

Testimony of Susan E. Voss

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Capital Markets, Insurance, and Government Sponsored  
Enterprises

“Recent Innovations in Securitization”

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## **Introduction**

Chairman Kanjorski, Ranking Member Garrett, and Members of the Subcommittee, thank you for the opportunity to testify at today's hearing. My name is Susan Voss, and I am the Commissioner of the Iowa Insurance Commission, with jurisdiction over insurance and securities regulation in my state. I am also the Vice President of the National Association of Insurance Commissioners, and I am here representing that organization.

I congratulate the subcommittee for taking the time to learn more about life settlement products, as many of them are legitimate business transactions. Life settlements were first developed as "viatical settlements" during the 1980s, in response to demand from HIV/AIDS patients who wished to sell their life insurance policies in order to raise much-needed funds for personal and health care expenses.

Life settlements are currently regulated by 43 insuring jurisdictions. Such transactions are proliferating rapidly; according to the Financial Industry Regulatory Agency, this industry had grown from \$5.5 billion in 2005 to \$11.8 billion by last year. There are \$26 billion worth of life insurance policies out there right now; the possibility for growth in this field (and related securitization) is significant.

Life settlements are growing and diversifying at a much more rapid pace than the speed at which regulators have been able to conduct oversight, yielding significant opportunities for the conduct of fraud. It is extremely important that steps are taken to

ensure transparency and consumer protection, first regarding the transactions themselves, and second regarding any related securitizations.

### **Update on Efforts against STOLI Policies**

During this decade, a new type life settlement transaction has emerged. STOLI, or “stranger-owned life insurance,” policies are owned by a person that has no interest in the insured at the time of policy issuance.

Under STOLI, investors solicit a healthy and high net-worth individual, who is typically at least 70 years of age, to obtain a life insurance policy with a certain minimum death benefit. The individual buys the life insurance with the specific intent to sell that new policy to a third party, and after a minimum period of incontestability ends, ownership of the life policy is automatically transferred to the investors in exchange for a taxable lump sum. The investors then receive the face value of the death benefit (tax free) when the insured individual dies.

The basic purpose of having life insurance is to provide financial security in the event of death for individual, family, and business needs. But STOLI transactions violate state laws, because there is no true insurable interest present at the time of policy issuance. The people who stand to benefit from the policyholder’s death are in no way related to that individual.

The National Association of Insurance Commissioners has adopted a Viatical Settlements Model Act as a recommended regulatory structure for states to protect consumers from unscrupulous settlement providers. Under that model, unless the policyholder meets certain criteria (such as developing a terminal illness or divorcing one's spouse), he or she must wait a certain period of time – anywhere from two to five years – before conducting a life settlement transaction. Requiring the policyholder to retain insurable interest in the policy for a set amount of time makes the transaction less attractive to STOLI investors.

### **The Impact of Life Settlements on Life Insurance Policy Issuance**

As states strengthen oversight of STOLI policies, bankers are turning to legitimate life settlement products as a new opportunity for securitization. Unfortunately, this market interest could have an unintended effect on the premiums that are individually assessed on all life insurance policies.

Writers of life insurance currently assume that a certain number of policyholders will eventually allow their policies to lapse. For example, a financially-stable single parent who has raised her children to adulthood may no longer see the need to maintain her life insurance policy, and will simply stop paying the premium on it. However, if the market existed for that parent (and tens of thousands like her) to sell her policy instead of just allowing it to lapse, premium rates would need to increase across the board in order for companies to prepare for the increased numbers of policyholders expecting to receive face value payouts down the line.

## **The Need for Greater Federal Oversight of Life Insurance Settlement Securities**

As banking interests purchase more and more life insurance settlements with the intent of combining them into securities products, there is an abject need for federal securities regulators to work together. They must quickly and efficiently fill all existing gaps regarding oversight of life insurance settlement securitization, in order to ensure that policyholders and investors alike are properly protected.

Please allow me to underscore when a life insurance product morphs into an investment product, the rights of the insured must still be guaranteed. Securities regulators must be cognizant of how their enforcement actions could affect the structure and value of the underlying insurance products. They must also take the privacy rights of the policyholders into consideration, and they must work to complement the state regulatory structure that already exists to protect these policyholders.

Regardless of how federal regulators address life settlement securities, protecting the basic virtues of the life insurance policies will be of paramount importance to state insurance regulators across our country. Specifically, we must ensure that life insurance beneficiaries – those people holding that insurable interest I discussed earlier, such as relatives of the deceased – will still be able to receive their proceeds tax-free. Beneficiaries are financially and emotionally dependent on the life of the insured person, and their needs remain as great today as they were before the development of the life settlement industry.

Due attention must also be given to the privacy rights of policyholders. When seniors engage in life settlement transactions, they often must provide the investor, and any subsequent investors, with access to their confidential medical records. I'm sure you will agree with me that the implications of providing this confidential information need to be fully examined and regulated.

Finally, I am very encouraged by the establishment of an agency-wide task force regarding life settlements at the Securities and Exchange Commission, and hope that body will make the protection of securitized insurance products a priority. This is the best example of the need for securities regulators and insurance regulators to work together to make sure that the insured's rights are protected while also protecting the investor in security purchases.

Mr. Chairman, thank you again for the opportunity to testify before your panel today. I hope this hearing will shed much-needed light on both the positive and negative aspects of life settlements, and I stand ready to answer any questions you may have. Thank you.