United States Government Accountability Office

GAO

Report to the Special Committee on Aging, U.S. Senate

July 2010

LIFE INSURANCE SETTLEMENTS

Regulatory Inconsistencies May Pose a Number of Challenges

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Highlights

Highlights of GAO-10-775, a report to the Special Committee on Aging, U.S. Senate

July 2010

LIFE INSURANCE SETTLEMENTS

Regulatory Inconsistencies May Pose a Number of Challenges

Why GAO Did This Study

Since the late 1990s, life settlements have offered consumers benefits but also exposed them to risks, giving rise to regulatory concerns. A policy owner with unneeded life insurance can surrender the policy to the insurer for its cash surrender value. Or, the owner may receive more by selling the policy to a third-party investor through a life settlement. These transactions have involved high-dollar-amount policies covering older persons. Despite their potential benefits, life settlements can have unintended consequences for policy owners, such as unexpected tax liabilities. Also, policy owners commonly rely on intermediaries to help them, and some intermediaries may engage in abusive practices.

As requested, this report addresses how the life settlement market is organized and regulated, and what challenges policy owners, investors, and others face in connection with life settlements. GAO reviewed and analyzed studies on life settlements and applicable state and federal laws; surveyed insurance regulators and life settlement providers; and interviewed relevant market participants, state and federal regulators, trade associations, and market observers.

What GAO Recommends

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. SEC agreed with our matter for congressional consideration, and the National Association of Insurance Commissioners did not agree or disagree with it but raised related concerns.

View GAO-10-775 or key components.
For more information, contact Orice Williams Brown, (202) 512-8678 or williamso@gao.gov.

What GAO Found

The life settlement market is organized largely as an informal network of intermediaries facilitating the sale of life insurance policies by owners to third-party investors. Policy owners may sell policies directly to investors in some cases, but owners and investors commonly use intermediaries. Life settlement brokers represent policy owners for a fee or commission and may solicit bids for policies from multiple life settlement providers with the goal of obtaining the best price. Life settlement providers buy life insurance policies for investors or for their own accounts. No comprehensive data exist on market size, but estimates indicate it grew rapidly from its inception around 1998 until the recent financial crisis. Estimates of the total face value of policies settled in 2008 ranged from around $9 billion to $12 billion.

State and federal regulators oversee various aspects of the life settlement market. Life settlements typically comprise two transactions: the sale of a policy by its owner to a provider, and the sale of a policy by the provider to an investor. As of February 2010, 38 states had insurance laws specifically to regulate life settlements. 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.

Inconsistencies in the regulation of life settlements may pose challenges. Policy owners in some states may be afforded less protection than owners in other states and face greater challenges obtaining information to protect their interests. Twelve states and the District of Columbia do not have laws specifically governing life settlements, and disclosure requirements can differ among the other states. Policy owners also could complete a life settlement without knowing how much they paid brokers or whether they received a fair price, unless such information was provided voluntarily. Some investors may face challenges obtaining adequate information about life settlement investments. Because of conflicting court decisions and differences in state laws, individuals in different states with the same investments may be afforded different regulatory protections. Some life settlement brokers and providers may face challenges because of inconsistencies in laws across states. GAO developed a framework for assessing proposals for modernizing the financial regulatory system, two elements of which are consistent consumer and investor protection and consistent financial oversight for similar institutions and products. These two elements have not been fully achieved under the current regulatory structure of the life settlement market.

