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Subject: **GAO and SEC Issue Reports on Life Insurance Settlements**

Major References: **[“Life Insurance Settlements: Regulatory Inconsistencies May Pose a Number of Challenges,” Government Accounting Office Report No. GAO-10-775; “Life Settlements Task Force,” Staff Report to the U.S. Securities and Exchange Commission](#)**

Prior AALU Washington Reports: 10-58; 10-32; 09-51; 09-30; 09-29; 08-104; 08-13

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Two simultaneously issued reports, one by the Government Accounting Office (GAO) and the other by the Staff of the Securities and Exchange Commission (SEC) examine life insurance settlements. The GAO Report was prepared at the request of Sen. Herb Kohl (D-WI), who is Chair of the Senate Select Committee on Aging. The SEC Report was prepared at the direction of SEC Chairman Mary Schapiro.

The GAO Report, which found numerous inconsistencies in the regulation of life settlements, recommends that Congress may wish to consider taking steps to help ensure that policy owners involved in life settlements are provided a consistent and minimum level of protection. The SEC Report states that Congress should consider amending the definition of “security” under the Federal securities laws to include life settlements.

Both Reports are voluminous, and cannot be easily summarized here. However, both note the exponential growth of life settlements since the late 1990s and the inconsistent manner of regulations of these transactions by the various states. Estimates of the total face value of policies settled in 2008 ranged from around \$9 billion to \$12 billion, but have declined recently to less than \$8 billion.

The GAO Report describes life settlement as a means whereby a policy owner with unneeded life insurance, who might otherwise surrender the policy to the insurer for its cash surrender value, may receive more than its CSV by selling the policy to a third-party investor. The Report notes that, “[d]espite their potential benefits, life settlements can have unintended consequences for policy owners, such as unexpected tax liabilities.” Other downsides include the potential loss of future insurability. In addition, “policy owners commonly rely on intermediaries to help them, and some intermediaries may engage in abusive practices.”

Among these “abusive practices” is the promotion of “Stranger-Owned Life Insurance,” or “STOLI,” which the GAO Report describes as “the issuance of a life insurance policy for the benefit of a third party who has no insurable interest in the insured when the policy was issued.” (*See, e.g.*, our Bulletins Nos. 10-58, 10-32, 09-51, 09-30, 09-29, 08-104 and 08-13). Approximately 26 states have laws that include specific provisions to deter or prohibit STOLI.

The GAO Report goes on to address how the life settlement market is organized and regulated, and what challenges policy owners, investors, and others face in connection with life settlements. Approximately 38 states regulate life settlements, but such regulation is neither uniform nor consistent. The Report notes, with respect to the current regulatory system, that:

“State insurance regulators focus on regulating life settlements to protect policy owners by imposing licensing, disclosure, and other requirements on brokers and providers. The Securities and Exchange Commission (SEC), where its jurisdiction permits, and state securities regulators regulate investments in life settlements to protect investors. One type of policy (variable life) is considered a security; thus, settlements involving these policies are under SEC jurisdiction. SEC also asserted jurisdiction over certain investments in life settlements involving nonvariable, or traditional, life insurance policies, but their status as securities is unclear because of conflicting circuit court decisions. All but two states regulate investments in life settlements as securities under their securities laws.”

The Report therefore calls for Congress to consider steps to insure that policy owners involved in life settlements are provided a consistent and minimum level of protection. The SEC reviewed the GAO Report and largely agreed with its conclusions. However, the National Association of Insurance Commissioners (NAIC), as could be anticipated, “disagreed that an optional federal charter for insurance would help address the inconsistent regulation of life settlements.”

For its part, the SEC Task Force recommends the following:

- The SEC Should Consider Recommending to Congress that It Amend the Definition of Security under the Federal Securities Laws to Include Life Settlements
- The SEC Should Instruct the Staff to Continue to Monitor that Legal Standards of Conduct Are Being Met by Brokers and Providers
- The SEC Should Instruct the Staff to Monitor for the Development of a Life Settlement Securitization Market (Note: ACLI advised the GAO that it “supports banning the securitization of life settlements, because securitization would encourage promoters to elicit STOLI.”)
- The SEC Should Encourage Congress and State Legislators to Consider More Significant and Consistent Regulation of Life Expectancy Underwriters
- The SEC Should Instruct the Staff to Consider Issuing an Investor Bulletin Regarding Investments in Life Settlements

AALU did not submit written comments to either the GAO or the SEC, but its views in opposition to STOLI have been widely known and continue to be strongly held. AALU will continue to monitor the examination of life settlements.

Any AALU member who wishes to obtain a copy of the either or both of the GAO or SEC Reports may do so through the following means: (1) use hyperlink above next to “Major References,” (2) log onto the AALU website at www.aalu.org, enter the *Member Portal* and select *Current Washington Report* for linkage to source material or (3) email Anthony Raglani at raglani@aalu.org and include a reference to this *Washington Report*.

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