application represented Mrs. Berger's net assets as almost $16 million and stated that premiums would be paid from her savings account.

Mrs. Berger's actual net worth was less than $1 million. Mrs. Berger testified that she was not concerned about the size of the premium, because she never planned to – and in fact never did – actually pay any premiums. Brasner's assistant testified that the premium payment process, orchestrated by Brasner and Coventry, "was designed to mislead." Mrs. Berger also testified that she did not need or want life insurance, knew that the policy would be owned by someone else, and did not inquire into the identity of the owner.

The court held that the policy was void *ab initio* for lack of an insurable interest. Thus the contestability period limitation was irrelevant, as the policy containing it never went into effect. The court also found that the pre-existing understanding that the policy would be transferred to someone who lacked an insurable interest demonstrated that "the policy was not procured in good faith."

The court also decided that Pruco Life Insurance was entitled to retain all premiums paid on the policy, as parties to a contract declared to be void *ab initio* should be "left where the court found them." While the final owner of the policy, Wells Fargo was not responsible for the fraud, the court found that "the fact that Mr. Brasner concocted an elaborate scheme to cover up the fact that this was a wagering policy, and the fact that Wells Fargo ultimately purchased the policy as a securities intermediary for Lavastone (the third party investor in the policy) does not change the fact that Florida law does not [allow] return of the premiums." In addition, the Court reasoned that Lavastone had the ability to go after the other entities involved in the transaction to recover any loss.

United States District Court, Southern District of Florida
Pruco Life Insurance Company v. Steven M. Brasner
November 2011

[Language proposed by Fortress to amend FL insurance law. It was to be added to an Omnibus Insurance bill that was enacted this session.]

(1)(A) An insurer shall confirm that it will not challenge the validity of a life insurance policy for any reason, including lack of insurable interest, as defined in s. 627.404, other than non-payment of premium, within 90 days of receipt of a verification of coverage request from the owner of the policy or its designated representative to the extent it has been more than two years from the date the policy was issued.

(2) Failure to comply with this section shall constitute a violation of the Florida Deceptive Unfair Trade Practices Act, as set forth in s. 501.201 et seq., and shall give the owner of the policy the right to a judicial declaration as to the validity of the policy in the civil court. This section is not intended to exclude or limit any other remedies available to the owner of the policy.

(3) This section does not apply to the owner of life insurance policy who engaged in fraud in connection with the issuance of the policy.

This Act clarifies existing law and applies to all life insurance policies in effect upon and issued after the enactment of the law.

Taken from the Life Settlement Report website:

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By Donna Horowitz
February 10, 2012 5:52 AM PST

Fortress Investment Group has sued **Pacifica Group** and **KBC Bank NV alleging fraud in its purchase of the $6.2 billion KBC portfolio and is seeking $50 million in damages, plus 9% interest.**

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Essentially, a Fortress entity named Lima LS PLC is alleging that Pacifica Group, a defunct premium-finance firm and KBC Bank defrauded it in the sale of the KBC portfolio in October 2010.

The summons said Fortress is suing for breaches of the purchase agreement between Lima and Pacifica that includes, but is "not limited to breaches of representations, warranties and covenants contained in the Purchase Agreement, for which KBC is the guarantor of Pacifica's obligations pursuant to the KBC Guaranty."

Fortress also is alleging negligent misrepresentation, fraud and fraudulent inducement in the sale Allan Arffa, an attorney with Paul, Weiss Rifkind, Wharton & Garrison in New York whose firm is representing Fortress, declined to comment. Gordon Runte, a spokesman for Fortress, also declined to comment. Lisa Fuller, general counsel for NorthStar Life Services, an Irvine, Calif., servicing firm who is the former general counsel for Pacifica, also declined to comment.

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CT SB 409

Section 1. (NEW) (Effective July 1, 2012) (a) For purposes of this section, "cost of insurance" means the portion of the total periodic premium charged by a life insurance company for the insurance cost of a potential death benefit under a life insurance policy.

(b) Any life insurance company that delivers, issues for delivery, renews, amends or continues a universal life insurance or similar policy that reserves the right to periodically increase the cost of insurance shall:

(1) Prior to a proposed cost of insurance increase, disclose in a conspicuous manner to each policyholder not later than one hundred twenty calendar days prior to the effective date of such proposed cost of insurance increase, in writing and in such form as the Insurance Commissioner may prescribe, a notice that includes: (A) The dollar amount of such proposed cost of insurance increase, including any increase because of the insured's age or change in age rating classification; (B) the specific class or classes of insureds that will be subject to the cost of insurance increase; (C) the applicable policy language governing cost of insurance increases and the specific term or terms therein on which the cost of insurance increase is based; (D) a description of the events or circumstances that triggered the insurance company's decision to propose the cost of insurance increase; (E) the methodology and assumptions used to develop the proposed cost of insurance increase; (F) a copy of any illustration provided to the policyholder at the time the policy was issued and a revised illustration that reflects the proposed cost of insurance increase; (G) an explanation of the policyholder's right to file a complaint for such proposed cost of insurance increase with the Insurance Department and the contact information for said department; and (H) an explanation of the policyholder's right to withhold the cost of insurance increase from premium payments remitted by such policyholder during an action filed in the Superior Court by the policyholder concerning such cost of insurance increase. The provisions of this subdivision shall apply to a universal life insurance or similar policy that reserves the right to periodically increase the cost of insurance that is in force as of July 1, 2012;