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Abbreviations

ACLI	American Council of Life Insurers
FINRA	Financial Industry Regulatory Authority
ILMA	Institutional Life Markets Association
LISA	Life Insurance Settlement Association
LSI	Life Settlement Institute
NAIC	National Association of Insurance Commissioners
NASAA	North American Securities Administrators Association
NCOIL	National Conference of Insurance Legislators
SEC	Securities and Exchange Commission
STOLI	stranger-originated life insurance

United States Government Accountability Office
Washington, DC 20548

July 9, 2010

The Honorable Herb Kohl
Chairman
Special Committee on Aging
United States Senate

Emerging in the late 1990s, the life settlement market offers consumers benefits but also exposes them to risks, which have raised regulatory concerns. Policy owners with unneeded or unaffordable life insurance can surrender their policies to their insurance companies for the cash surrender value.[1] However, life settlements provide policy owners with another option: in a life settlement transaction, third-party investors compete to buy an existing, or in-force, policy from its owner—potentially resulting in an offer for the policy that is higher than its cash surrender value.[2] In exchange for the payment, the investor becomes the new policy owner and is responsible for paying the policy premiums but is entitled to receive the policy death benefit when the insured dies. Life settlements evolved from viatical settlements, which historically have involved insured persons who are chronically or terminally ill and expected to live 2 years or less. In contrast, life settlements traditionally have involved policies covering older persons (for example, 65 or older) who are expected to live more than 2 years.[3]

Importantly, life settlements are complex transactions that can take several months to complete. Policy owners commonly rely on specialized intermediaries to help them understand and complete the transactions. As

[1]The cash surrender value of a policy is the contractual price at which a policy owner can return the policy to the insurance company that issued it.

[2]Policy owners had the right to sell their life insurance policies before the emergence of the life settlement market. A Supreme Court decision in 1911 (Grigsby v. Russell, 222 U.S. 149) determined in effect that a life insurance policy is private property that can be sold at the will of the owner.

[3]Both life and viatical settlements involve the sale of a life insurance policy by its owner to a third-party buyer, but the life settlement industry distinguishes between life and viatical settlements based on the insured's life expectancy. However, some state regulators define "viatical settlement" broadly to include both life and viatical settlements, as defined by the industry, and others define the term narrowly to include only viatical settlements, as defined by the industry. We generally use the term "life settlements" to refer to sales of policies covering insured persons expected to live more than 2 years and, thus, draw a distinction between life and viatical settlements.

the Senate Special Committee on Aging highlighted in its April 2009 report, life settlements may have unintended consequences for older Americans.[4] For example, policy owners entering into life settlement transactions may incur unexpected tax liabilities or not be able to obtain additional life insurance, if needed, in the future. Just as there have been cases of fraud and abuse in viatical settlements, there are examples of similar problems with life settlements. Abusive business practices by intermediaries include charging policy owners excessive commissions, not seeking competitive bids for policies from potential buyers, and not providing policy owners with all relevant information.

Recognizing that life settlements can not only provide important benefits to older Americans but also pose risks to them, you asked us to address the following questions:

- How is the life settlement market organized?
- How are the life settlement market and its participants regulated?
- What challenges are policy owners, investors, and life insurance companies facing in connection with the life settlement market?

We conducted this performance audit from August 2009 to July 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

On April 23, 2010, we provided a briefing to your staff on the results of our audit. This report includes the materials used at that briefing and the matter for congressional consideration. We have added information to the briefing materials as requested during the briefing. The full briefing materials, including details on our scope and methodology, are reprinted in appendix I. The briefing included summary results of our two surveys of state insurance regulators and life settlement providers; the full results of those surveys are reprinted in appendixes II and III, respectively.

[4] Majority staff, U.S. Senate Special Committee on Aging, *Life Settlements: Risks to Seniors, Summary of Committee Investigation* (Washington, D.C., Apr. 29, 2009).

Background

State insurance regulators are responsible for enforcing state insurance laws and regulations. They oversee the insurance industry through the licensing of agents, approval of insurance products and their rates, and examination of insurers' financial solvency and market conduct. The National Association of Insurance Commissioners (NAIC) assists state regulators with various oversight functions, including maintaining databases and coordinating regulatory efforts by providing guidance, model laws and regulations, and information-sharing tools.

