



January 2007

### **New Obstacles to Stranger-Owned Life Insurance Transactions (“SOLI”)\***

On December 11, 2006, the Life Insurance and Annuities (A) Committee (“LIAC”) of the National Association of Insurance Commissioners (“NAIC”) took action to eradicate SOLI transactions by unanimously adopting certain amendments to their Viatical Settlements Model Act (the “LIAC Amendments”) that impose a ban on the sale of life insurance policies within 5 years of issuance.

#### **Criticism of SOLI Transactions**

*Violates the Insurable Interest Requirement.* Critics of SOLI transactions charge that such arrangements violate the purpose of the insurable interest requirement and the long-standing public policy against gambling on human lives. The insurance departments of Louisiana, New York and Utah have all voiced similar charges in recent bulletins and opinions, noting that SOLI transactions appear to violate the insurable interest requirement because the investors never have an insurable interest in the insured. *See* Louisiana Department of Insurance Bulletin No. 06-05, New York Insurance Department Opinion 05-12-19 and Utah Insurance Department Bulletin 2006-03. In addition, New York Life and Annuity Corporation (“NYL”) recently served notice to a trustee of its intent to rescind a \$1,000,000 policy held by an insurance trust. NYL based its rescission on allegations that the trust lacked an insurable interest in the insured, since it was created at the behest of unrelated investors who were also the trust beneficiaries and the premium payors. The Supreme Court of New York, County of New York, is scheduled to hear the case and will initially determine the validity of NYL’s actions.

*The LIAC Approach.* Taking even more decisive action, the LIAC adopted its amendments to the Viatical Settlements Model Act (the “Model Act”) in order to, according to the LIAC’s chairman, Jim Poole, “surgically remove the cancer of investor-initiated life insurance.” The LIAC Amendments have two major purposes:

1. The increased regulation of the life settlement market in general, including new requirements for brokers (such as additional disclosure obligations), the strengthening of policy sellers’ rescission rights and new restrictions on the advertising and marketing of life settlements; and
2. The elimination of SOLI transactions through a ban on policy sales, including:



- A general five year ban on policy sales (“5 Year Ban”). The general prohibition of the sale of a life insurance policy within five years of issuance unless one of the following exceptions applies to the policy owner (the “Owner Exceptions”):
  1. the policy owner (or the insured) is terminally or chronically ill;
  2. the policy owner becomes divorced, mentally disabled, retired from employment or is adjudicated bankrupt;
  3. the policy owner’s spouse dies; or
  4. the policy was issued upon exercise of the policy owner’s conversion rights.
  
- Exceptions for the sale of certain policies after only two years (“2 Year Exception”). A policy owner may sell a policy two years after issuance if the following requirements are met:
  1. Premiums have been funded exclusively with unencumbered assets, including financing only to the extent of a policy’s net cash surrender value, provided by, or fully recourse liability incurred by, the insured;
  2. No agreement or understanding exists to guarantee any liability or to purchase the policy, including an assumption of the loan; and
  3. Neither the insured nor the policy has been evaluated for settlement.

In the typical SOLI arrangement, the owner sells or assigns the subject insurance policy within two or more years of its issuance, in order to satisfy the outstanding loan and not in response to a specific change in circumstances (*e.g.*, retirement). Thus, none of the Owner Exceptions would apply. Also, financed SOLI transactions will likely not qualify for the 2 Year Exception, since they typically involve premium financing and/or an agreement providing for the purchase of the insurance policy.

If enacted, it would curtail fairly vanilla financing transactions where the policy is the sole collateral. It will likely boil-down to whether: (a) the economics force a settlement and (b) settlement was reviewed as an option. These days it is fairly common practice to order so-called life-expectancy’s when dealing with an insured age 70 or older, and push to secure the best possible rating to make the policy more attractive for sale.

*Effective Date for LIAC Amendments.* The LIAC Amendments will not take effect until both the NAIC’s executive committee and the plenary, which includes all voting NAIC members, approve them. The NAIC plans to consider the LIAC Amendments in early 2007, and the life insurance industry may begin lobbying states for enactment of the Model Act shortly thereafter. Currently, 28 states have adopted some form of life settlement legislation, with some states



basing their regulations specifically on the Model Act. It is uncertain, however, when and to what extent these and other states will adopt the LIAC Amendments or similar legislation.

\*Cites: Exposure Draft of the Revised Viatical Settlements Model Act, at [http://www.naic.org/documents/committees\\_models\\_Viatical\\_Act.doc](http://www.naic.org/documents/committees_models_Viatical_Act.doc); Steve Leimberg's Estate Planning Newsletter # 1051 (November 16, 2006) at <http://www.leimbergservices.com>; Steve Leimberg's Estate Planning Newsletter # 1061 (December 12, 2006) at <http://www.Leimbergservices.com>; Jim Connolly, "NAIC Life Panel Blesses Viatical Model Changes," NU Online New Service, December 11, 2006; Louisiana Department of Insurance Bulletin No. 06-05, September 5, 2006; New York Insurance Department Opinion 05-12-19, December 19, 2005; Utah Insurance Department Bulletin 2006-03, July 10, 2006; Code §7872; Treas. Regs. §§1.61-22, 1.79-0 and 1.7872-15.



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