(2) Prior to a proposed cost of insurance increase, file with the Insurance Commissioner not later than one hundred twenty calendar days prior to the effective date of such proposed cost of insurance increase: (A) Notice and amount of such proposed cost of insurance increase; (B) the specific class or classes of insureds that will be subject to the cost of insurance increase; (C) the applicable policy language governing cost of insurance increases and the specific term or terms therein on which the cost of insurance increase is based; (D) the methodology and assumptions used to develop the proposed cost of insurance increase; (E) all advertising and marketing materials used by the insurance company to advertise or market the policy or policies that will be subject to such cost of insurance increase; and (F) an actuarial memorandum, certified by a qualified actuary, as defined in section 38a-78 of the general statutes, that to the best of such actuary's knowledge, (i) such proposed cost of insurance increase is in compliance with law, and (ii) such increase is not excessive. A cost of insurance increase is excessive if it is unreasonably high for the insurance provided in relation to the underlying risks and costs after due consideration to the projected costs of the life insurance company with respect to the factors on which such company is permitted to increase the cost of insurance under the terms of the policy. The provisions of this subdivision shall apply to a universal life insurance or similar policy that reserves the right to periodically increase the cost of insurance that is in force as of July 1, 2012; and

(3) Disclose in a conspicuous manner to an applicant, at the same time and on the same document as the policy quote and on any illustration provided to the applicant with such policy quote:

(A) The following statement: "(Name of insurance company) MAY, IN THE FUTURE, INCREASE THE COST OF INSURANCE YOU PAY FOR THIS POLICY FOR THE FOLLOWING REASONS: (insert relevant policy language). PLEASE SEE (insert section number or page number for the relevant policy provision) OF YOUR POLICY."; and

(B) For any class of life insurance product for which the life insurance company has increased the cost of insurance within the previous ten years, a statement that such company has increased the cost of insurance within the previous ten years, the dollar amount or percentage of such cost of insurance increase and the class or classes of insureds that were subject to such cost of insurance increase.

(c) A violation of subsection (a) or (b) this section shall be deemed an unfair practice pursuant to section 38a-816 of the general statutes.

(d) (1) If a policyholder files an action in the Superior Court regarding a cost of insurance increase, during the pendency of such action, such policyholder may withhold from any premium payment made to the life insurance company for such policy the amount of such cost of insurance increase. The life insurance company shall not impose penalties, administrative or late fees or interest on any amount so withheld and shall take no action to cause the policy to lapse or to enter a lapse pending mode during such appeal.

(2) (A) If the court affirms the decision of the Insurance Commissioner or dismisses the appeal, or the life insurance company and the policyholder enter into a settlement prior to the court issuing a decision, and such policyholder elected to withhold the amount of the cost of insurance increase pursuant to subdivision (1) of this subsection, not later than thirty calendar days after the date of such affirmation, dismissal or settlement, the life insurance company shall send a notice, in writing, to the policyholder that sets forth the additional amount due, if any, for the accrued cost of insurance increase.

(B) Not later than sixty calendar days after receiving such notice, the policyholder shall (i) remit the additional amount due, in which case the policy shall continue in force, or (ii) rescind the policy, effective as of the date the policyholder received the notice of the proposed cost of insurance increase required under subdivision (1) of subsection (b) of this section. If the policyholder elects to rescind the policy, the life insurance company shall refund to the policyholder the full amount of any premium paid by the policyholder on and after such date.

[Comment - The Insurance Department opposed this bill – particularly Sections 1 and 2, stating that the Department lacked the resources to review and approve all that was required in those section.]

United States Announces $8 Million Penalty and Non-Prosecution Agreement with Florida-Based Imperial Holdings Inc.

U.S. Attorney's Office
April 30, 2012

District of New Hampshire
(603) 225-1552

CONCORD, NH—Imperial Holdings Inc., a publicly traded specialty finance corporation headquartered in Boca Raton, Florida, has entered into a non-prosecution agreement (NPA) with the U.S. Attorney's Office for the District of New Hampshire to pay an $8 million penalty to resolve fraud allegations related to Imperial's involvement in making misrepresentations on life insurance applications in connection with its premium finance business, U.S. Attorney for the District of New Hampshire John P. Kacavas announced today.

According to the NPA, from December 2006 through January 2009, as part of its premium finance business, certain Imperial employees, who were licensed insurance agents, worked with external general agents and brokers, to obtain life insurance policies on individuals over 65 years of age for which Imperial would offer premium finance loans. These Imperial employees had direct contact with the prospective insureds and worked with the insureds and external general agents and brokers to complete life insurance applications for submission to various life insurance companies.

While Imperial employees were engaged in this business, many life insurance applications required the insured and the agent to disclose information about whether premium payments would be funded by a premium finance loan. An insured was typically required to disclose if he or she intended to seek such a loan to pay premiums, and often, the agent was also required to disclose if he or she was aware of an intent by the insured to obtain such a loan. When applications were submitted to insurance companies that likely would not have issued a policy if the application accurately described the insured's intent to obtain premium financing, the Imperial employees, who were acting as life insurance agents on the policies, made and/or facilitated misrepresentations on the applications that concealed the insured's intent to seek a premium finance loan from Imperial.

