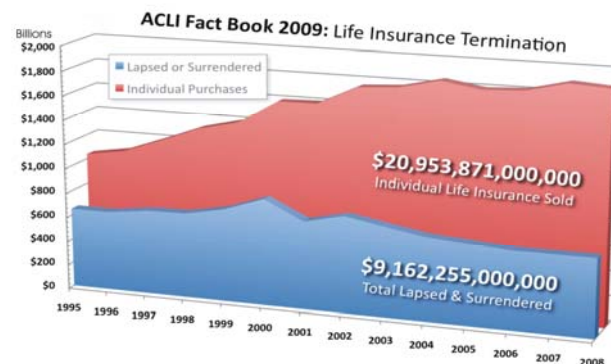


A Critique of the February 3, 2010 request by the ACLI to ban securitizations of life insurance settlements. By Insurance Studies Institute, February 5, 2010.

Some degree of abuse is inseparable from the proper use of everything. *James Madison*

On February 3rd the American Council of Life Insurers (ACLI) released a statement asking policymakers to ban the securitization of life insurance policies sold in the secondary market. Policymakers need to realize the true intention of ACLI and the life insurance industry appears to be destruction of a vibrant secondary market for life insurance, thereby denying seniors the option and right to realize full market value for their unwanted, unneeded and unaffordable life insurance policies. Such action by the life insurance industry is a slap to all life insurance policyholders, particularly seniors. Public policymakers should insist that consumers purchasing life insurance deserve the option a secondary market may provide.

Consider a few facts published by the ACLI Life Insurers Fact Book 2009. During the period 1995 to 2008, life insurance sold to individuals totaled over \$20.9 trillion and the lapsed and surrendered life insurance over that same period totaled \$9.2 trillion, or about 45% of the total sales. Clearly, the life insurance industry is motivated to protect their revenues from lapses and surrenders.



Conning Research & Consulting reported in its 2009 report, "Life Settlements, It's A Buyer's Market for Now," that total outstanding life insurance policies held as settlements approximated \$31 billion as of 2008. That is a mere .30% of total \$10.2 trillion of individual in-force life insurance, and only .34% of total lapses and surrenders from 1995 through 2008. Clearly, the life insurance secondary market does not represent a threat to the life insurance industry.

ACLI's assertion that banning of life insurance settlement securitizations would eliminate STOLI fraud is a bit disingenuous. Is the ACLI suggesting that securitization of stocks and bonds should be banned to prevent securities fraud by people such as Bernie Madoff, Allen Sanford, Raj Rajaratnam, Joshua Levinberg, and Mark Kurland? Is the ACLI suggesting a convoluted remedy to stop already reputed illegal STOLI transactions which have no value in the secondary market? Is the ACLI suggesting that life insurance is a poor asset for investment by the consumers who purchase life insurance? Is the ACLI suggesting that mortality does not impact most financial investments, pension funds, and governments? Is the ACLI suggesting that the life insurance secondary market does not provide material value to seniors who seek to realize maximum value in their life insurance investments?

Rather than curtail seniors' options, the key, it turns out, is educating and informing consumers of their options with respect to the ownership of life insurance, as reported in a December, 2009 research study conducted by the University of Minnesota's Carlson School of Management, "Increasing Awareness of Life Settlements," published by Insurance Studies Institute, January, 2010. ACLI's statement simply plays into what researchers at the University of Minnesota found to be confusing and uninformed messaging being communicated to consumers and policymakers.

Seeking stability in securitized insurance-related assets is a long established concept that has been well documented by rating agencies such as A.M. Best and DBRS. Consider for example “Regulation XXX” securitizations which are based on the NAIC Model Regulation that defines the life insurance reserve methodology for level premium term products. Because of complexities and the lifetime coverage of ULSG products, there are many moving parts that need to be handled when developing a securitization based on Regulation XXX, and the first such securitization, known as an “AXXX” transaction to finance the redundancy in statutory reserves underlying ULSG products, did not get completed until October, 2006. The insurance industry has relied heavily on securitizations for financing their risk in the form of XXX and AXXX securitizations, disability reserve securitizations, embedded value securitizations and annuity arbitrage securitizations.

Is the securitization by a life insurer of expected future profits of a closed block of business with massive lapse and surrender assumptions not disingenuous to investors in the securitization? But now when those same tools and techniques are available for the consumers’ benefit, the ACLI asks policymakers for an outright ban to the practice. Of course the insurance industry welcomes investments from individuals for insurance base securitizations and life insurance policies, but the industry now says it does not want individuals to realize full market value for their unwanted, unneeded and unaffordable policies.

Like XXX and AXXX securitizations, A.M. Best notes the complexity of securitizing life insurance settlements in its published securitization guidelines. But should complexity be a reason to legally ban a securitization?

In testimony to the Senate Committee examining STOLI, as reported in STOLI Alert, March, 2009, Frank Keating (Chairman of ACLI) said: *“Sometimes, circumstances force consumers who purchased life insurance policies in good faith to consider life insurance settlements. We are not trying to shut down this option for consumers. Our legislative efforts are targeted at STOLI.”* So if the goal is to eliminate STOLI which is already illegal in most states, why ban securitizations of life insurance settlements which will eliminate most capital from the life insurance secondary market and thus materially curtail this valuable resource? For the life insurance secondary market to stay vibrant for seniors, capital is needed, and capital markets require liquidity, thus the need for securitizations.

In the opening Statement at the Special Committee on Aging Hearing “Betting on Death in the Life Settlement Market – What’s at Stake for Seniors?” April 29, 2009, Senator Herb Kohl said: *“Needless to say, seniors are looking for ways to bolster their sagging savings. One of them is the life settlement business, a burgeoning multi-billion dollar industry that has exploded in recent years. Life settlements can be a worthy alternative for seniors who are considering the sale of their life insurance policy, and offer a higher payment than the cash surrender value offered by the insurance company.”*

The ACLI statement further says: *“Since there are only a limited number of insured individuals who want or need to sell their existing insurance policies and are of an age and expected mortality profile to be of interest to settlement providers, promoters of life settlement artificially manufacture new life insurance sales to generate an inventory of policies for investors.”* Is the ACLI representing that the insurance industry is issuing “artificially manufactured” life insurance policies, i.e., STOLI policies with no insurable interests? This is what has been asserted by Olive Tree Holdings L.L.C. and a trust administrator who are suing the Phoenix Companies Inc., Hartford and two of its subsidiaries, alleging the companies used fraud to convince elderly individuals to purchase multi-million dollar life insurance policies, telling them

the policies could be freely changed into life settlements, as reported in Life & Health National Underwriter, "Trusts Sue Insurer Over Settlements", October, 2009.

The life insurance secondary market industry is in agreement that STOLI transactions are illegal and should not be condoned. Many states have enacted legislation to better define and prohibit STOLI transactions. But why ban investment products and the formation of capital for the life settlement option that is good for senior consumers? If purchasing a life insurance policy is good for a consumer, then why is selling a policy bad?

Policymakers should take note: Consumers are entitled to fair options to manage their life insurance policies. Don't allow a strong industry lobby to trash those options. The vibrant secondary market for life insurance is pro-senior, pro-consumer and pro-government regulation. It needs protection.

About Insurance Studies Institute (ISI): ISI is a 501(c)3 non-profit research think tank focused on: a) researching and analyzing challenges and opportunities within the field of insurance-based risk management; b) educating industry stakeholders, public policymakers and consumers, and advancing scholarship in insurance-based risk management; and c) promoting dialogue and informed actions to foster industry advances, fair public policy and greater risk protection for consumers. To learn more link to: www.InsuranceStudies.org.

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