Your Death: The Royal Flush of Wall Street's Gamble

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NOTE

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I. INTRODUCTION

Securitization impacts the economy in a wide-ranging fashion, from the simplistic daily transactions of individual citizens to the complex management of corporate structure.¹ Within this spectrum of securitized products lies an array of venture opportunities and strategies that are available to both novice and sophisticated investors alike. The subject of this Note—life settlements—is one example of an investment strategy that has become available through the advent and now prevalence of securitization. In a life settlement agreement, an insured will sell his policy to an investor for an immediate cash return. The investor then becomes the beneficiary of the insured’s policies and will ultimately collect the death benefit. These settlements, therefore, not only offer clear benefits to consumers and the general public, but also present a host of controversial implications that have made life settlements the target of criticism and, recently, the focus of proposed legislation. This Note will outline the general principles of securitization, discuss life settlements as a securitized versus non-securitized product, address the advantages and disadvantages of life settlements, and consider the achievable (or perhaps the most suitable) methods for administering or monitoring the life settlements industry through a uniform approach.

Americans depend on the practice of securitization in carrying out their everyday lives. Although the emergence of securitization in the financial markets can be marked from the 1930s,² securitization of fixed income financial assets is a recent phenomenon. Beginning in the 1970s with mortgage-backed securities, the practice of securitization in the


bond market has become a multi-trillion dollar business. Today, a variety of assets are securitized. Securitization is a wonder of daily life as it enables Americans to obtain mortgages, lease or finance automobiles, and procure loans for other necessary (and some not so necessary) purchases. As the Securities and Exchange Commission ("SEC") Chairman, Christopher Cox, stated in his speech at the American Securitization Forum in 2006:

Any American with a home, a car, or a child in college—that is to say, millions of Americans—depend[s] on what [the SEC] do[es]. Homes, cars, and college tuition, like so many other things we need, are more often than not financed with loans. And the chances are good that when we finance these necessities, our loans are securitized. It’s also very likely that had they not been securitized, many of these loans could never have been extended in the first place.

With this in mind, it is important to understand that not all securitized products, or the way they are regulated, are necessarily beneficial to society. One example, the life settlement, is becoming increasingly prevalent. This Note will prove that life settlements can be quite effective for various uses; however, they also have large moral and ethical consequences.

To understand these words, we must first answer questions such as: What is securitization? What are the mechanics behind securitization? What are life settlements? And ultimately, how does securitization affect us in relation to life settlements?

4. See id.; see also Cox, supra note 1.
5. Cox, supra note 1.
6. See generally id. (discussing the benefits of securitization). Although not the topic of this Note, many argue that the Asset Backed Securitization ("ABS") of residential mortgages (leading to the subprime mortgage crisis), where mortgages were pooled thereby creating securities, is one of the many factors behind the current economic recession. One such contention is brought out by Steven L. Schwarcz, who argues that "[t]he subprime mortgage crisis appears to have discredited, though, at least one form of complacency: widespread investor obsession with securities that have no established market and, instead, are valued by being marked-to-model." Steven L. Schwarcz, Protecting Financial Markets: Lessons from the Subprime Mortgage Meltdown, 93 MINN. L. REV. 373, 405 (2008).

II. WHAT IS SECURITIZATION?

Black’s Law Dictionary defines the term “securitize” as: “[t]o convert (assets) into negotiable securities for resale in the financial market, allowing the issuing financial institution to remove assets from its books and thereby improve its capital ratio and liquidity while making new loans with the security proceeds.”

Securitization is the process by which individual loans are packaged, converted into a security, thereby enhancing the package’s rating, and sold to third party investors. As Leon T. Kendall explained, “[t]he process converts illiquid individual loans or debt instruments which cannot be sold readily to third-party investors into liquid, marketable securities.”

It is essential to the economy that the securitization process is utilized appropriately. When not abused, securitization pours money into the economy, and increases productivity. At its worst, some would argue, imprudent securitization has largely led to the recent economic downfall. As explained by Frederick L. Feldkamp of Foley & Lardner LLP, in a comment letter to the SEC:

Good securitization increases liquidity and lowers the net cost of funding the productive side of an economy. There is no other legitimate or long-term purpose for this process. While good securitization reduces the cost of intermediation, abusive securitization raises that cost by seeking to hide the increasing leverage of conventional finance within a perception of an asset transfer. Such deceptions reduce investor confidence and increase the cost of intermediation, to everyone’s detriment.

A. Basic Mechanics of Securitization

A loan broker brings together a borrower and a loan originator to begin the origination process. The loan originator, or the source of the

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9. Id. at 2.
loan, will decide the terms\textsuperscript{12} of the loan.\textsuperscript{13} When the origination process concludes, the loan originator will sell the loan to a securitized sponsor,\textsuperscript{14} which will commence the transaction and transfer the loan to a pool of amassed loans.\textsuperscript{15}

The aggregated loans are then commonly transferred to a trust that will issue securities.\textsuperscript{16} The trust, called a Special-Purpose-Entity ("SPE") or Special-Purpose-Vehicle ("SPV"), is one of the methods a company can use to shield itself from liability. An SPE is an entity organized by the company "in such a way that the likelihood of [the company's] bankruptcy is remote."\textsuperscript{17} Although the use of an SPE is not a requirement of securitization, they are commonly used by companies (the originators) to shift the source of payment (that is, the risks) from the company to this new entity.\textsuperscript{18} Companies' assets are transferred to the SPE as a way to eliminate their resources in the event of bankruptcy, as creditors will not be able to acquire these funds.\textsuperscript{19} As such, business activity of the SPE is strictly limited.\textsuperscript{20} An independent director is usually required to be appointed when a company owns an SPE.\textsuperscript{21}

After the transfer process is complete, the SPE will then issue securities for the company to raise revenue.\textsuperscript{22} This secures the finances of the originator\textsuperscript{23} and allows for the company to raise a higher amount of proceeds, since the interest rate of the SPE will typically be lower than what the company can secure.\textsuperscript{24} For an investor, the Modern Portfolio Theory tells us that there is typically a smaller risk of investing in a pool of assets, as compared to any single asset.\textsuperscript{25} Therefore, the

\textsuperscript{12} Terms typically include: the rate of the loan, whether the originator will charge origination fees, the Annual Percentage Rate ("APR"), the escrow requirements, down payment requirements and the processing time for the loan. See Why Realty, Home Financing: Comparing Loan Terms, http://www.whyrealty.com/realestate/guide/loanterms.html (last visited Apr. 9, 2009).

\textsuperscript{13} American Securitization Forum, supra note 11, at 9.

\textsuperscript{14} Id.

\textsuperscript{15} Id.

\textsuperscript{16} Id. at 9-10.

\textsuperscript{17} SCHWARCZ ET AL., supra note 3, at 6.

\textsuperscript{18} See id. at 6-7.

\textsuperscript{19} See id. at 7.

\textsuperscript{20} See id.

\textsuperscript{21} See id.

\textsuperscript{22} Id.

\textsuperscript{23} This is because at this point, the SPE will reimburse the originator. Clarissa C. Potter, A Wrench or a Sledgehammer? Fixing FASITs, 56 SMU L. REV. 501, 505 (2003).

\textsuperscript{24} Id. at 507-08.

\textsuperscript{25} When you compare this statement to the recent (2008-09) example of Bernard Madoff, the truthfulness of this assertion may be consciously disregarded as investors get taken with the notion of high yield returns. However, investors should make use of the Modern Portfolio Theory and
lower the investment, the lower the interest rate the SPE must pay out to investors. As Steven L. Schwarcz explains,

the securities issued by the SPE, depending upon the structure of the transaction, may have a higher investment rating than securities issued directly by the originator and, therefore, would bear a lower interest rate than the originator might be able to obtain on its own securities, bank lines of credit, or secured borrowings.

Revised Article 9 of the Uniform Commercial Code ("UCC"), adopted uniformly throughout the United States, contains provisions relating to, and even favoring, securitization. Revised Article 9, "[e]xcept as otherwise provided . . . applies to . . . a sale of accounts, chattel paper, payment intangibles, or promissory notes . . . ." When an asset is securitized, or in other words when the assets are "transferred" from one entity to another, it is often under the UCC’s "payment intangibles." Essentially, "payment intangibles" means merely the promise to pay money. Since the UCC does not distinguish between sales and security transfers, it is in the court’s discretion to determine whether a transfer of assets is a sale or loan and, when a problem arises, the buyer’s recourse under the contract.
B. What Can Be Securitized?