The U.S. Attorney's Office for the District of New Hampshire entered into the NPA with Imperial based, in part, on Imperial's decision to terminate its premium finance business and separate the employees who are known at this time to have been primarily involved in the misconduct identified above; Imperial's substantial cooperation to date in the investigation into its premium finance business; and the U.S. Attorney's Office for the District of New Hampshire's desire to limit the negative impact and adverse consequences to the non-premium finance aspects of Imperial's business and the company's employees and shareholders that would result from a prosecution of Imperial. In addition to the monetary penalty, Imperial has agreed, among other things, to provide cooperation to the U.S. Attorney's Office for the District of New Hampshire and investigatory agencies, including providing documents and the assistance of its officers, agents, and employees.

U.S. Attorney Kacavas praised the agreement saying, "This NPA ensures the end of Imperial's life insurance premium finance line of business while allowing it to carry on its legitimate lines of business. Importantly, Imperial has provided and will continue to provide substantial assistance in the investigation of those individuals whose fraudulent conduct was at the root of the illegal business practices."

This case is being investigated by the FBI, U.S. Secret Service, U.S. Postal Inspection Service, and the Office of the Special Inspector General for the Troubled Asset Relief Program. Assistant U.S. Attorneys Arnold H. Huftalen and Seth R. Aframe are handling the case for the U.S. Attorney's Office for the District of New Hampshire.

Fortress Facts

- Fortress Investment Group LLC (FIG) is a publicly traded partnership. Per their website: "We are generally not subject to federal or state income tax. Instead, each partner is required to report an allocable share of our items of income, gain, loss deduction or tax credit in the partner's income tax return."

- FIG is incorporated in Delaware with their principal executive offices in New York. Per their December 31, 2011 Form 10-K, which was filed with the U.S. SEC, they have 212 subsidiaries.

- Of the 212 subsidiaries, 174 are incorporated in Delaware with the remaining subsidiaries incorporated off-shore or in other countries (mostly the Cayman Islands). FIG is not incorporated in any other state of the United States, other than Delaware.

- FIG rents office space in the following United State cities: Atlanta; Charlotte; Dallas; Los Angeles; Philadelphia; and San Francisco. FIG does not own property in Delaware nor has offices in Delaware.

- Lima Holdings LLC is listed a subsidiary of FIG.

- LIMA LS PLC is a company incorporated in England and the Issuer of 650,000,000 asset-backed securities. Fortress Investment Group is the Portfolio Adviser for the Security.

- LIMA LS PLC is a portfolio of life insurance policies, premium finance loans, and options to acquire interests in life insurance policies.

- The LIMA LS PLC prospectus (LIMA, December 21, 2010) specifically includes the following "risk factors" for investors to consider before participating in the portfolio of life insurance policies: insurable interest; premium finance loan and life insurance origination programs are susceptible to practices which can invalidate the underlying life insurance policy; premium financed life insurance policies and life insurance policies originated through other structured programs are susceptible to a higher risk of fraud and misrepresentations in life insurance applications; contestability of policies; and risk of litigation with insurance companies.

U.S.	EUROPE	ASIA	
DJIA	15,326.60	+135.54	0.89%
S&P 500	1,689.13	+5.14	0.31%
NASDAQ	3,725.01	-4.01	-0.11%

Insurance Agents in New York and Florida Charged in $100 Million Fraud

By Edvard Pettersson - Feb 16, 2012 9:22 PM ET

0 COMMENTS Q QUEUE

Three insurance agents based in New York and Florida were charged with using straw buyers to obtain more than $100 million in life insurance policies they resold to third-party investors.

Michael Binday, 48, of New York; James Kevin Kergil, 57, of Peekskill, New York; and Mark Resnick, 56, of Orlando, Florida, were charged with conspiracy, fraud and obstruction of justice, Preet Bharara, the U.S. attorney in Manhattan, said in a statement today. They each face as long as 80 years in prison if convicted, he said.

"These three insurance agents concocted an elaborate scheme, using straw buyers and third-party agents, to deceive life insurance providers into issuing policies to unintended beneficiaries," Bharara said. "When their scheme was unraveling, they allegedly sought to throw investigators off the trail by destroying documents and telling other individuals to lie."

The three recruited elderly clients of "modest means" to apply for life insurance policies without disclosing to the insurance companies that they intended to sell the policies to investors, according to prosecutors. They earned millions of dollars in commission and purchased some of the policies from the straw buyers for themselves, prosecutors said.

"We intend to vigorously contest that a crime even occurred here," JaneAnne Murray, Resnick's lawyer, said in a phone interview. "Much less that Mr. Resnick is guilty of any crime."

Richard Strassberg, Binday's lawyer, said in a phone interview that he entered a not guilty plea on behalf of his client. Binday voluntarily surrendered to authorities and was released on bail, the lawyer said.

His client expects to be "fully vindicated," Strassberg said.

Roger Stavis, Kergil's lawyer, didn't immediately return a call to his office for comment on the allegations after regular business hours.

The case is U.S. v. Binday, 12-152, U.S. District Court, Southern District of New York (Manhattan).

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Fortress Steps Up War Against Carriers in State Legislatures
By Donna Horowitz
June 06, 2012 4:00 AM ET

Fortress Investment Group, a major buyer of distressed life settlements, has taken a lead role in trying to push through state legislation this year to fight what market players consider egregious conduct by carriers.

So far, the private-equity firm has not been successful in the five states that it has pursued legislation. But that doesn't mean it won't be back next year to lend its clout when the legislative battle begins anew.