Federal and state securities regulators oversee the securities markets, in part to protect investors. The U.S. securities markets are subject to a combination of industry self-regulation (with the Securities and Exchange Commission's (SEC) oversight) and direct SEC regulation. This regulatory scheme was intended to relieve resource burdens on SEC by giving self-regulatory organizations, such as the Financial Industry Regulatory Authority (FINRA), responsibility for most of the daily oversight of the securities markets and broker-dealers under their jurisdiction.[5] In addition, state securities regulators administer state securities laws and regulations, which include registering nonexempt and noncovered securities before they are marketed to investors; licensing broker-dealers, investment advisers, and their agents; and taking anti-fraud and other enforcement actions.

Over the years, we have made a number of recommendations to encourage state regulators to implement a consistent set of insurance regulations.[6] Given the difficulties of harmonizing insurance regulation across states through the NAIC-based structure, we reported that Congress could consider the advantages and disadvantages of providing a federal charter option for insurance and creating a federal insurance regulatory entity.[7]

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[5]FINRA was established in 2007 through the consolidation of NASD and the member regulation, enforcement, and arbitration functions of the New York Stock Exchange. FINRA is involved in various aspects of the securities business—from registering and educating industry participants to examining securities firms; writing rules; enforcing those rules and the federal securities laws; informing and educating the investing public; providing trade reporting and other industry utilities; and administering a dispute resolution forum for investors and registered firms.

[6]See, for example, GAO, *Insurance Reciprocity and Uniformity: NAIC and State Regulators Have Made Progress in Producer Licensing, Product Approval, and Market Conduct Regulation, but Challenges Remain*, GAO-09-372 (Washington, D.C.: Apr. 6, 2009).

[7]GAO, *Financial Regulation: A Framework for Crafting and Assessing Proposals to Modernize the Outdated U.S. Financial Regulatory System*, GAO-09-216 (Washington, D.C.: Jan. 8, 2009).

We also recently developed a framework comprised of nine elements to help Congress and others evaluate proposals for financial regulatory reform.[8] One of these elements is consistent consumer and investor protection: market participants should receive consistent, useful information, as well as legal protections for similar financial products and services, including disclosures, sales practice standards, and suitability requirements. Another element is consistent financial oversight: the regulatory structure should ensure that similar institutions and products are subject to consistent regulation, oversight, and transparency, in part to help minimize negative competitive outcomes.

Life Settlement Market Organized Largely as an Informal Network of Specialized Intermediaries

The life settlement market is organized largely as an informal network of specialized intermediaries that facilitate the sale of existing life insurance policies by their owners to third-party investors. Policy owners may sell their policies directly to investors in some cases, but owners and investors commonly use intermediaries to assist them with their life settlement transactions. Life settlement brokers represent policy owners for a fee or commission and may solicit bids for policies from multiple life settlement providers with the goal of obtaining the best price. Life settlement providers buy life insurance policies on behalf of investors for a fee or commission or for their own account. The number of brokers and providers varies widely from state to state.

No comprehensive data exist on the size of the life settlement market, but estimates and other data indicate that the market grew rapidly from its inception around 1998 until the recent financial crisis. Industry estimates of the total face value of policies settled in 2008 ranged from around $9 billion to $12 billion. Life settlement providers responding to our survey reported purchasing policies with a total face value of around $5.50 billion, $9.03 billion, $12.95 billion, and $7.01 billion in 2006, 2007, 2008, and 2009, respectively.[9] Life settlements traditionally have involved high-dollar-amount policies insuring older Americans. Individuals and financial institutions, including some banks, hedge funds, and life insurance companies, have invested in life settlements by buying individual policies, fractionalized interests in individual policies, interests in pools of policies, or other products.

[8] GAO-09-216.

[9] We surveyed 49 life settlement providers that were licensed in two or more states, and 25 providers completed our survey.

State and Federal Regulators Oversee Various Aspects of the Life Settlement Market

State insurance and securities regulators and federal securities regulators oversee various aspects of the life settlement market. Life settlements typically comprise two transactions: (1) the sale of a policy by its owner to a provider, which itself is the life settlement contract, and (2) the sale of a policy by the provider to an investor. The majority of states regulate the first transaction, called the front-end transaction, under their insurance laws. The second transaction, called the back-end transaction, is regulated under state and federal securities laws in certain circumstances.