It should be stressed that any profit-turning asset can be securitized,\(^3\) including automobile loans and English musician David Bowie's recordings.\(^4\) Securitization is a part of every individual's daily activities relating to, for example, homes, cars, and credit cards. However, aside from the everyday activities of individuals, it should be emphasized that securitization is quite an important player in our economy. A strong example of the importance of securitization is equity ownership in corporations (for example, the stock market).\(^5\) The stock market has proven to be an extremely successful product of securitization.\(^6\) When one buys shares on a stock market, that individual is essentially buying ownership in a company.

With so many assets able to withstand securitization, there is much skepticism of the process. One critique came in 1996, when Lynn LoPucki asserted that, "[a]sset securitization may be the silver bullet capable of killing liability."\(^7\) Much of the negativity associated with securitization is a result of the notion that almost anything can be securitized,\(^8\) both the good and the bad. LoPucki's claim is that businesses are essentially "judgment proof," and one way to be safe is via secured debt.\(^9\)

While this Note has previously explored the thriving aspects of securitization, Part III's analysis of life settlements will offer a critical view of the securitization process. Though life settlements are not a "bad" product, the risks associated with the securitization of life settlements are deeply understated.

III. THE SECURITIZATION OF LIFE SETTLEMENTS

As previously stated, almost anything can be securitized.\(^10\) "Death bonds," also known by the terms "life settlements," "life settlement-

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36. Id.
38. See id. at 25.
39. LoPucki states that "[p]robably most individuals and businesses are either judgment proof, or capable of rendering themselves so between commencement of a civil action against them and the entry of judgment." Id. at 4-5 (footnote omitted).
backed securities,” “stranger-oriented life insurance” (“STOLI”),41
“speculator-initiated life insurance” (“SPINLIFE”),42 “viatical
settlements,”43 or “senior settlements,”44 are a recent phenomenon and
simultaneously a modern example of how the market has perhaps gone
too far. In these types of settlements, an individual is usually paid a lump
sum for his insurance policy, and investors, who paid the premiums for
the policy, will then collect the large cash payment upon the individual’s
death.45 The death benefits of these life settlements are securitized and
thereby financed via the capital markets.46 As one company, which sells
this product, stated, “[a] life insurance policy is an asset that can be sold
like a stock or bond.”47

A. Life Settlements Securitized

The Securities Act of 1933 (the “33 Act” or the “Securities Act”)
defines the term “security.”48 Under § 77b(a) of the ‘33 Act, an

41. See Kelly J. Bozanic, Comment, An Investment to Die For: From Life Insurance to Death
Bonds, the Evolution and Legality of the Life Settlement Industry, 113 PENN ST. L. REV. 229, 241-
42 (2008). These terms refer to the process where individuals acquire funding from a third party to
buy life insurance policies, pay the premiums, and assign the policy to someone lacking an insurable
27, 2009).
42. Janice Francis-Smith, Bill Seeks Licensing for Viatical Insurers, J. REC. (Okla. City), Apr.
24, 2008, at 8A.
43. This type of settlement is used when the insured is terminally ill. See Miriam R. Albert,
Selling Death Short: The Regulatory and Policy Implications of Viatical Settlements, 61 ALB. L.
44. “A senior settlement is the process where the holder of a life insurance policy sells [the
policy] to a buyer for a cash payment.” GoLifeSettlement.com, Guide to Top Senior Settlements,
http://senior-settlements.golifesettlement.com (last visited Apr. 9, 2009).
45. See Ideal Life Settlements: Financial Security for Seniors,
46. Patrick D. Dolan & Anna E. Panayotou, Securitization of Life Settlements, in NEW
DEVELOPMENTS IN SECURITIZATION 2002, at 1203, 1205 (PLI Commercial Law & Practice, Course
Handbook Series No. 843).
47. BSM Holdings, LLC, Senior Life Insurance Settlements, http://www.bsmlife.com (last
visited Apr. 9, 2009). Balsam Settlement Management LLC (BSM Holdings LLC) is a company
that sells life insurance for seniors.
48. The ‘33 Act defines the term “security” as any:

note, stock, treasury stock, security future, bond, debenture, evidence of indebtedness,
certificate of interest or participation in any profit-sharing agreement, collateral-trust
certificate, preorganization certificate or subscription, transferable share, investment
contract, voting-trust certificate, certificate of deposit for a security, fractional undivided
interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on
any security, certificate or deposit, or group or index of securities (including any interest
therein or based on the value thereof), or any put, call, straddle, option, or privilege
entered into on a national securities exchange relating to foreign currency, or, in general,
An investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise.

In SEC v. Mutual Benefits Corp., the Court of Appeals for the Eleventh Circuit restated: "Congress' purpose in enacting the securities laws was to regulate investments, in whatever form they are made and by whatever name they are called.' To that end, it enacted a broad definition of 'security,' sufficient 'to encompass virtually any instrument that might be sold as an investment.'

The Eleventh Circuit further determined that in a viatical settlement there is no question that the elements of an investment of money, a common enterprise and an expectation of profits, are present. However, the Mutual Benefits court analyzed "whether the investor's expectation of profits is based 'solely on the efforts of the promoter or a third

any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

49. Id.
50. A viatical settlement, as later discussed, is a settlement where a terminally ill patient sells his or her policy, at a discounted rate, to investors for a lump sum. See Albert, supra note 43, at 1014.
53. 328 U.S. 293 (1946).
54. Id. at 298-99.
55. Mutual Benefits Corp., 408 F.3d at 742 (quoted source omitted).
party."\textsuperscript{56} The court determined that the "investors’ expectations of profits in [that] case relied heavily on the pre- and post-payment efforts of the promoters in making investments in viatical settlement contracts profitable."\textsuperscript{57} Therefore, the court held that a viatical settlement is a security under the purview of both the '33 Act and the 1934 Securities Exchange Act ("'34 Act" or "Exchange Act").\textsuperscript{58} Similarly, the word "efforts," as used in connection with the sale of a viatical settlement, is said to be "performed by the viatical settlement company or its agents because the investor is totally passive."\textsuperscript{59} For the reasons stated above, life settlements can therefore be securitized. More specifically, life settlements meet the Howey test and can therefore be classified as investment contracts.

B. The Securitization of Life Insurance Policies

To begin the securitization process in a life settlement, an investor or a settlement company approaches the insured to purchase the life insurance policy in return for a payout.\textsuperscript{60} Once the terms are agreed upon between the parties, the investor or settlement company sells or promises all of its interest in the life insurance policies to an SPE.\textsuperscript{61} The SPE will then transfer all of its interest in the life insurance policies either to a Related Provider Trust,\textsuperscript{62} a Titling Trust, or other trust which can be used for these purposes.\textsuperscript{63} The Trust will issue a certificate of beneficial interest ("UTI Certificate") to the SPE, which then circles around and promises the certification to the SPE’s lenders or investors.\textsuperscript{64} Life

\textsuperscript{56} Id. at 743.
\textsuperscript{57} Id. at 744.
\textsuperscript{58} Id. at 745.
\textsuperscript{59} 12 JOSEPH C. LONG, BLUE SKY LAW § 3:16.5 (2008).
\textsuperscript{61} Dolan & Panayotou, supra note 46, at 1209.
\textsuperscript{62} A "Related Provider Trust" has been defined as:
A titling trust or other trust established by a licensed Provider or a Financing Entity for the sole purpose of holding ownership or beneficial interest in purchased policies in connection with a Financing Transaction. In order to qualify as a Provider Trust, the trust must have a written agreement with the licensed Provider under which the licensed Provider is responsible for ensuring compliance with all statutory and regulatory requirements and under which the trust agrees to make all records and files relating to life settlement transactions available to the Department of Insurance as if those records and files were maintained directly by the licensed Provider.
\textsuperscript{63} See Dolan & Panayotou, supra note 46, at 1209.
\textsuperscript{64} Id.
insurance policies can then be purchased from the seller using the money that was lent or invested to the SPE. Finally, the insurer, generally the insurance company, will issue an indemnity in the form of an extension risk policy in favor of the Titling Trust or other trust that was used.

In the process of securitizing a life settlement, the transactions usually have both a servicer and a back-up servicer. The function of these positions is to supervise payment of premiums, track the insured, and make pertinent claims under the life insurance policies. The investor who financed the cash payments made to the insured through the capital markets is now the beneficiary of the insurance policy. Therefore, the end result for the beneficiary is a securitized death benefit.