Life settlement market participants say they are encouraged that a firm of Fortress' size, with $46 billion in assets under management, would put its muscle behind an effort to fight the vastly better-funded life insurance industry. Until now, provider Coventry First and, to a lesser extent, the Life Insurance Settlement Association and the Institutional Life Markets Association, have been the main groups lobbying on behalf of the market during the past few years.

Fortress, which manages $332.8 million in life settlement investments in two funds, was behind a bill in Connecticut that would have forced The Phoenix Cos. and other insurers to give notice of cost-of-insurance increases. It also pushed for other legislation in Minnesota, Florida and Delaware that would have prevented carriers from keeping premiums when voiding policies. In addition, Fortress was behind a bill in South Dakota that would have prevented policies from being issued unless premiums and interest can be returned.

Only legislation in Delaware, Senate Bill 220, which is to be heard June 6 at a second hearing in the Judiciary Committee, still is under consideration. But even Sen. Patricia Blevins, sponsor of the legislation, was doubtful that it would make it through the Legislature before it adjourned June 30 because of the complexity of the issue, according to her legislative assistant, Valerie McCartan.

Fortress spokesman Gordon Runte declined to comment about the firm's legislative strategy.

Connecticut Showdown

However, it's clear where the firm stands from March 13 testimony by Doug Cardoni, chief administrative officer for Fortress, before the Connecticut Insurance and Real Estate Committee.
In Connecticut, Fortress had tried to push through Senate Bill 409 that would have forced carriers to explain why they planned to increase cost-of-insurance charges. But the bill ultimately was watered down and then died on the Senate floor.

"This law will bring transparency and honesty to what is currently a hidden process that victimizes consumers without their knowledge," Cardoni said in his written testimony. "The notice required under the bill is not onerous. It only requires disclosure of basic information about the amount of the increase and the reason that the costs are going up."

He said that the bill also required insurers to notify potential future customers if they had raised the rate previously.

The furor over Phoenix's cost-of-insurance increases first erupted two years ago, and then came up again last year, when owners of settled policies were stung by the unexpected increases for the mortality portion of the premium. They considered them discriminatory because they believed they unfairly targeted investors who optimize premiums to pay the minimum amount to keep policies in force. The first increase impacted about 700 policyholders in 2010, and the second one affected most of the 1,300 policyholders who were notified of the increase in 2011.

Three lawsuits have been filed against Phoenix because of these increases, including one by Fortress. The New York insurance regulator has directed Phoenix to roll back the increase that took effect in 2010, but let stand a second increase that went into effect Nov. 1.

Cardoni testified that the raises could push up premium costs by more than 50% "without providing any justification for the increase which could be evaluated or challenged."

He said that when Phoenix notified policyholders of the raises, it didn't state the reasons for them. When Fortress called to follow up, it was told nothing.

In addition, he said that Phoenix, which has its headquarters in Hartford, Conn., was imposing the increases because the company lost lots of money by investing in subprime securities and other exotic derivatives and, as a result, had its rating downgraded from "A" to low "B" and "almost no one has been willing to buy their policies since."

"During this hearing, and in the hallways, you will hear people talking about things like STOLI (stranger-originated life insurance) and investors who 'gamble' on the lives of others, but those are just red herrings. The life insurance industry will use those false arguments and deflections to try and hide their actual behavior," Cardoni testified.

Kate Kiernan, regional vice president of state relations for the American Council of Life Insurers (ACLI), which represents major carriers, opposed the Connecticut legislation, contending that Fortress made a bad investment and was trying to recover through a new law.

"This legislation is a protectionist measure being raised by a sophisticated group of investors at the expense of insurers," Kiernan said in her written testimony. "These investors have been targeting insurers through litigation and, having suffered some setbacks in the courts, are now trying to pass legislation in various states in an attempt to protect their bad investments."

She said the problem facing these investors is that they bought large blocks of policies, including some that were stranger-originated life insurance. She said the proposed legislation was an attempt by the investors "to indemnify themselves against a poorly investigated investment."

In its latest filing with the Securities and Exchange Commission for the quarter ending March 31, Fortress said it already paid out $94.2 million to its investors from its main life settlement fund in which $307.6 million had been invested, and almost $7.7 million in distributions to investors from its $25.2 million fund.

Gina Collopy O'Connell, senior vice president for Phoenix, also opposed the bill, saying that the maximum cost-of-insurance rates are included in policy forms, which are reviewed and improved by the insurance department. She said such disclosures are in policy illustrations, schedule pages, annual statements, and the policy itself. Furthermore, she testified that they are based on tables developed by the National Association of Insurance Commissioners and independent actuaries.

The Connecticut Insurance Department also weighed in, saying it opposed the bill because it would dramatically increase the agency's responsibility, is unprecedented, and would probably require the hiring of an additional full-time actuary.

Market players have long considered Connecticut more of an insurance-friendly state rather than a life-settlement favorable state because Phoenix and **The Hartford** are headquartered there.

Protecting Its Interests

Fortress entered the market with a splash in October 2010 when it beat out **Apollo Global Management** to buy the $6.2 billion **KBC Financial Products** portfolio for just more than $330 million.

But a year later, Fortress filed suit against **Pacifica Group** and **KBC Bank NV**, alleging fraud in connection with the purchase of the portfolio and seeking $50 million in damages, plus 9% interest. The case, which is before the Supreme Court of New York in Manhattan, is pending.

