Article from:

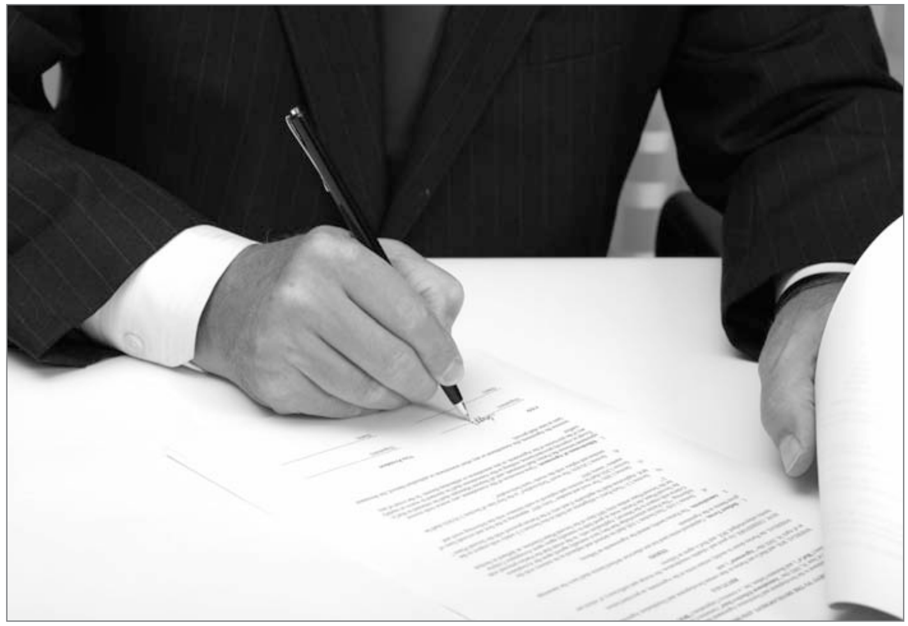
Reinsurance News

August 2008 – Issue No. 63

STOLI POSES DANGER TO INDUSTRY, REINSURERS WARNED

by Jim Connolly

***Editor's Note:** This article appears with the express permission of The National Underwriter (c) 2008, The National Underwriter Company.*



Stranger-Originated Life Insurance (STOLI) poses a danger to the insurance industry and to Congress' perception of life insurance, several speakers contended at an annual reinsurance conference held here earlier this month.

However, a number of speakers at ReFocus 2008, jointly presented by the American Council of Life Insurers, Washington, and the Society of Actuaries, Schaumburg, Ill., did say there is a place for properly regulated life settlements.

To understand the issue, it is necessary to start with basics focusing on protection, the original intent of life insurance, said Stuart Reese, chairman, president and CEO of MassMutual Life Insurance Company, Springfield, Mass., during a direct writer CEO panel.

However, he said that if a policy is purchased with protection in mind and is no longer needed after a period of time, then a contract holder does have property rights and "there is a legitimate life settlement business which is consistent with the purpose of insurance."

But, Reese continued, if there is no insurable interest, "that strikes me as a situation that is not what Congress had in mind when they gave us a tax advantage. It puts the insurance industry at risk, if Congress says, 'Wait a minute. This is speculation on life.' It is a huge risk for the industry."

In an environment in which Congress is going to be looking for ways to generate tax revenue, "this is something that we should all be worried about."

Mike Bell, executive vice president with Pacific Life Insurance Company, Newport Beach, Calif., said that while more insurance will be sold in the next decade, fewer professionals will be selling it, raising the concern that life insurance will become a commodity with little cash value that will be vulnerable to replacement and settlement. The industry needs to be careful about how it develops products because "there is no second chance," he said. "Today, if you underprice a product, Wall Street will kill you."

Bell says he supports a regulated life settlement industry. "The horse has left the barn," he noted, adding, however, that it is important not to take in any STOLI business. "We talk about how bad it is, but we don't do anything to stop it. We need to be first in line to say no and mean no."

Rather than delivering more money to seniors who settle rather than surrender a contract for the cash surrender value, Bell said that life settlements will actually cost seniors more because the cost of insurance built into contracts will increase, fewer products including no-lapse provisions will be available, capacity will be smaller and underwriting tougher.

During this panel, David O'Maley, chairman, president and CEO of Ohio National Life Insurance Company, Cincinnati, noted the importance of aligning the interests of the company and agent. Ohio National Life did this in 1994, he said, when it established an agent-owned reinsurance company to discourage practices such as table shaving which

continued on page 40

STOLI poses danger to Industry … from page 39

leads to more liberal underwriting. "It gets the company and the agent on the same side of the table."

When stranger-originated life insurance first came on the market, National Financial Partners, New York, a distributor of financial services products to the high net worth market, met with carriers to discuss what they considered all right to sell and what was not, said Jessica Bibliowicz, chairman and CEO. NFP then decided what it did not want to participate in, she explained.

The most important thing, she noted, is that manufacturing and distribution come back together again.

Life settlements do make people feel more relaxed about their options, open up insurance markets and provide "an excellent hedge" for the life insurance industry, she said. For contract holders, it offers an additional option, Bibliowicz added. "It is not just a matter of surrender or die."

But she said there are rules in place at NFP regarding settlements: anonymity of the insured, because "investors don't need to know someone's name," and, disclosure of compensation.

Regarding the 5-year ban on settlement of contracts in the current Viatical Settlements Model Act of the National Association of Insurance Commissioners, Bibliowicz said that "personally, I am not a fan of the 5-year provision" or other "arbitrary requirements."

Such requirements can result in an industry that has a lot of loopholes, she noted.

Bibliowicz added that NFP has "worked very hard in the scrubbing of non-recourse financing" of contracts for settlement.

Both Bell and Bibliowicz said the real problem is that stranger-originated products are "stealth, very stealth" and that it is an ongoing battle.

Throughout the conference, speakers and attendees offered observations and possible solutions on the issue. One theme raised was developing new products that offer contract holders an incentive not to settle.

"If the client is 10 years into a contract and the underwriting changes, can we put money into the contract and help them get it tax free?" Bell asked.

Products need to be updated so that policyholders receive additional benefits that will make them want to hold on to their contracts, said Fred Jonske, president and CEO of M Group, Portland, Ore. He noted that in his company's case product reprises resulted in $40 million in additional policyholder benefits which totaled $200 million when the time value of money was considered.

During a discussion group, one participant noted that "it is incumbent on actuaries to build products that don't change the benefit but allow people to get money out without selling the policy."

Another participant noted that if there is better retention, then a lot of companies can increase income as well as their bottom lines.

Still other observations focused on the company-producer relationship. Another participant in the discussion group said there was a large increase in settlements in contracts owned by those in the 71+ age group that was traced back to one big producer. That producer was terminated, the participant recounted.

Another participant said he had heard anecdotal information that those investors initiating STOLI were structuring these contracts like 5-year term products to get around the 5-year ban being advocated as a solution to the increase in the number of STOLI contracts. ✷

Jim Connolly is Senior Editor of National Underwriter's Life and Health/Financial Services edition with The National Underwriter in Hoboken, NJ.
He can be reached at *jconnolly@nuco.com.*