Although after this process there exists a securitized transaction, there is much that goes on beyond the above outlined elements of these transactions. For example, before any investor partakes in any securitized transaction, it is best practice for the investor to conduct an analysis of the securitized asset. Goldman Sachs Group, Inc., in an effort to maneuver into this market, created the first of a progression of indexes to help financial firms understand the risks in investing in American mortality, and to manage exposure in the capital markets. The head of Goldman Sachs' Longevity Markets Group, Alex Dubitsky, said that “[t]his will result in more transparent pricing of longevity risk, should reduce transaction friction, and will likely lead to improved economics for market participants.”

65. Id.
66. Id. Extension Risk is referred to as the risk associated with a rise in interest rates. Investors may not be able to pull money away from their current investment to take advantage of opportunities with higher interest rates since refinancing activity turns sluggish and the likelihood of prepayment is diminished. See Roberta Romano, A Thumbnail Sketch of Derivative Securities and Their Regulation, 55 MD. L. REV. 1, 69 (1996).
67. Dolan & Panayotou, supra note 46, at 1209.
68. Patrick D. Dolan, New Developments in Securitization, in NEW DEVELOPMENTS IN SECURITIZATION 2007, at 567 (PLI Commercial Law & Practice, Course Handbook Series No. 11346, 2007); see also Kendall, supra note 2, at 3 (explaining that the function of a servicer is to oversee and guarantee that the borrower will meet his or her obligations, and that investors' rights are protected).
69. Dolan, supra note 68, at 567.
70. Id.
71. See id. at 565.
72. See, e.g., John Flowers, Goldman to Publish Mortality Index to Help Firms Assess Risk, FT. WAYNE J. GAZETTE, Dec. 26, 2007, at 12B.
73. See id.
74. Id.
help guide market participants in their quests to find the right individuals to participate in both life and viatical settlements.

This initial Goldman index "independently track[s] . . . a pool of 46,290 anonymous U.S. citizens over the age 65 [on a monthly basis], providing real-time publication of mortality information. The results will be periodically verified by a third party." In December 2007, Jack Kelly, the Director of Governmental Relations of the Institutional Life Markets Association ("ILMA")—commenting on Goldman Sachs' "swap index"—was quoted as saying, "[i]t shows that they anticipate growth within this space," and "adding that in 2008 'we will see others' establishing indexes of their own."77

C. Risks in Securitization of Life Settlements

Investors are always looking for something new to get involved with. As life settlements are a new type of investment, they have become increasingly popular. However, investors engaging in this business should familiarize themselves with the risks of investing in life settlements.

As with any investment in a securitized product, there are both payouts and risks in engaging in this type of enterprise. When investing in life settlements, specifically in viatical settlements, an investor opens him or herself up to vulnerability. Among the risks of investing in viatical settlements are the possibilities that either the insured will live well beyond his or her life expectancy or that the patient received a misdiagnosis from his or her doctor, or both.

Therefore, when a life settlement is securitized, much like any other security, protective measures are established. In the case of life settlements, the risk can be combated by a protective measure called an "extension risk policy," which can be taken out on either an individual policy, or on a pool-wide basis. An extension risk policy is essentially

75. Id.
77. Id.
78. See Matthew Goldstein, Profiting from Mortality: Death Bonds May Be the Most Macabre Investment Scheme Ever Devised by Wall Street, BUS. WK., July 30, 2007, at 46.
79. See Dolan & Panayotou, supra note 46, at 1206.
80. See supra note 66 and accompanying text (explaining extension risk).
81. Dolan & Panayotou, supra note 46, at 1206; cf. Dolan, supra note 68, at 567 ("Transactions today do not have extension risk policies. Investors get comfortable with the actuarial analysis regarding the life expectancies of the underlying insureds in the pool of policies being securitized.")
“insurance” on the life settlement which “typically guarantees payment of an amount equal to the death benefit of a policy if the insured individual is still alive two years after the projected life expectancy.”

IV. THE LEGITIMACY AND ILLEGITIMACY OF LIFE SETTLEMENTS

Though life settlements are legal and therefore legitimate, one specific type, the STOLI, is illegitimate. The problem is not in the securitization of life settlements generally; rather, it is that the risk factors are being ignored. Elements or risks in this business are being understated, and Wall Street is profiting from the common individual’s misunderstanding. As a Wall Street Journal article from February 2007 explains, “[y]our life insurance is meant as a hedge against personal tragedy. Wall Street increasingly wants to invest in it like a security.”

The way life settlements work is simple. The typical life settlement or senior settlement agreement allows for people, and in the case of senior settlements, the elderly over sixty-five, to be able to sell their life insurance to investors. After owning a policy for several years, the insured’s needs may have changed so that he or she no longer requires the policy. Rather than allowing the policy to lapse or simply accept the cash-out value, the insured can sell his or her policy in a life settlement, and make money to live on. Investors of these “arrangements,” usually acting under institutions called “life settlement companies” or “life settlement providers,” pay the premiums. The insured gets a lump sum payment while the investors wait for the policies to mature, or stated more directly, for the named insured to die. After a period of two years, the policy is sold to secondary

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82. Dolan & Panayotou, supra note 46, at 1206.
83. See Diana Levick, Autism Therapy Measure Passes, HARTFORD COURANT, May 10, 2008, at E.1 (discussing the passage of a bill in Connecticut that would deter STOLI transactions).
85. See e.g., GoLifeSettlement.com, supra note 44.
87. See Duhigg, supra note 60.
90. The insurer can cancel a life insurance policy for two years after the policy was taken out for reasons of fraud. See Lauer v. American Family Ins. Co., 769 N.E.2d 924, 926 (Ill. 2002) (holding that the two-year contestability period began on the policy issue date).
investors for a fraction of the death benefit. These secondary investors can then either hold on to the policy, sell the policy, or sell interests of bundled policies to hedge funds and other investors. After death, the current investor then collects the life insurance payout and, depending on if there is a pool of investors, divvies the profits.

Viatical insurance policies or viatical settlements are another type of life settlement and somewhat different than the typical life settlement. In a viatical insurance policy, the insured is usually someone who is terminally ill. Unlike the life settlement, the viatical settlement does not take age into account. In a viatical settlement, the insured receives immediate cash to surrender his or her life insurance policy. The concept of viatical settlements became prevalent in the 1980s when investors began to buy life insurance policies from AIDS patients.

Viatical settlements, when done properly, can be quite beneficial to those who participate in them. In fact, viatical settlements can help alleviate the debt from medical expenses and other costs incurred from a sick family member. For example, the New York Times reported the story of Andrew Schneider of Kaysville, Utah, who greatly benefited from his participation in a viatical settlement. Mr. Schneider and his wife, Karen, who was sick with cancer, participated in a viatical life settlement, selling Karen’s life insurance for $250,000. Mr. Schneider stated that “[i]f I hadn’t been able to sell this policy we would have lost our house, all our savings, everything.” Mrs. Schneider’s medical bills exceeded her medical insurance so much so that Mr. Schneider further commented, “[i]f this market hadn’t existed, we would have become financially destitute.” Investors received $500,000 upon Karen’s death in 2005.

91. See News Release, supra note 88.
93. Dolan & Panayotou, supra note 46, at 1205.
94. Grant, supra note 86, at C1.
95. See Dolan & Panayotou, supra note 46, at 1205.
96. Duhigg, supra note 60. This fact that viatical settlements began with insuring AIDS patients has been argued to be a positive of this industry. See Albert, supra note 43, at 1050 (“[i]nsurers are showing a willingness to insure the lives of AIDS patients.”).
97. Duhigg, supra note 60.
98. Id.
99. Id.
100. Id.
101. Id.
In the STOLI scheme, of more questionable legitimacy, the people buying the insurance are those who have no "insurable interest." Further, many times the insured had no intention to procure life insurance coverage before being approached by investors. Commonly, the insured will be approached by initiators offering the premium financing, as well as a cash incentive for signing away his or her insurance policy. After the two year initial waiting period is over, the insured will receive a cash-out lump sum, and the investor becomes the owner of a new life insurance policy. The reason that the STOLI scheme is considered problematic and worrisome, while a life settlement is deemed acceptable practice, is due to the fact that in the case of the STOLI scheme, the consumer is buying a life insurance policy without revealing to the insurance company their true intent—namely, to sell the policy to investors who are hoping to profit from the scheme. In this STOLI scenario, the investor is not buying the policy for personal protection, nor is he buying the policy for one who would have an insurable interest. The insurance companies, therefore, construe the insured’s undisclosed intentions as fraud.