One market player familiar with the KBC portfolio said it contained large, mostly premium-financed policies that could have insurable-interest issues. Thus, if the policies got rescinded and premiums were retained, Fortress would have a lot to lose.

An executive with a provider firm said Fortress' litigation and legislation against carriers is part of an overall strategy to protect its interests. The person said Fortress may have assumed when it bought the KBC portfolio that it would have to sue carriers over certain policies, but it may have underestimated how much litigation would be necessary.

Fortress also was the impetus behind legislation in the Minnesota House of Representatives and the South Dakota House of Representatives earlier this year. Neither House File 2794 in Minnesota nor House Bill 1271 in South Dakota was adopted before the legislative sessions ended.

The Minnesota bill went even further than the Delaware legislation. One clause said that if a life insurer refused to say it would not contest the policy for lack of insurable interest within 120 days of receiving a verification-of-coverage request from the policyholder or a representative, the owner had a right to a judicial declaration of the policy's validity by bringing an action in district court. The measure said it would not apply to a policy owner who committed fraud in connection with issuance of the policy.

In Florida, Fortress also was behind an amendment to House Bill 1101 earlier this year that would have forced carriers to return premiums for voided policies. The amendment later was withdrawn.

ACLI became so incensed about it that it put out a news release Feb. 21 saying that if adopted, "hedge funds and other investors would be given a green light to lure Florida seniors into stranger-originated life insurance arrangements."

ACLI further said the amendment would not allow insurers to contest whether insurable interest was present at policy inception. The group also said the amendment would give an insurer 90 days to contest insurable interest, saying that would not be possible "due to the complexity of STOLI transactions and the inability of the insurer to compel production of information and documents from participants in the scheme that are needed to make such a determination."

Referring to the Delaware legislation, Michael Freedman, senior vice president of government affairs for Coventry, said the life settlement industry supports the efforts by Fortress to clarify long-standing public policy requiring that premiums be returned when policies are rescinded for lack of insurable interest.

He said he believes that carriers are targeting the secondary and tertiary markets in an attempt to create uncertainty. He said carriers are following a litigation strategy that attempts to make laws in the courts using cases with bad facts or serious fraud.

"They're doing it in the judicial branch and not the legislative branch, and all Fortress is doing is forcing that debate into the proper branch of government," Freedman said.

Two attorneys who fight on behalf of secondary market investors say they also appreciate Fortress' effort to get legislation passed to clarify the premium-retention and cost-of-insurance issues.

"Up to now, Coventry has been the large player with the ability to finance legislative lobbying," said Ira Lipsius, an attorney with Lipsius-Benhaim Law in Kew Gardens, N.Y., who represents clients in Phoenix cost-of-insurance and other cases. "It's nice to see someone striking back against ACLI, using its political clout."

He said there have been discussions in the investor community about setting up investor-financed lobbying groups similar to groups set up by insurance companies.

Lipsius said the insurance companies wrote policies and knew they would have to pay on them. But now they don't want to honor their obligations.

"They made bad bargains and they're trying to avoid their programs," he said.

If a bill is drafted properly, it would provide clarity and certainty to the market, said Steven Sklaver, an attorney with Susman Godfrey in Los Angeles who represents investors in STOLI, cost-of-insurance and premium-retention cases.

"It's always better than ad hoc, piece-by-piece case adjudication by the courts," he said.

Sklaver said trial court decisions can be overturned by appellate courts and those decisions can be reversed by the Supreme Court.

"Of course it's better to cut to the chase and get legislative clarity. Legislation can provide the bright line that market participants can plan around better," he said.

"Whether you agree with Fortress or not, they have the resources to go toe-to-toe with the insurance industry," Sklaver said. "These issues may finally be decided on their merits, not on which advocate has the most money."

(Correction: An earlier version of this story incorrectly described a bill in South Dakota.)

LAW | July 9, 2011

Insurers, Investors Fight Over Death Bets

By LESLIE SCISM

After Esther Adler died in 2009, the insurer that was on the hook to pay a $5 million death benefit discovered she wasn't all she had appeared.

Instead of the $12 million estate listed in her application, the insurer alleged in a federal-court civil suit, Ms. Adler had assets of less than $100,000, relied on Social Security checks for income and had sought help from a program that helps pay for medicine.

Last fall, jurors in a courthouse in Manhattan heard the details as investors who bought the policy while Ms. Adler was still alive fought to force AXA SA's AXA Equitable unit to honor the contract.

The insurer wanted to void the policy, citing alleged fraud, even though it conceded during the trial that it "did not do everything perfectly." The jury's verdict: a full payout to the investors.

Collecting on Death

Key steps in sales of some death-benefit policies

Agent talks older person into applying for policy

Across the U.S., hundreds of disputes are playing out in the legal wreckage caused by the collapse in what was once a

Agent submits application, citing 'estate planning' needs

Some insurers lightly vet 'estate' details, and issue policy

Investors buy policy from older person, assume responsibility for premium and collect when the insured dies

booming secondary market for life-insurance policies. A key question in many, according to court records, is whether insurers did enough to vet applications.

At stake are billions of dollars of insurance that older people took out on their own lives from 2004 to 2008—and then sold to investors for cash. Typically, investors pay the insured person a small percentage of the face value of the policy and then assume responsibility for the premiums, aiming to collect the death benefit. Many of the lawsuits relate to unexpectedly early deaths that triggered costly payouts for insurers.