NAIC and the National Conference of Insurance Legislators have developed model acts to help states craft legislation to regulate viatical and life settlements. As of February 2010, 38 states had enacted insurance laws and regulations specifically to regulate life settlements—many based on one or both of the model acts.[10] State insurance regulators generally focus on regulating the front-end transaction to protect policy owners, such as by imposing licensing, disclosure, reporting, and other requirements on brokers and providers. Although state insurance laws regulating life settlements generally share basic elements, we identified differences between state laws through our survey of state insurance regulators.[11]

State securities regulators and, in certain circumstances, SEC regulate investments in life settlements (the back-end transaction) to protect investors. Variable life policies are securities; thus, settlements involving these policies are securities subject to SEC's and FINRA's sales practice rules.[12] SEC also has asserted jurisdiction over certain types of investments in life settlements of nonvariable, or traditional, life insurance policies, but their status as securities is unclear because of conflicting decisions from the U.S. Courts of Appeals for the District of Columbia and the Eleventh Circuit. In 2002, the North American Securities

[10]As noted above, we generally use the term "life settlements" to refer to sales of policies covering insured persons expected to live more than 2 years and, thus, draw a distinction between life and viatical settlements.

[11]We surveyed insurance regulators in all 50 states and the District of Columbia. Forty-five states and the District of Columbia completed our survey.

[12]Variable life insurance policies build cash value through the investment of premiums into separate investment options and offer an income tax-free death benefit to the beneficiaries. The cash value and death benefit vary based on the performance of the underlying investment choices. These policies are similar to traditional, or nonvariable, life insurance except that the policy owners have investment choices in connection with the underlying asset.

Administrators Association (NASAA) issued guidelines for states to regulate viatical and life settlement investments under their securities laws. According to NASAA and our independent research, all but two states regulate investments in life settlements as securities under their securities laws.

Regulatory Inconsistencies May Pose Challenges for Policy Owners, Investors, and Life Settlement Intermediaries

Inconsistencies in the regulation of life settlements may pose a number of challenges. First, life settlements can provide policy owners with a valuable option, but policy owners in some states may be afforded less protection than policy owners in other states due to regulatory inconsistencies. Consequently, such policy owners may face greater challenges obtaining information needed to protect their interests. Twelve states and the District of Columbia have not enacted laws specifically governing life settlements, and disclosure requirements can differ among the states that have such laws. Based on our survey of state insurance regulators, state regulators have conducted a limited number of broker or provider examinations. For example, 24 of the 34 state regulators that had the authority to examine brokers licensed in their state had not done any such examinations in the past 5 years. Similarly, 22 of the 33 state regulators that had the authority to examine providers licensed in their state had not done so in the past 5 years. In addition to the lack of uniformity, policy owners in some states could complete a life settlement without knowing how much they paid their brokers or whether they received a fair price for their policies, unless such information voluntarily was provided to them.

Second, some individual investors may face challenges obtaining adequate information about life settlement investments, including the risks associated with such investments. Because of the conflicting court decisions (noted previously) on whether investments in life settlements are securities and differences in state securities laws, individuals in different states investing in the same life settlement investment may be afforded different regulatory protections and receive different disclosures about their investments. Third, some life settlement brokers and providers may face challenges because of inconsistencies in laws across states. For example, two brokers and four providers told us that regulatory differences between states were burdensome or increased their compliance costs. Also, brokers and providers told us that some states have adopted laws that impede their ability to do business in those states.

Conclusion

Because life settlements and related investments can have characteristics of both insurance and securities, their regulatory structure involves multiple state and federal regulators. State insurance regulators have played the primary role in protecting policy owners by regulating the sale of in-force policies by their owners to life settlement providers. In turn, state and federal securities regulators have played the primary role in protecting investors by regulating the sale of life settlement investments.