102. Under New York law, "insurable interest" is defined as:
(A) in the case of persons closely related by blood or by law, a substantial interest engendered by love and affection;
(B) in the case of other persons, a lawful and substantial economic interest in the continued life, health or bodily safety of the person insured, as distinguished from an interest which would arise only by, or would be in enhanced in value by, the death, disablement or injury of the insured.

N.Y. INS. LAW § 3205(a)(1)(A)-(B) (McKinney 2006).


104. Id.

105. See supra notes 89-90 and accompanying text.

106. See Rosenberg v. MetLife, Inc., 866 N.E.2d 439, 440 (2007) (holding that "third party payments can be indicative of speculative insurance practices").


108. Life Product Clearing LLC v. Angel, 530 F. Supp. 2d 646, 653 (S.D.N.Y. 2008) ("Only one who obtains a life insurance policy on himself 'on his own initiative' and in good faith—that is, with a genuine intent to obtain insurance protection for a family member, loved one, or business partner, rather than an intent to disguise what would otherwise be a gambling transaction by a stranger on his life—may freely assign the policy to one who does not have an insurable interest in him."); see also Crotty v. Union Mut. Life Ins. Co., 144 U.S. 621, 623 (1892).
Senior citizens, more commonly than any other class of people, are the main targets of schemes involving life settlements. In a senior settlement, senior citizens are often offered cruises or other lavish gifts in exchange for taking out a policy, and proceed to sell the policy to investors. Critics of life settlements, commonly the insurers, advise against senior citizens partaking in these schemes, arguing that all that senior citizens are accomplishing is draining money from their estates.

These settlements have proved worrisome for life insurance companies, as well as the insured. As part of the life insurance business, insurers have to assume that policyholders will default on their policy. However, with the increasing trend of investors paying the premiums, the chance of default is decelerated.

These modern schemes, involving variable insurance products, which are securities, have become so common that the National Associations of Securities Dealers ("NASD") put out news releases, investor alerts serving as guidance letters, and even a Notice to Members on the issue. In a news release, NASD Chairman and CEO Mary Schapiro stated:

Life settlements are not for everyone.... While they can be a valuable source of liquidity for people who no longer want or need their current policies, life settlements can have high transaction costs and can have negative consequences for your financial situation. And it is very difficult to determine whether you’re getting a fair price for your policy. The best advice is to proceed with caution.

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109. See Goldstein, supra note 78, at 46; Zolkos, supra note 103.
110. Goldstein, supra note 78, at 51.
112. Zolkos, supra note 103.
113. Id.
115. See generally News Release, supra note 88 (cautioning investors about the "potential pitfalls of selling their existing life insurance policies for cash in transactions known as 'life settlements' or 'senior settlements'").
116. Id.
Similar to mortgages, investment banks and insurance companies are marketing this “security” to third parties. In 2006, an estimated $15 billion worth of life settlements were transacted. The NASD has reported that some studies indicate the potential market exceeds $100 billion.

In August 2006, FINRA published a Notice to Members with respect to life settlements involving variable life insurance policies. The noted purpose was “to remind firms and associated persons that life settlements involving variable insurance policies are securities transactions, and firms and associated persons involved in such transactions are subject to applicable NASD rules.” The NASD was concerned that as the industry of life settlements increases and competition to find those who are interested in selling their life insurance to third parties grows, dealers may engage in inappropriately aggressive sales tactics to gain prospective clients.

As there is much by way of efforts to cease the life settlement business—or as noted above, much effort to regulate the industry—there is also much in favor of the business of life settlements. The proponents of life settlements are, of course, the large investment companies. One example of the proponents of this emerging market is the Life Insurance Settlement Association (“LISA”). Founded in 1995, and currently the largest trade association in the industry of life settlements, LISA specializes in this business and encourages effective regulation of this industry.

Another such company is ILMA. Formed in April 2007, ILMA is an active lobbying group. Created to sway opinion in favor of the life settlements business, ILMA’s members include large financial firms

117. See id.
118. Goldstein, supra note 78, at 46.
121. Id.
122. Id.
125. For more information on the ILMA, see Institutional Life Markets Association, http://www.lifemarketsassociation.org (last visited Apr. 9, 2009).
126. See Flowers, supra note 72.
such as Goldman Sachs, Credit Suisse Group, and the now-defunct Bear Stearns. In December 2007, ILMA sent a letter to Ohio Representative Jay Hottinger commenting on Ohio House Bill No. 404 ("H.B. 404"). The Bill was proposed to revise and ratify specific provisions of the Ohio Revised Code as they relate to viatical settlements. The proposed changes also sought to curtail STOLI. The Bill, as set forth, sought to eliminate STOLI through trust arrangements, specified a five-year hold after a viatical settlement contract was entered into before a policy could be issued, and required that life settlement brokers complete a requisite continuing education program.

John A. Kelly, Director of Governmental Affairs at ILMA, put forth in his response to H.B. 404 that the objective of ILMA in responding to this Bill was to "strengthen H.B. 404 in a way that will benefit both consumers and the marketplace." However, in his letter, Mr. Kelly proposed certain changes to benefit investors and not the insured. One example can be seen with "ILMA's most significant concern with H.B. 404"—namely, the five-year restriction on life settlements. ILMA, instead, proposed a two-year restriction to align with the two-year time frame for which an insurance company can contest a policy. It is obvious by the Bill’s language, however, that Ohio’s goal is to protect consumers, while ILMA’s goal is seemingly pro-investor. Likewise, it is quite obvious that a five-year restriction would be disadvantageous to investors and for this reason ILMA is opposed to the proposed five-year time period.

Cantor Fitzgerald and other investment banks have begun to enter this industry as well. In 2007, Cantor Fitzgerald set up an Internet-based exchange for buying and selling policy rights. In March 2008, Phoenix Companies, a financial services provider, joined the fray.

127. Id.
129. Id.
131. Id.
132. E-mail from John A. Kelly, supra note 128.
133. Id.
134. Id.
135. Flowers, supra note 72, at 12B.
Phoenix aligned itself with four brokerage agencies to form its Phoenix Life Solutions subsidiary and began to market life settlements to its investors.\(^\text{137}\)

Investment banks are not alone in entering this market. The market is also available to individual players, especially high net-worth persons. For example, Larry King, an affluent individual, has taken advantage of this market. In October 2007, Larry King filed a lawsuit in the United States District Court for the Central District of California (located in Los Angeles) against the Meltzer Group insurance brokerage firm ("Meltzer").\(^\text{138}\) The lawsuit was filed against Meltzer and alleged that Larry King could have secured a larger profit by selling his policy on his own.\(^\text{139}\) Larry King "bought a new life insurance policy for $10 million [in 2004] and within a few weeks resold it [to a third party] for $550,000, under the advice of the Meltzer Group."\(^\text{140}\) Mr. King does not know the identity of who currently owns this life insurance policy.\(^\text{141}\) As a matter of law, when a contract does not provide for an insurable interest,\(^\text{142}\) that contract is void.\(^\text{143}\) Therefore, the fact that Mr. King’s "beneficiaries" are not closely related to him, goes against the purpose of life insurance, namely, to benefit those closely related to the insured.\(^\text{144}\) Life insurance has turned into a mere profit scheme, rather than an assurance to the insured that his or her beneficiaries are provided for.

This specific case brought a lot of public attention and interest to the life settlement industry.\(^\text{145}\) This newfound interest stemmed from the primary element of the life settlement industry: namely, the industry offers a product, life insurance, that many people, especially the middle class, already own. Taking that one step further, anyone owning this product can essentially be a player in the industry.\(^\text{146}\)
V. FRAUD IN CONNECTION WITH THE SECURITIZATION OF LIFE SETTLEMENTS

As securitization of life settlements is on the rise, so is fraud in connection with this new booming business. As with any new product, everyone is looking to play the game. However, not everyone has good intentions, and many will cheat their way to prosperity. The three examples presented below are a glimpse of both the ethical and moral issues of life settlements, as well as the notion that there is money to be made in this new product.

A. The Potential of Racial Profiling

Two men, Robert Alvin Coberly, Jr. and Curtis Devin Somoza, arrested in May 2006, were alleged to have been involved in a scheme that defrauded investors out of tens of millions of dollars. They purchased the policies of 2000 members of an African American church organization in South Central Los Angeles, the Personal Involvement Center ("PIC"). According to a Business Week article, the indictment specified that investors received a twenty-five percent return rate due to the fact that the church group’s members “were predominantly African Americans and had a higher mortality rate than the average population.” Soon after, Coberly and Somoza began stealing from the trust to purchase various luxuries. They were later arrested on charges of securities and wire fraud. A press release issued by the Department of Justice reported that “Somoza allegedly used the money to purchase items that include a 2003 Aston Martin automobile for $250,000; a 2003 Ferrari for $240,000; two 2004 Mercedes-Benz automobiles for a total of approximately $300,000; a... race boat for $290,000; and a... wristwatch for $447,000.”