Insurers allege they were sometimes duped into the sales by complicated plots by commission-hungry agents and other middlemen that hid the involvement of investors. The insurers contend the policies amount to unlawful bets on strangers' lives.

For their part, investors claim that insurers, hungry for premiums that often exceed $100,000 a year, sometimes skipped steps such as credit checks or authenticating documents, which could have shown the applicants couldn't afford the policies, and were likely candidates for flipping. They also say some insurers ignored warning signs that did pop up on credit reports.

In the AXA Equitable case, a company official confirmed in testimony that the insurer's guidelines called for credit reports of buyers of $5 million policies, but that its staff could skip them if they were satisfied with other materials.

A credit report wasn't ordered up for Ms. Adler, and investors argued to the jury that this was one of numerous missed opportunities in the vetting process that would have helped the insurer learn she neither needed a big estate-planning policy nor could afford premiums topping $300,000 a year.

Court filings show AXA Equitable had relied partly on an accountant's statement to verify Ms. Adler's wealth. Only after her death did the insurer check state licensing records to learn the "accountant" was a fake, the filings show.

The $5 million payout went to an investment entity, Settlement Funding LLC, which told jurors it was an innocent party that hadn't been involved in any of the alleged fraud at the policy's inception.

An AXA Equitable spokesman said the insurer assessed the application appropriately and hadn't missed any red flags, as it had been scrubbed carefully to hide signs it was headed to investors' hands.

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"Combating insurance fraud is an endless learning process, because each new scam we detect and shut down often spawns even more sophisticated scams," the AXA Equitable spokesman says.

David McDowell, a lawyer for insurers American International Group Inc. AIG +0.22% and Phoenix Cos., PNX 0.00% says the industry has continually tried to improve procedures for identifying policies destined for investors' hands. "Companies are a lot better today at separating the good from the bad," he says.

In some cases, investors are using the legal-discovery process to turn up internal emails to bolster their contentions. In a federal-court lawsuit in New Jersey, emails show that an employee at an AIG unit expressed concern in 2006 about issuing a $10 million estate-planning policy that the insurer now is seeking to void.

The employee cited "conflicting financial info," among other things, but a colleague suggested proceeding with the sale, the emails show.

After the Brooklyn, N.Y., man died in 2008, AIG's American General sought to void the policy, alleging vast overstatement of the man's estate and other problems.

In December, the court allowed investors to proceed with their own fraud claim, alleging American General deliberately overlooked potential problems in applications so that it could use them later when trying to avoid paying out on policies.

In a filing, American General called the claim "patently false."

Some of the shortcomings in vetting are surfacing within the insurance companies themselves. In 2007, an ING Groep NV ING +3.00% unit issued a $10 million policy on the life of a Philadelphia man purportedly worth $46 million, despite a "HIGH RISK FRAUD ALERT" on a credit report, according to court records and people familiar with the matter.

The alert said the Social Security number used on the application belonged to a person who died in 1982. His credit history also showed bankruptcy filings by the man in 2002 and 2005.

Months after issuing the policy, an internal investigation unit took a closer look and turned the matter over to authorities, filings show. Federal authorities have accused the policyholder and his purported accountant of participating in a gang that allegedly defrauded three insurers, court filings show.

One of the men has pleaded not guilty, and the other has been in plea-agreement negotiations, the filings show. An ING spokesman says the company's "procedures, policies and training for detecting" misrepresentations "have improved considerably" since the mid-2000s.

In a case involving insurer Phoenix, a federal judge agreed last year to void a $10 million policy on the basis of alleged fraud, and this spring awarded the nearly $485,000 in paid premiums to investors, citing shortcomings by the insurer in vetting the application.

The applicant was an elderly Florida man supposedly worth $1.2 billion, mostly in the form of emeralds recovered from a sunken Spanish ship.

While assessing the application in 2007, Phoenix employees had unsuccessfully searched online to confirm the treasure hunter's exploits, according to an email in federal court in Atlanta.

One employee asked the sales agent to provide his client's tax returns, but the agent nixed the idea, according to another email, and supplied letters from a gemologist and a warehouse.

After issuing the policy, Phoenix learned that the gemologist's letter was a forgery, its court filings state. In a sworn statement, the policyholder, Faye Keith Jolly, asserted his Fifth Amendment rights in response to most questions from Phoenix about his finances and the emeralds.

In his ruling awarding premiums to the investors, the judge said Phoenix had failed to determine if the agent-supplied documents "were actually real documents or if they were, instead, fabricated or forged," among other shortcomings. Phoenix is appealing the ruling on the premiums.

Mr. Jolly died in February; an obituary didn't mention treasure-hunting.

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SmartMoney Glossary: secondary market, face value, ruling, flipping, participating,

THE WALL STREET JOURNAL.
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BUSINESS | April 19, 2012, 8:07 p.m. ET

Vulture Investor Battles for Death-Bet Payouts

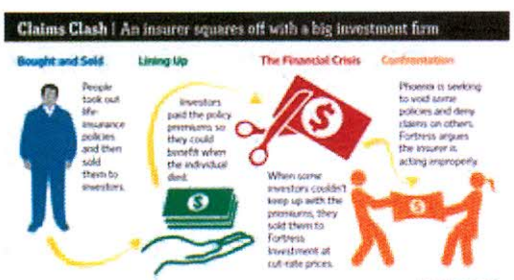
By LESLIE SCISM

Fortress Investment Group, a self-described "garbage collector" of distressed assets, thought it had uncovered another winning junk pile when the market for repurchased life-insurance policies crashed.