We recently developed a framework for assessing proposals for modernizing the financial regulatory system.[13] One element of that framework is consistent consumer and investor protection: market participants should receive consistent, useful information and legal protection for similar financial products and services, including disclosures, sales practice standards, and suitability requirements. Another element is consistent financial oversight: the regulatory structure should ensure that similar institutions and products are subject to consistent regulation, oversight, and transparency, in part to help minimize negative competitive outcomes.

These two elements have not been fully achieved under the current regulatory structure of the life settlement market. First, not all states have enacted life settlement laws to provide policy owners with a minimum level of protection. Second, licensing, disclosure, and other requirements differ among some states with life settlement laws, resulting in different protections for different policy owners. Third, policy owners also can be afforded different protections, depending on whether the policy being sold is a variable policy subject to FINRA and federal sales practice rules or a nonvariable policy. Although variable policies, unlike nonvariable policies, expose their policy owners to investment risk, life settlements involving both types of policies generally raise the same potential risks for policy owners.

A potential federal role in the regulation of insurance has been the subject of debate, which the current financial crisis has renewed. For example, the financial regulation reform legislation currently under consideration by Congress would, among other things, create a Federal Insurance Office, in part to monitor the insurance industry (other than health and crop insurance).[14] The bill contains a provision directing the office to consult

[13] GAO-09-216.

[14] Dodd-Frank Wall Street Reform and Consumer Protection Act, H. Rep. No. 111-517 (June 29, 2010) (to accompany H.R. 4173).

with states on matters of national importance and conduct a study on how to modernize and improve insurance regulation, including gaps in state regulation. In the last decade, we have made a number of recommendations to encourage state regulators to implement a consistent set of insurance regulations.[15] In providing a framework for assessing proposals to modernize the financial regulatory system, we recently reported that Congress could consider the advantages and disadvantages of providing a federal charter option for insurance and creating a federal insurance regulatory entity because of the difficulties in harmonizing insurance regulation across states through the NAIC-based structure.[16]

Matter for Congressional Consideration

As Congress continues to consider how best to reform the regulatory structure of the financial services sector, life settlements offer another example of products that may lack clear comprehensive regulation. Therefore, Congress may wish to consider taking steps to help ensure that policy owners involved in life settlement transactions are provided a consistent and minimum level of protection.

Agency Comments and Our Evaluation

We provided the Chairman of SEC, the Commissioner of Internal Revenue, and the Chief Executive Officer of NAIC with a draft of this report for their review and comment. We received written comments from SEC and NAIC, which are summarized below and reprinted in appendixes IV and V. SEC also provided us with technical comments that were incorporated in the report where appropriate. The Internal Revenue Service did not provide any written comments. SEC generally agreed with our conclusions and matter for congressional consideration. NAIC and not state whether it agreed or disagreed with our matter for congressional consideration but raised related concerns.

In commenting on a draft of the report, SEC stated that it agreed with our matter for congressional consideration and, based on the work of its Life Settlement Task Force, believes that enhanced investor protections should be introduced into the life settlement market. SEC noted that investors often face challenges in obtaining adequate information about life settlement investments and, as indicated in our report, may be afforded different regulatory protections and receive different disclosures,

[15] See, for example, GAO-09-372.

[16] GAO-09-216.

depending on where they reside. According to SEC, these are issues that should be addressed through clarification of regulatory authority. In that connection, SEC's Life Settlement Task Force has focused its review on enhancing investor protections and addressing regulatory gaps in the life settlement market and is expected to make recommendations to the commission along those lines.