This is just one example of how life settlements can potentially have unprincipled consequences. The fact that this specific church group was targeted because it largely consisted of African Americans, who statistically may have a higher mortality rate, may be patently

147. Goldstein, supra note 78, at 49.
149. Goldstein, supra note 78, at 49.
150. Id.
151. Id.
152. Press Release, supra note 148.
153. See Goldstein, supra note 78, at 49.
unethical. First, the argument must be made that it segments the American economy to the extent that it makes one group of Americans inferior in terms of their mortality rate. Second, even if the higher mortality rate of African Americans is true in fact, there is always the issue of new medical information and economic developments coming into play that can potentially impact the investment.\textsuperscript{154}

\textbf{B. Spitzer Versus Coventry First}

Another fraudulent scandal having to do with life settlements involved Coventry First, a company considered to be an industry leader in life settlements.\textsuperscript{155} On October 26, 2006, Coventry First was accused by Elliot Spitzer, then New York Attorney General, of fraud and violations of anti-trust laws by making "secret payments" to competitor brokers that muffled rival bidding\textsuperscript{156} for life settlement policies.\textsuperscript{157} Further, it was alleged that these payments were made to brokers hired to convince both elderly and ill insurance holders to sell their life insurance policies at lower prices.\textsuperscript{158} During the course of the fraud, Coventry First was alleged to have acquired over $3.6 billion in life insurance policies.\textsuperscript{159} The lawsuit specifically alleged that "Coventry paid one broker . . . $49,000 to shelve a competing offer for a policy that would pay $4.9 million on the death of an 80-year-old woman."\textsuperscript{160}

Although merely allegations, they toppled a $300 million death bond offering from a Coventry partnership with Ritchie Capital Management, a hedge fund. The deal was scheduled to be underwritten

\textsuperscript{154} The targeting of different groups for investment purposes is not uncommon. A more recent example of racial profiling is that of Bernard Madoff’s hedge fund, Ascott Partners. The devastation to Jewish institutions and charities as a result of Madoff’s now infamous Ponzi scheme is overwhelming. Gary Tobin, President for the Institute for Jewish and Community Research stated, “‘[i]n the Jewish world, we’ve just taken a major, central player, and introduced fear and uncertainty all over the system. It’s like finding out your brother is a murderer.’” Eleanor Laise & Dennis K. Berman, The Madoff Fraud Case: Impact on Jewish Charities Is Catastrophic, \textit{WALL ST. J.}, Dec. 16, 2008, at A20.

\textsuperscript{155} See Coventry, About Coventry Life Settlement and Financial Planning, http://www.coventry.com/about-coventry/index.asp (last visited Apr. 9, 2009) (“Coventry holds Standard & Poor’s highest ranking (2004, reaffirmed 2006) and has been ranked \#1 in the insurance category of the Inc. 500 listing of the fastest growing privately held companies in America.”).


\textsuperscript{157} Dolan, \textit{supra} note 68, at 567.


\textsuperscript{159} Duhigg & Treaster, \textit{supra} note 156.

\textsuperscript{160} \textit{ld.}
by Lehman Brothers, Inc., and "would have been backed by a pool of
life insurance policies with a face value of $1.16 billion, by far the
largest U.S. death bond offering to date." When news of this lawsuit
was made public, the deal, which was ready to buy with a AAA rating,
was quickly withdrawn and the deal collapsed.

In February 2008, Judge Denise Cote, of the United States District
Court for the Southern District of New York dismissed all but one of the
complaints in the lawsuit. The court explained Coventry's course of
dealing in this industry. Coventry is known for their vigorous
investment in "high-premium life insurance policies." These policies
are taken out on high-powered executives and wealthy individuals who
would rather sell their life insurance policies than preserve them.

This is a perfect example of a situation where the elderly and ill are
exploited, and the large investment company is profiting. In this case the
elderly were convinced to sell their policies for lower rates, which
earned the large company a profit. Further, the allegations of muffling
rival bidding are a prime example of just how far investors will go to get
these life insurance policies.

C. David W. Laing

In 1997, David W. Laing, former President of Personal Choice
Opportunities, pled guilty in the United States District Court for the
Southern District of New York on charges of defrauding investors out of
over $95 million. The charges accused Mr. Laing of assuring
approximately 1600 investors that they would receive short term gain
from buying viatical insurance policies from the ill. Mr. Laing
cunningly created these illusory patients, their medical documents, and

161. Goldstein, supra note 78, at 50.
162. Id.
542596, at *6 (S.D.N.Y. Feb. 29, 2008) (As discovery was in progress for the plaintiff's breach of
contract claim, the court did not address that particular issue.).
164. "In the course of its business, Coventry purchases life insurance policies and either holds
them, paying the applicable premiums and eventually collecting the death benefits, or sells them to
third parties." Id. at *1.
166. Id.
167. Susan McRae, Victims Get Another Chance to Win Back Swindled Funds, DAILY J.
(L.A.), Sept. 25, 2002, at 1; see also Halbfinger, supra note 92.
168. Halbfinger, supra note 92.
their insurance policies, and then presented his creation to the 1600 investors.\textsuperscript{169}

This case is a sample of the corruption that the life settlement industry invites. Although it explains how one man deceived investors, it is quite possible that many people, specifically the ill, will fall prey to this type of predator. A way to help alleviate these avenues of deception is via proper regulation of the industry and an educated public.

VI. POLICY REASONS AGAINST LIFE SETTLEMENTS

The cases outlined above are examples of how "death bonds" have become so prevalent. Moreover, they outline a strong need for further regulation of the industry. Despite the earlier explanation of the issue of viatical settlements and how they can be a positive asset to policyholders,\textsuperscript{170} this fairly recent phenomenon of "death bonds" contradicts America's social and economic values.\textsuperscript{171} In essence, Wall Street is betting on people's lives. More explicitly stated, Wall Street has created a product where investors are betting on others to die. The mechanics are simple: the sooner the person dies, the fewer premiums have to be paid, the more money in the investors' pockets.

Not only does the concept of life settlements contradict American values, it also is argued to be a exploitation of life insurance. The New York Insurance Department states as the purpose of life insurance:

> Your need for life insurance will vary with your age and responsibilities. The amount of insurance you buy should depend on the standard of living you wish to assure your dependents. You should consider the amount of assets and sources of income available to your dependents when you pass away. Social security benefits, available cash and other sources of income and investments may not provide the standard of living you have in mind. Life insurance helps bridge the

\textsuperscript{169} Id.
\textsuperscript{170} See supra notes 97-101 and accompanying text.
\textsuperscript{171} This Note will not attempt a discussion of what encompasses American values. However, Michelle Obama provided a good summation of American values when she described the shared values of herself and then President-Elect Barack Obama by saying that: "you work hard for what you want in life, that your word is your bond and you do what you say you're going to do, that you treat people with dignity and respect, even if you don't know them and even if you don't agree with them." Wife Stresses Obama's American Values, MSNBC.COM, http://www.msnbc.msn.com/id/26379521 (last visited Apr. 9, 2009). It is not far-fetched to assume that people commonly think about their dependents and life insurance when working hard for what they want in life. The tax benefits in the collection of life insurance policies are meant to promote the social objective of providing for dependents and spouses upon death. See Wayne M. Gazur, Death and Taxes: The Taxation of Accelerated Death Benefits for the Terminally Ill, 11 VA. TAX REV. 263, 317 (1991).
gap between the financial needs of your dependents and the amount available from other sources, is the amount to be provided by life insurance [sic]. Your agent or other financial advisor can help you with these calculations. The Internet, as well as many financial magazines, books and articles are available to help you as well.\footnote{172}

The argument that this secondary market of life settlements exploits life insurance is based on the premise that life insurance should be used as protection for your loved ones. Rather than the typical use of the insurance proceeds as security for one’s beneficiaries, the insured is using this money to live—and, in many instances, to buy extra luxuries. Aside from encouraging death, there are many other ethical and moral arguments that can be made against this business.