Following its usual blueprint, Fortress starting in late 2010 snapped up about 1,000 of these policies at cut-rate prices, then waited to reap the benefits due once the original holders died. The firm had raised a $500 million fund for these "life-settlements," which were available in the bargain bin in part because other investors were struggling to pay the premiums.

Along this path to easy profits, Fortress encountered an unlikely obstacle: Phoenix Cos., a beaten -down insurer with a penchant for suing to void many of the policies that have since been sold to hedge funds and other investors, and denying death claims on some policies.

Phoenix, which issued about 200 of the contracts owned by Fortress, is seeking through lawsuits to shed policies it contends shouldn't have been taken out in the first place. The company alleges that commission-hungry agents defrauded it when they induced older people to take out the policies for the sole purpose of reselling them to investors.



Fortress is fighting back, arguing in court that the insurer improperly denied some of its claims. "We will pursue every course necessary to protect our investors' interest," said Doug Thomas, a managing director for the New York firm, which has $43.7 billion under management.

Phoenix defends its practices and says it will continue to fight what it sees as the improper use of life-insurance policies.

The unfolding fight is the latest sign that the controversial secondary market in life policies remains a treacherous place for investors. In the mid 2000s, money managers piled into life settlements for their high returns and independence from a volatile stock market. But arcane insurance rules and mounting litigation have caught many sophisticated investors flat-footed.

Less than a decade ago, Phoenix was one of the U.S.'s top-10 life insurers. Its specialty: multimillion-dollar policies wealthy Americans bought to help limit estate taxes. Some of those policies were eventually bought by investors.

Phoenix, of Hartford, Conn., fell hard during the financial crisis, and in 2009 four rating firms sharply downgraded its financial strength—all but stripping the company of its ability to sell new policies.

Since then, Phoenix has focused on selling annuities and consulting services, while paying out claims and managing its remaining liabilities. On its website, the company touts "A history of keeping our promises since 1851."

Phoenix has denied tens of millions of dollars in investors' claims for death benefits since 2007, its regulatory filings show. In 2008, its peak year for challenges, it reported seven claims in dispute, totaling $50 million, or 7.6% of the face amount of claims it received that year. The industry average is less than 1%.

It has been involved in dozens of lawsuits asking courts to void policies. It also boosted the premium rates for keeping in force certain types of policies that are favored by hedge funds and other investors.

Fortress is a practiced distressed-asset investor: It once invested in singer Michael Jackson's debt and bought mortgage-backed securities after the housing market tanked.

The firm has filed four federal suits against Phoenix. One contends the insurer's rate increases breach its contracts; the others allege Phoenix has improperly denied $33 million in benefits from three deaths since November.

Fortress has lobbied legislators in Connecticut and other states to pass laws to protect policyholders' rights to sell to investors and other matters relevant to investor-owners. And it has pushed regulators to probe alleged bad-faith practices at Phoenix and other insurers. It is unclear if any inquiries are under way.

Phoenix says it has done nothing wrong. "We take seriously the instances where there is misrepresentation, fraud or the misuse of insurance policies as wagers on human life, and where appropriate, take action," said Gina Collopy O'Connell, a senior executive. The company pays all valid claims, she added.

Insurers have filed several hundred lawsuits since 2008 seeking to void policies and keep some or all of the premiums, attorneys estimate. Meanwhile, several state and federal prosecutors have brought criminal actions alleging fraud by agents and other middlemen who sold the policies. Judicial rulings and jury verdicts have been mixed.

Investors often assert that insurers failed to properly vet their customers' applications and should be forced to honor what they sold. In some lawsuits, investors argue that Phoenix's managers had encouraged investor-driven sales to boost revenue and their own compensation. Phoenix said it continually takes appropriate steps to screen out fraud.

Fortress made its push into the market in late 2010, when its executives believed that prices had fallen far enough to justify the risks, people familiar with its thinking said. The policies it bought were all past the standard two-year contestability period, Mr. Thomas said.

But Phoenix has continued to bring lawsuits. It filed seven suits in federal court on a single day in March, in the wake of a state Supreme Court ruling that makes it easier for insurers to challenge older policies.

Some market participants speculate that Phoenix finds it more worthwhile than bigger insurers to bring such suits because each multimillion-dollar policy it voids represents a meaningful reduction in its liabilities. Phoenix posted $8.1 million in net income for 2011, reversing a loss of $12.6 million in 2010.

Write to Leslie Scism at leslie.scism@wsj.com

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SmartMoney Glossary: take out, secondary market, net income, hedge, stripping,

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09/01/2009 06:31 PM

Investing in Death

Betting on US Life Expectancy Proves Risky

By Christoph Pauly and Anne Seith in Frankfurt

Deutsche Bank and other financial institutions manage complex funds that buy up Americans' life insurance policies and pay their premiums in return for their payouts. But angry German investors are finding that Americans aren't dying as quickly as expected -- and that only the bankers are making a buck.

Gisbert Soballa has a rather dispassionate stance toward death. The 72-year-old retired cardiologist says that, to him, dying was always "something completely normal."

