



SB 1224 (Machado): Life Settlement Contracts

Position: Support

The National Association of Insurance and Financial Advisors of California (NAIFA-California) is an association representing over 5,000 insurance professionals from all sectors of the industry, including life, health, property, casualty, and financial services.

BACKGROUND

Existing law, under the Corporate Securities Law of 1968, provides for regulation by the Commissioner of Corporations of the issuance and sale of securities; however, within the law is a loophole that excludes most life settlements from the definition of a security. As a result of this loophole, the market has grown significantly and has been largely unregulated. The lack of regulation in this area has opened these products to abusive practices, such as those in stranger owned life insurance (STOLI) transactions.

STOLI schemes are designed to entice seniors to take out life insurance policies so that investors can profit when the senior dies. The senior usually receives an upfront payment and the investors finance the life insurance premium. The seniors purchase the policies in their own names but agree to an arrangement where the investors, after the expiration of a two-year contestability period, stand to profit from the insured's death. These types of transactions are in sharp contrast to those unique situations where a life agent may have a policyholder who, for whatever life changing circumstance, no longer needs the life insurance policy that was purchased years before and the agent recommends looking at a life settlement as an option of getting some value out of the policy rather than simply surrendering it to the life insurance company.

Seniors in California are being hurt by STOLI transactions because more often than not they do not understand the ramifications of both the short and long-term consequences to them and their families. They are often unaware that the income derived from the STOLI transaction is generally taxable and that numerous legal fees and other expenses have to be paid before the transaction is complete. They may also be unaware that by entering into a STOLI transaction they could affect their available insurable capacity and they will not become aware of the fact until they attempt to purchase life insurance for their family. Furthermore, STOLI transactions could ultimately increase the cost and limit the availability of life insurance for other individuals.

Lastly, the growing life settlement industry tends to solicit newly licensed and inexperienced insurance agents to help entice other agents to help sell STOLI. NAIFA-California members have been approached by these recruiters and the focus during the meetings has tended to be on how much money NAIFA-California members can make on the STOLI transaction rather than how NAIFA-California members' clients can benefit.

SOLUTION

NAIFA-California supports the provisions in SB 1224 that would require individuals negotiating life settlements to be licensed by the California Department of Insurance. Having extensive knowledge of the way life insurance policies operate and an understanding of the importance of looking out for the best interests of consumers are critical when advising individuals on the various options that need to be considered prior to a client making the decision to enter into a life settlement.

Additionally, SB 1224 establishes a regulatory framework for viatical and life settlement contracts, which will go a long way towards addressing the problems with the unregulated market and unlicensed individuals who would continue to cold call seniors in an effort to convince them to enter into detrimental STOLI transactions.

For more information regarding NAIFA-California's position on this bill, please contact NAIFA-California's Legislative Advocate, Shari McHugh, at (916) 930-1993.