One such argument is that the life settlement industry essentially encourages people to cheat the traditional life insurance system. For instance, take a senior citizen collecting social security with a pension. This senior citizen passes a physical and now wants to take out a $1 million life insurance policy. The insurance company has to evaluate this senior citizen. One of the questions the company will consider is: Is this individual really worth the large payout he or she is seeking? The problem stems from the fact that an insurance company will not insure an individual for more than he or she is worth. The individual must prove he or she has a certain value and whether his or her life is worth what they think it is. In truth, it is much easier for an insurance company to evaluate a forty-year old man wishing to take out a $3 million policy, over the same request made by a seventy-five-year-old man. The reason being that insurance companies weigh factors,\footnote{173} determining which persons receive policies, and for how much. Among these factors are potential earning capacity and life span. In evaluating the factors, an individual may possibly lie, cheat, or withhold information from the insurance company. So the question then becomes, how does the insurance company justify giving this senior citizen a $1 million life insurance policy?


Although many insurance companies are not advocates of life settlements,\textsuperscript{174} they still seem to be doing something unethical. The scenario above highlights the concept that the greater the premiums, the higher the payouts. The insurance company will award the senior citizen the requested policy; however, the insurance company will only grant the policy on the condition that the senior citizen pays outrageous premiums. Though not sponsors of the industry, insurance companies have begun to realize that to succeed in this market, they can no longer shield their eyes from the industry. Therefore, participants from the angle of the insurance companies have to earn back what the settlements are costing them.\textsuperscript{175}

In this respect, it can be argued that to some degree the insurance companies are not doing their due diligence. However, they are not necessarily obligated to. It must be noted that insurance companies are beginning to question an applicant’s intent when taking out a life insurance policy.\textsuperscript{176} A life insurance policy applicant must fill out a form and attest that all the information on the form is true and accurate. Until recently, the insurance companies did not look at an individual’s intentions for taking out a life insurance policy.\textsuperscript{177}

There are a few recent federal cases focusing on applicant intent.\textsuperscript{178} In each case, the facts include an individual who bought an insurance policy worth millions of dollars with the intention of selling the policies to investors.\textsuperscript{179} Likewise, in each case, the insurance companies attempted to cancel the insurance policies after the two-year contestability period had already ended.\textsuperscript{180} In \textit{Sun Life Assurance Co. of Canada v. Paulson}, United States District Court Judge David S. Doty said that, as a general matter, in order for the insurance company to prevail, it must be able to prove that the individual bought the life insurance policies with the intent to sell them in accordance with a predetermined understanding to trade the policy.\textsuperscript{181} This is a very high

\begin{itemize}
  \item \textsuperscript{174} See Lincoln Nat'l Life Ins. Co. v. Calhoun, No. 08-2917, 2009 WL 221946, at *2 (D.N.J. Jan. 27, 2009).
  \item \textsuperscript{175} Goldstein, supra note 78, at 51.
  \item \textsuperscript{176} Darla Mercado, Legal Cases Bring Scrutiny to Life Insurance Applications, \textit{INVESTMENT NEWS}, May 12, 2008, at 32.
  \item \textsuperscript{177} See \textit{id}.
  \item \textsuperscript{179} Mercado, supra note 176, at 32.
  \item \textsuperscript{180} Id.
  \item \textsuperscript{181} See \textit{Sun Life}, 2008 WL 451054, at *2.
\end{itemize}
burden for the insurance company, and ultimately puts the insurance company at a disadvantage. Further, the insurance company has to be careful when asking questions about intent on its application, as the state of incorporation will vary the language the insurance company can use on their forms. MetLife, Inc. of New York has addressed this issue of intent by including pointed questions on their application including, for example, who is the payer of the policy and whether premium financing is involved. Still, it is unclear whether MetLife can directly ask if the insured plans to sell his or her policy on the secondary market.

Proponents of life settlements point to an insured's needs in advocating for life settlements, namely, ordinary living expenses. In a viatical life insurance settlement, the insured is a terminally ill patient who needs money to pay hospital bills and fulfill any last wishes that may exist. In the case of one who sold away their life insurance in a life settlement or in the case of a viatical settlement, opponents of life settlements point to the lack of funds for burial, or for the care of spouses and children, upon the life settlement victim's death. The industry of death bonds is making people both "cash-poor and coverage-poor." Kansas Insurance Commissioner Sandy Praeger said the concept makes her "'uncomfortable.'" These are folks who may be using up all their ability to buy $100,000 in insurance . . . . They sell it for cash, go through the money and then later realize they may not be able to get insurance to function the way it should."

There are many additional complications of life settlements. First, the possibility exists that the insured will not be able to buy more

182. Mercado, supra note 176, at 32.
183. Id.
184. Id.
186. Mercado, supra note 176, at 32.
187. See Duhigg, supra note 60.
188. Id.
190. Id.
191. Id.
192. Id.
life insurance if his or her health has deteriorated.\footnote{193} Second, which especially holds true for the elderly, is the problem with Medicaid. When an applicant applies for Medicaid, there is a sanction period of five years,\footnote{194} meaning that if the settlement date is within five years of the Medicaid application, the Medicaid applicant can be sanctioned for the "discounted price and the cash surrender value of the policy."\footnote{195}

Another concern regarding this developing industry—which is the essence of why life settlements are legal and STOLI settlements are problematic—is the lack of respect for human life. Resolutely put, the problem with STOLI settlements is that the investors do not have an insurance interest in the life of the insured.

Critics of STOLI can straightforwardly point to the case of a Los Angeles woman accused of murdering a homeless man in order to collect his life insurance.\footnote{196} The alleged scheme involved two elderly women who killed two men, staged the homicides to look like hit-and-runs, and then collected $2.8 million in insurance claims on the men.\footnote{197} This is yet another example of why this industry needs further regulation, perhaps even from a federal standpoint.

\section*{VII. Legislation Nationwide}

Many of the largest life insurance companies in America are currently performing nationwide lobbying efforts "to prevent some of the more blatant abuses of 'stranger-oriented life insurance,' or STOLI."\footnote{198} To date, approximately forty states have adopted policies dealing with life settlements.\footnote{199} The UCC does not govern the transfer of security interests in life insurance policies.\footnote{200} Therefore, each state has its own statutes (distinct from the UCC) and common law principles used in evaluating the permitted transfer of life insurance policies.\footnote{201}
The regulation of life settlements by individual states are divided into four categories: (1) states that regulate all settlements (the majority of states); (2) states that regulates viatical settlements; (3) states that only have STOLI regulations in place; and (4) states with no regulation at all. States and territories regulating all life insurance settlements include: Alaska, Arkansas, Colorado, Connecticut, Florida, Georgia, Hawaii, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maryland, Maine, Mississippi, Montana, Nebraska, Nevada, North Carolina, North Dakota, New Jersey, Ohio, Oklahoma, Pennsylvania, Puerto Rico, Tennessee, Texas, Utah, Virginia, and West Virginia. The states that currently regulate viatical settlements only include: California, Delaware, Illinois, Massachusetts, Michigan, Minnesota, New Mexico, New York, Oregon, Vermont, Washington, and Wisconsin. Only one state, Arizona, regulates just STOLI settlements. Finally, Alabama, Idaho, Missouri, New Hampshire, Rhode Island, South Carolina, South Dakota, Wyoming, and the District of Columbia remain without any regulation of life settlements.

There are two primary models of life settlement regulation that states can utilize to create legislation. The first is the Viatical Settlements Model Act ("NAIC Model Act"), prepared by the National Association of Insurance Commissioners ("NAIC"). The second is the Life Settlements Model Act ("NCOIL Model Act") as adopted by the National Conference of Insurance Legislators ("NCOIL"). There are many inherent tensions between the two acts,
and states have to decide whether to follow the NAIC Model Act or the NCOIL Model Act, or whether to incorporate provisions of both into their proposed state legislation.

The NAIC Model Act addresses many of the concerns of the overall life settlement industry. The Act was adopted in 1993 to create "barriers for consumers seeking to sell their policies and harsh burdens for life settlement companies seeking to make the market." The NAIC has now expanded its arena and now has model regulations that address both viatical and life settlements. Amendments to the NAIC Model Act were initiated in 2007 to target concerns regarding STOLI settlements and consumer protection. In response to the 2007 amendments, Julie McPeak, Life Insurance and Annuities Committee Chair and Kentucky Office of Insurance Executive Director, made the following comment: "The intensity of the discussions during our review process validated the Committee’s belief that this should be an area of major concern to those of us charged with protecting the public. This is a victory for consumers, particularly those who are ill, elderly or otherwise vulnerable."

It is important to note that the NAIC Model Act provides for a five-year suspension on settlements. To alleviate this five-year hurdle, the seller must provide the buyer with evidence that one of six conditions is met which would lighten the five-year requirement. The NAIC Model Act also provides for a sixty-day rescission period after the settlements are completed and for criminal sanctions for non-compliance. States

The National Conference of Insurance Legislators (NCOIL) is an organization of state legislators whose main area of public policy concern is insurance legislation and regulation. Many legislators active in NCOIL either chair or are members of the committees responsible for insurance legislation in their respective state houses across the country.