Given that, the doctor didn't pause when his adviser at Deutsche Bank suggested a peculiar deal with death. The "db Kompass Life" fund buys up life insurance policies of Americans and assumes responsibility for paying their future premiums. When a policyholder dies, the entire payout from the policy goes to the fund. And since everybody dies, it would seem to be a fairly crisis-proof investment.

Soballa and his wife together invested €16,000 (about $23,000) into the fund. In 2007, they received a small dividend. Since then, the Bavarian couple has received quarterly statements -- all of which notify him that "unfortunately, there will be no dividend payments this quarter." So, it would appear that bankers' betting on the demise of anonymous Americans hasn't born much fruit.

Many thousands of investors have had similar experiences. Since 2005, Deutsche Bank has taken in €500 million ($720 million) from clients for its db Kompass Life I and II funds. But, now, huge losses are on the horizon.

When Dreams Become Disenchantment

"At the Deutsche Bank branch, they told me it was a booming business," said a 50-year-old executive assistant who was looking to securely invest a severance payment for her retirement. Today, she is worried about her savings. In a call to the fund's public service representative, she was informed "promptly and unequivocally" that her contract also stipulated the possibility of a total loss -- a warning that's pretty well buried in the small print of the sales prospectus.

But how can that be? Returns ostensibly only depend on the life expectancy of the original policyholder, which should be a fairly simple statistical variable. Still, the fact is that, since the funds take over entire policies, they have to pay monthly premiums for the duration of each and every one of them. A life insurance policy pays out only once the insured person has died. But, until then, there are only costs.

The real issue is related to the fact that the insured aren't dying as fast as they were expected to. Apparently Deutsche Bank, like many other providers, relied too much on medical experts and statistics for the United States.

When Deutsche Bank launched these funds, the market was still in the grip of great euphoria. In Germany alone, investors poured about €2 billion ($2.87 billion) into such enterprises in 2004 and 2005.

But it didn't take long for disillusionment to set in. Many providers couldn't generate the yields promised in their prospectuses. For one thing, many of the insured simply lived longer than expected. For another, buying up policies became more and more expensive due to high demand. Also, a change in the law made American life insurance funds taxable in Germany for the first time.

As early as 2005, the Sachsenfond, a subsidiary of the Sachsen LB, the now-dissolved bank of the state of Saxony, pulled its product from the market. But other institutions have kept on hoping and stuck with their investments. Just this year, WealthCap, for example, a subsidy of HypoVereinsbank, launched its fourth US life insurance fund after its other products beat expectations.

Even Deutsche Bank is getting back into the business, as well. In 2008, it launched a third Life Kompass fund, though it has been structured somewhat differently, which collected investor funds in two tranches, one of $100 million and the other of $144 million.

Still, when it comes to the other two funds, things haven't gone so well for investors, and only the bank itself has turned a profit from them. One fund -- db Kompass Life I -- netted the bankers €32 million ($46 million). For instance, they figured on "fund structuring" fees of 3.485 percent. And the bank took 9.5 percent up front in equity capital brokerage fees.

The structure of the product is so complicated that even experts don't understand it. The Kompass Life funds were structured by London-based bankers for Deutsche Bank, who apparently put their own profit above all else. With things just too far above their heads, investors chose to simply rely on the judgment of their advisers. In essence, the lion's share of the risk was palmed off on investors, while financial managers raked in a buck.

Uppity Investors

Investors in the db Kompass Life I fund financed the purchase of life insurance policies with total maturity payments of $770 million. Through the end of January 2009, a total of three policies had paid out, bringing in about €20 million ($29 million). But, as investors were tersely informed, the money was "applied to the advance payment of premiums and other costs."

At the moment, time is of the essence: The funds will reach maturity in 2015, when Deutsche Bank's London-based operation must buy back the remaining life insurance policies from investors at 80 percent of their purchase price. "Through the payment of this sum, which is considerably smaller than the maturity payments of these policies, investors would incur financial losses," the prospectus notes.

But, now, investors are slowly beginning to revolt. "In what dark alleyway have my savings been hidden?" an e-mail from one investor reads. Another writes: "I now have a very bad feeling that I'll never see my €10,000 again."

One of them -- who prefers to remain anonymous -- wants to call a special shareholders' meeting to launch an independent inquiry aimed at looking into whether Deutsche Bank was negligent in how it calculated the funds' value at the time they were launched. But there's just one problem: To call such a meeting, you first have to know who to call. And the only entity that has such information -- the names and addresses of the co-investors -- is the fund administrator itself.

The anonymous investor has been pestering the fund administrator to release this information for months, but the fund has refused to do so, claiming that data-privacy protection laws don't allow it to. In the end, though, the fund sent out a letter to all the investors saying that one of the fund's investors had taken "the occasion of the fund's current economic development" to request that he be given their personal information. Dozens of co-investors then contacted the anonymous investor directly. Together, they have employed the services of a lawyer and launched a Web site.

The lawyer, Karl-Georg von Ferber, agreess that the fund's prospectus spells out the investment risks rather thoroughly. But, he argues, the document gives rise to the impression "that it's all just about statistics and actuarial mathematics."

It's probable that many of the investors just took a cursory glance at the description of the highly complicated products. Soballa, the physician, for one, will admit to this. At the time, he says, he was just putting his faith in the strong reputation of his bank -- and his financial adviser. "He seemed very reliable," Soballa says. But it just might be the case that, when it came to these funds, the banker didn't really know what he was talking about.

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