Date: 08/2008 **SA01-08**

SENIOR ADVISORY

Topic: **WHAT IS "STOLI" or "SPINLIFE"?**

Seniors may find themselves being approached by investors or life agents who encourage them to purchase life insurance that will be transferred a couple of years later to an investor. Often these sales pitches occur in a pleasant setting such as nice restaurant, or even on a yacht. The sales pitches can paint a tempting picture: the life insurance purchase itself is characterized as being "free," "risk-free" or "no-cost," and the senior is often promised an up-front cash bonus. These types of schemes are becoming increasingly common and are known as "Stranger Originated Life Insurance (STOLI)" or "Speculator Initiated Life Insurance (SPINLIFE)." The California Insurance Commissioner is also aware of unscrupulous operators pitching "longevity survey" schemes. This is where seniors are paid a sum to fill out a "longevity survey" where their private medical information is divulged to unknown third parties. The Department of Insurance suspects that the latter are also used to purchase life insurance for investors who wish to wager on the senior's death.

In understanding what constitutes STOLI or SPINLIFE schemes, it is helpful to understand the concept of a "life settlement." A life settlement is a transfer of an ownership interest in a life insurance policy to a third party for compensation less than the expected death benefit under the policy. The third party then makes any required premium payments and holds the policy until the death of the insured, at which time the third party is paid the death benefit under the policy. Life settlements can be a favorable option for a senior to access the death benefit of a policy for which he or she no longer has a good economic need to keep in force. A life settlement can pay such an individual more than the surrender value of the policy offered by the insurer, and he or she is relieved of the responsibility of making premium payments. While life settlements thus originated in the context of a sale of a life insurance policy that was originally purchased for all of the traditional reasons (for example, for the protection of "widows and orphans" should the family wage earner die), STOLI or SPINLIFE schemes involve investors soliciting the original purchase of the insurance for the sole purpose of an eventual sale to them which usually occurs two years after the policy is first taken out.

Another important fact to keep in mind is that life settlements are not currently regulated by the California Department of Insurance. If the senior wishing to sell his or her policy has a life threatening illness, the buyer of the policy must be licensed by the California Department of Insurance. However, if the seller is not seriously ill, California does not currently have licensing requirements or restrictions on who can buy a senior's life insurance policy.

Are STOLI or SPINLIFE Schemes Legal?

Under California law, any party purchasing life insurance must have an insurable interest in the person being insured. If there is no insurable interest, the insurer has a basis for declaring the policy void. Simply put, an "insurable interest" exists where the owner of the policy is closely related to the insured, or otherwise has a financial interest in the continued life of the insured. One cannot take out a life insurance policy on a perfect stranger. STOLI or SPINLIFE marketers argue that there is no problem with meeting the insurable interest requirement because when the policy is first purchased, an insurable interest does exist. The problem with this argument is that if the main goal of everyone (the purchaser and the investors) is to transfer the policy in a couple of years, the insurable interest requirement may be inappropriately circumvented. There thus is a great deal of uncertainty regarding whether these schemes meet the insurable interest requirement. In addition, California law prohibits executing insurance policies as "wagers" on people's lives. STOLI transactions may violate that rule. Further, as discussed below, STOLI transactions involve various risks to seniors.

What Are the Risks Associated with STOLI and What Can Seniors Do to Protect Themselves?

Investor's Interest in the Death of the Senior

STOLI or SPINLIFE transactions involve stranger investors wagering on a senior's death. Once a "stranger" owns a life insurance policy on the life of the senior, that policy typically can be sold or transferred to another investor, this can occur multiple times. Think about it: do you want just anyone to have a financial interest in your early demise? The potential threat is underscored by the fact that some of these policies pay out in the millions once a senior dies. Even if the "Tony Soprano" scenario does not come to fruition, the insured must be comfortable with giving strangers access to their private medical information, and they will be subject to periodic contacts by the investors for the purpose of checking on the senior's health status. Again, the investors are betting on the senior's death and they'll want to know the status of the "maturity" of their investment.

Possibility of Liability on the Part of the Senior or His or Her Estate

Seniors must be scrupulously careful that there is a legitimate insurable interest in any life insurance policy that is taken out on their lives. If an insurer finds that the policy sold lacked an insurable interest, the insurer can sue to rescind the policy. In such a scenario, it is quite possible that investors would then sue the senior or his or her estate for damages because the life insurance policy they were holding to secure the death benefit (their "investment") would be declared void.

Potential Loss of Ability to Purchase Additional Life Insurance

An individual has only a finite amount of "insurance capacity" on his or her life. Insurers will often decline to write additional insurance if substantial insurance already exists on an insured's life. Thus, once a senior has life insurance taken out on his or her life and then sells the policy, the senior may be unable to obtain more life insurance should a legitimate need for life insurance arise.

Tax Consequences

Seniors may suffer adverse tax consequences from a STOLI transaction. It is also important to keep in mind that life insurance payouts have traditionally enjoyed tax-free protection; this is not true of proceeds from a STOLI transaction.

How can a senior protect him or herself?

(1) It's best to remember the old adage, "if it seems too good to be true, it probably is." Seniors need to be suspicious of slick marketing schemes involving "no-cost" life insurance and entreaties for seniors to "sell their valuable asset of insurance capacity." As we have seen, there are often profound, although hidden costs. Remember, these schemes are typically marketed by agents who stand to make thousands in commissions, for the benefit of investors, who hope to enrich themselves when the senior dies. The purpose of life insurance is to protect your own interests; unless you have a legitimate need for life insurance to protect your dependents, steer clear of schemes involving the purchase of life insurance to be transferred to investors.

(2) If you are not sure whether it could be a STOLI scheme, make sure to secure the independent advice of a trusted professional (for example, your lawyer or financial adviser) of the personal, legal and financial consequences of the purchase of life insurance. Do not simply take the word of those who are trying to profit on your death. You'll want your independent advisor to fully explore whether a clear insurable interest exists in the transaction and whether or not there could be an adverse financial impact from it. You can also contact the California Department of Insurance for guidance.

(3) As in all insurance applications, make sure you fill out an application for life insurance truthfully and completely. Misrepresentations on an application for life insurance will give insurers a basis to rescind the policy. STOLI marketers prefer that insurers are kept in the dark about a senior's intention to transfer the policy, as this is a tip-off for a STOLI scheme.

(4) Never, ever agree to give up private confidential medical information without first consulting with a trusted independent advisor and determining exactly what the party intends to do with the information.

(5) If you believe that you have encountered an improper STOLI scheme, or wish to discuss an insurance matter, please contact the Department's Consumer Hotline. You may also contact the Hotline at 1-800-927-HELP (4357).