212. Kohli, supra note 207, at 305.
215. Id.
218. Id. § 10C; see also Life Insurance Settlement Association, supra note 211.

http://scholarlycommons.law.hofstra.edu/hlr/vol37/iss2/7
which have adopted the NAIC Model Act include: Iowa, North Dakota, and West Virginia. Other states, including Illinois, Louisiana, Massachusetts, Nebraska, Ohio, and Oklahoma, have pending legislation supporting the NAIC Model Act.

In 2005, Georgia enacted the Georgia Life Settlements Act based largely upon the NAIC Model Act. In adopting this Act, the stated intent was:

[T]o provide for the protection of contractual and property rights of a life insurance policy owner to seek a life settlement; to establish consumer protections by providing for the regulation of a life settlement transaction; to provide for the licensing and regulation of a life settlement provider and others involved in a life settlement transaction; to provide for antifraud measures.

Similarly, and as previously stated, NCOIL formulated the NCOIL Model Act which regulates both viatical and life settlements. Contrary to the NAIC Model Act, the NCOIL Model Act has a two-year suspension on settlements, modeled after the two-year insurance contestability period. Unlike the NAIC Model Act, the NCOIL Model Act does not impose criminal penalties or bond requirements.

The NCOIL Model Act is "a targeted attempt to prohibit controversial [STOLI] transactions while encouraging legitimate life settlements." To accomplish this, in November 2007, NCOIL amended its Model Act, implementing a number of changes. First, the amendment includes an appeal to states to amend their insurable interest laws. Second, for contracts settled within five years of issuance, it includes an annual statement requirement. Third, the amendment

219. Life Insurance Settlement Association, supra note 211.
220. Feldman & Heinrich, supra note 213, at 778.
221. Id.
224. Id.
225. See Kohli, supra note 207, at 305.
226. See Schroeder & Bolden, supra note 216. For a comparison of the two- versus five-year controversy, see supra text accompanying notes 131-34.
227. Feldman & Heinrich, supra note 213, at 778.
229. See Schroeder & Bolden, supra note 216.
230. Id.
231. Id.
addresses fraudulent life settlements.\textsuperscript{232} However, the most notable among the amendments of the NCOIL Model Act is the newly adopted definition of STOLI that is said to be a \textquoteleft\textquoteleft first-of-its-kind definition.'\textsuperscript{233} The new definition states that STOLI is \textquoteleft\textquoteleft a practice or plan to initiate a life insurance policy for the benefit of a third-party investor who, at the time of the policy origination, has no insurance interest in the insured.'\textsuperscript{234} It expands the definition of STOLI:

STOLI practices include but are not limited to cases in which life insurance is purchased with resources or guarantees from or through a person, or entity, who, at the time of policy inception, could not lawfully initiate the policy himself or itself, and where, at the time of inception, there is an arrangement or agreement, whether verbal or written, to directly or indirectly transfer the ownership of the policy and/or the policy benefits to a third party.\textsuperscript{235}

\textbf{A. Actions Taken by Individual States}

Although the practice of transferring life insurance for securitization is legal in New York, it is contrary to public policy. The New York statute for insurable interest explicitly allows transfer of one's life insurance by a person of \textquoteright\textquoteright lawful age.\textsuperscript{236} Still, \textquoteright\textquoteright New York has a strong public policy against speculation on the death of individuals.\textsuperscript{237}

In connection with New York's public policy against speculation on the death of individuals, Paul Zuckerman, the Principal Attorney with the Office of the General Counsel of the State of New York Insurance Department, stated that \textquoteleft\textquoteleft this issue goes back to legislative history. One of the principal reasons why life insurance has an insurable interest requirement is to protect an insured from those whose only interest in the person is the person's death.\textsuperscript{238} In discussing the New York State Insurance Department's opinion on the issue of life settlements, he commented, \textquoteleft\textquoteleft essentially we have a similar concern with life settlements in whether the obtaining of interest was done appropriately.\textsuperscript{239}

\begin{itemize}
  \item \textsuperscript{232} \textit{Id.}
  \item \textsuperscript{233} \textit{Id.} (quoting Press Release, NCOIL, \textit{supra} note 228).
  \item \textsuperscript{234} \textbf{LIFE SETTLEMENTS MODEL ACT} § 2(Y) (Nat'l Conf. of Ins. Legislators 2007).
  \item \textsuperscript{235} \textit{Id.}
  \item \textsuperscript{236} \textbf{N.Y. INS, LAW} § 3205(b)(1) (McKinney 2006).
  \item \textsuperscript{238} E-mail from Paul A. Zuckerman, Assistant Deputy Superintendent & Counsel, New York Ins. Dep't., to Ariella Gasner (Mar. 24, 2009, 21:21 EST) (on file with the Hofstra Law Review).
  \item \textsuperscript{239} \textit{Id.}
\end{itemize}
In New York, a life settlement Bill, introduced by the New York Insurance Department, has been presented in the Assembly and the Senate. The Bill would regulate the life settlement business. Kristina Baldwin, counsel to the Senate Insurance Committee, said that this is a "top priority" for Senator James L. Seward. She further stated that "[c]urrently, life settlements are unregulated in New York, and Sen. Seward believes that we need to get some consumer protection in place."

Aside from disclosure requirements, if passed, the proposed New York Bill would require investors in life settlements, who are not participating in securitized pools, to register with the New York State Insurance Department. The registration process keeps track of investors who have access to the names of the insured. Once passed, only a registered investor would be able to purchase a policy after it has been sold. Kermitt J. Brooks, the First Deputy Insurance Superintendent in charge of the Life Insurance Bureau, commented: "'The risk is that you sell your policy to me, and I sell it to someone else, who may view it as a wager on your life, and you don't even know they own the policy . . . .'" However, with the new policy requiring registration, Brooks said, "we would know who owns the policy, and if need be, we can contact them if there's an issue." Under the New York proposed Bill, the owners of a policy, would be able to contact the insured at varying levels of frequency, depending on the life expectancy of the insured. If the insured's life expectancy is less than one year, the insured could be contacted once a month. If however the insured’s life expectancy is a year or more, the insured can only be contacted every three months.

Also in response to the prevailing issue on life settlements, the Connecticut General Assembly passed a Bill to prevent STOLI. This Connecticut Bill, signed by the Governor and effective on October 1,
2008, stops investors from contracting with senior citizens to buy life insurance with an agreement to sell their policies later on.²⁵¹

On April 23, 2008, the House of Representatives for the State of Oklahoma approved Senate Bill 1980.²⁵² If passed, the Bill, which deals with viatical life insurance, would require brokers of viatical life insurance policies to be licensed by the Oklahoma State Insurance Department and would further require them to comply with their rules and regulations.²⁵³ Bruce Ferguson, of the American Council of Life Insurers, said that the Bill "bends over backwards to protect the property rights of consumers...."²⁵⁴ Importantly, the Bill also recognizes the need for a legitimate viatical life insurance business.²⁵⁵

In Kansas, on April 21, 2008, Senate Substitute for House Bill 2110 was signed into law by Governor Kathleen Sebelius.²⁵⁶ On this issue, Kansas Insurance Commissioner, Sandy Praeger, stated:

STOLI’s are life insurance policies that are more concerned with your demise than your life.... That’s why we refer to them as ‘death futures.’ This bill is a consumer protection measure that responds to this rapidly growing practice of treating human lives as commodities to be traded on the open market.... As Commissioner, it is my job to protect consumers from deceptive practices that target our most vulnerable constituents.... This bill protects our Kansas consumers and their beneficiaries from STOLI practices without hurting the legitimate life settlement industry.²⁵⁷

B. Criminal Ramifications Imposed by States

In April 2008, Senate Bill 704 in West Virginia was passed and signed by the Governor.²⁵⁸ The Bill makes it possible to impose a prison sentence of up to twenty years for procuring a life insurance policy and then turning around and selling it to investors within the first five years of the policy’s life.²⁵⁹ West Virginia is not alone in its determination to sanction this conduct, as Illinois, New York, and Oklahoma have

²⁵¹ Levick, supra note 83, at E.1.
²⁵² S.B. 1980, 51st Leg., 2d Reg. Sess. (Okla. 2008); see also Francis-Smith, supra note 42.
²⁵³ Id.
²⁵⁴ Id.
²⁵⁵ See id.
²⁵⁷ Press Release, Sandy Praeger, supra note 89.
²⁵⁹ See Feldman & Heinrich, supra note 213.
pending legislation authorizing similar punishment.\textsuperscript{260} This arguably is an important step in the recognition of a need for further protection of consumers engaging in these transactions.

\section*{C. Life Settlements and the Commerce Clause}

State regulation of life settlements has already been attacked on the notion that local government regulation violates the Commerce Clause of the United States Constitution.\textsuperscript{261} Nonetheless, when presented with this issue, courts have held that state regulation of life settlements does not invoke a violation of the Commerce Clause.\textsuperscript{262}

For example, the Virginia Viatical Settlements Act regulates viatical settlement providers.\textsuperscript{263} In \textit{Life Partners Inc. v. Morrison}, the Fourth Circuit was asked to determine whether the Virginia Act was exempt from the dormant Commerce Clause.\textsuperscript{264} The court held that the McCarran-Ferguson Act\textsuperscript{265} "saves the Act from any dormant Commerce Clause challenge."\textsuperscript{266} In its analysis, the court stated that by "focusing on the business of insurance insofar as it involves the marketing, sale, execution, performance, and administration of insurance contracts, Congress gave States broad authority to regulate . . . ."\textsuperscript{267} The court further reasoned that "because the Virginia Viatical Settlements Act addresses these aspects of insurance contracts with Virginia residents, the Act 'relates to' the regulation of the business of insurance."\textsuperscript{268}

Similarly, in \textit{National Viatical}, as applied to related allegations that state regulation violated the Commerce Clause, the court used the same reasoning as the \textit{Life Partners} court, adding that "[t]he Georgia Life

\begin{footnotes}
\item[261.] U.S. CONST. art. I, § 8, cl. 3 (stating that the United States has the power to "regulate commerce with foreign Nations, and among the several States, and with the Indian Tribes"); see also Life Partners, Inc. v. Morrison, 484 F.3d 284, 299 (4th Cir. 2007); Nat'l Viatical, Inc. v. Oxedine, No. 1:05-CV-3059-TWT, 2006 WL 1071839, at *2 (N.D. Ga. Apr. 20, 2006).
\item[262.] \textit{See Life Partners, Inc.}, 484 F.3d at 299; Nat'l Viatical, Inc., 2006 WL 1071839, at *2.
\item[263.] Virginia Viatical Settlements Act, VA. CODE ANN. §§ 38.2-6002 to -6016 (2008).
\item[264.] \textit{Life Partners, Inc.}, 484 F.3d at 297-99; see also Circuit Review Staff, \textit{First Impressions}, 4 SETON HALL CIRCUIT REV. 59, 73 (2007).
\item[265.] The McCarran-Ferguson Act was enacted in 1945 to give the state broad power over the regulation of insurers. The Act reads, "[n]o Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance." McCarran-Ferguson Act, 15 U.S.C § 1012(b) (2006).
\item[266.] \textit{Life Partners, Inc.}, 484 F.3d at 299.
\item[267.] \textit{Id.} at 297.
\item[268.] \textit{Id.}
Settlements Act regulates these core aspects of the business of insurance" as was the intent of the McCarran-Ferguson Act.269 This is just a slight sampling of the case law indicating that this issue will be saved from any attacks advocating an encroachment of the Commerce Clause.

The conflict between state regulation and the overriding authority of the Commerce Clause is an issue that arises time and time again. Although the McCarran-Ferguson Act gives the states power to regulate insurers and the Gramm-Leach Bliley Act ("GLBA") provides that it is Congress's intent that insurance remain regulated by the states,270 it appears to be time to for the courts to look towards federal regulation of the issue. The National Association of Mutual Insurance Companies ("NAMIC")271 supports a need for insurance reform in the states.272 This national trade association recognizes the deficiencies in our current system. NAMIC supports state regulation of the business of insurance and has advocated that "[t]he insurance community, companies and agents alike, recognize the need to modernize regulation of the business of insurance. In many respects, the industry is collaborating, informally, and working with the NAIC, NCSL and NCOIL to accomplish the goals of modernization and uniformity."273 Specifically, as applied to life settlements, if the goal is uniformity, perhaps NAMIC should be looking towards federal regulation of the life settlement business.

VIII. CONCLUSION: SECURITIZATION OF LIFE SETTLEMENTS AS IT IMPACTS THE ECONOMY

Securitization is clearly a crucial component to the United States and global economy alike.274 Absent various forms of securitizations, individual transactions, such as taking out a loan to attend college or

271. NAMIC was founded in 1895 as a full-service national trade association serving the property/casualty insurance industry with more than 1,400 member companies that underwrite more than 40 percent of the property/casualty insurance premium in the United States. NAMIC members are small farm mutual companies, state and regional insurance companies, risk retention groups, national writers, reinsurers and international insurance giants.
272. Id.
273. Id.
274. See supra Part I.
financing a vehicle, would be severely impacted, and the methods by which individuals accomplish daily practices would be hampered. Securitization, without close monitoring and oversight, can result in a chaotic society where people kill one another to collect monetary gains. The regulatory oversight of securitization should therefore be tailored for each securitized product or category of products. Doing so would facilitate the labeling of an item—for example, life settlements—as a securitized versus non-securitized product as well as whether, at the outset, the product can be deemed an asset for the purposes of securitization.

It would be unfair to argue that there are no positive aspects of this booming industry. Vatical settlements can potentially save a family from foreclosure or other financial strains arising when a loved one is sick. However, there is also an abundance of moral and ethical problems that coincide with this secondary market of life insurance. Even though a family who participated in a viatical settlement is saved from debt, the investors are still betting on the ill to die. Morally and ethically, this is a problem.

There are many other moral and ethical arguments against this industry that are beyond the scope of this Note. For example, a problem exists where an insured sells his life insurance policy only to later find out that he cannot take out another policy to protect his family in the event of his death. Securitization of life settlements can therefore ultimately harm the beneficiaries of the policyholder. The issue also exists as to who can sell life settlements—for example, the insurer who sells life insurance and then a few months or even years later solicits his clients to sell those policies in life settlements. This sort of action by a broker creates a problem. While clients may be weary of this type of industry, using a familiar name may help entice a client to trust the life settlements industry and therefore become a participant.

Securitization of life settlements transforms insurance policies into commodities. As investment in life settlements grows, so too does the need for increased regulation of the industry. There is currently movement for legislative reform in several states. This reform should be handled at the federal government level to create consistency. Indeed, the field of securities is the most highly regulated area in the United States. The concept of employee filtration is an important aspect of

275. See supra notes 97-101 and accompanying text.
276. See supra Part VII.
the regulation of the securities industry. It is a prime example of how Congress and the Stock Exchanges have joined hands to keep out the potential "bad guys," as a means to protect people who have invested their life savings in the securities markets.\(^{278}\) Legislatures take action in order to protect investors from perhaps another Great Depression. On these bases, life settlements should be dealt with as a federal issue.

Moreover, Americans should be concerned about the prevalence of life settlements, and specifically about the ongoing securitization of life settlements. We should be concerned about the people who do not fully understand the ramifications of dabbling in the life settlement industry, the taxpayers who are going to have to support these people, and the potential increase in criminal activity. We should only hope that that those advocating continued state regulation in the area of life settlements will advocate towards a safe way of effectuating a reformed service.\(^{279}\)

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\footnote{\textit{Both provisions are enforced by brokerage houses and the stock exchanges, which bar covered individuals (subject to exceptions). \textit{See} N.Y. STOCK EXCH. R. 346. Should an exception to this rule be granted by the NYSE, it must be approved by the Securities and Exchange Commission. \textit{See} 17 C.F.R.\$ 240.19h-1(a)(1) (2008).  
\footnote{278. See 15 U.S.C. \$ 78o(b)(4); 15 U.S.C. \$ 78c(a)(39)(e).}
\footnote{279. National Association of Mutual Insurance Companies, \textit{supra} note 267.}

\footnote{* J.D. candidate 2009, Hofstra University School of Law. Thank you to Professor Ronald Colombo for the mentorship and large amount of valuable contributions added to this Note; Professor Colesanti for introducing me to this subject, and for your valuable input; Jacob Granek for your guidance; and Mark Reich, a wonderful mentor and friend. To the staff of the Hofstra Law Review, especially Drew Gulley, Jaime Laginestra, Lindsey Karl, Sean Masson, Megan Canepari, and Lara Cahan. This Note is dedicated to Ari, Caleb, and Jayden for their never-ending support and encouragement.}