In commenting on a draft of this report, NAIC's Chief Operating Officer and Chief Legal Officer summarized our matter for congressional consideration but noted that NAIC disagrees that an option for a federal charter for insurance is an appropriate solution for the life settlement market. He also noted that NAIC objects to the inclusion of a discussion of federal chartering for insurers or the creation of a federal insurance regulatory entity, as neither proposal has included any federal role in the life settlement market. Our references to federal chartering and a federal insurance regulatory entity in the conclusions served to illustrate the debate over the advantages and disadvantages of a federal role in the regulation of insurance, given the difficulties of harmonizing insurance regulation across the states. As discussed in our report, states also have faced difficulties in harmonizing their life settlement regulations. Because of regulatory inconsistencies, policy owners in some states may be afforded less protection than policy owners in other states, and addressing this issue should be part of any regulatory reform effort. Our matter for congressional consideration seeks to raise this as an issue to be considered but does not provide any specific approach that Congress should take. While NAIC discusses potential approaches that it views as inappropriate—regulation through federal chartering or a federal regulatory agency—other approaches have been taken to harmonize state insurance regulations. For example, in 1999, Congress passed the Gramm-Leach-Bliley Act, which encouraged states to enact uniform laws and regulations for licensing insurers or reciprocity among states when licensing insurers that operate across state lines.[17]

The NAIC official also commented that our report did not mention that policy owners entering into life settlements have received, in the aggregate, a small fraction of the face value of their policies (based on our provider survey)—indicating that such transactions are a poor financial choice for most consumers. The costs and benefits provided by life settlements to policy owners has been a controversial issue. For example, some have

[17] GAO-09-372.

noted that policy owners could maximize their estate value by liquidating assets other than their life insurance policies, and others have noted that life settlements offer policy owners an alternative to surrendering their policies for their cash value, which also typically is a small fraction of the face value of the policies. As we noted in our report, life settlements can provide policy owners with a valuable option, but policy owners can face challenges in assessing whether a life settlement is their best option or knowing whether they are being offered a fair price for their policy.

As agreed with your office, unless you publicly release its contents earlier, we plan no further distribution of this report until 30 days from its date of issue. At that time, we will send copies of this report to interested congressional committees, the Chairman of SEC, Commissioner of Internal Revenue, Chief Executive Officer of NAIC, and others. In addition, the report will be available at no charge on GAO's Web site at http://www.gao.gov.

If you or your staff have any questions concerning this report, please contact me at (202) 512-8678 or williamso@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix VI.

Orice Williams Brown

Orice Williams Brown
Director, Financial Markets and
Community Investment

Appendix I: Briefing to Congressional Staff on Life Insurance Settlements

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Briefing to the Senate Special Committee on Aging

Review of
Life Insurance Settlements (Life Settlements)

April 23, 2010

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Briefing Outline

- Objectives
- Scope and Methodology
- Background
- Summary
- Life Settlement Market Is Organized Largely as an Informal Network of Specialized Intermediaries
- State and Federal Regulators Oversee Various Aspects of the Life Settlement Market
- Regulatory Inconsistencies May Raise Challenges for Policy Owners, Investors, and Life Settlement Intermediaries
- Conclusions
- Matters for Congressional Consideration

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Objectives

As you requested, our review addresses the following three questions.

- How is the life settlement market organized?
- How are the life settlement market and its participants regulated?
- What challenges are policy owners, investors, and life insurance companies facing in connection with the life settlement market?

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Scope and Methodology

For objective one, we

- Reviewed and analyzed academic and other studies on life settlements and related investments, materials collected from the Web sites of life settlement brokers and providers, and information from firms offering life settlement investments.
- Reviewed licensing records in 34 states (where providers were required to be licensed) to compile a list of providers. We then conducted a survey of those 49 providers licensed in two or more states to collect data on their settlement transactions over the past 4 years. We received responses from 25 providers.
- Interviewed seven providers, four brokers, three institutional investors, the Securities and Exchange Commission (SEC), the Financial Industry Regulatory Authority (FINRA), three state insurance regulators, three state securities regulators, the National Association of Insurance Commissioners (NAIC), the North American Securities Administrators Association (NASAA), the Life Insurance Settlement Association (LISA), the Life Settlement Institute (LSI), the Institutional Life Markets Association (ILMA), the Insurance Studies Institute, and three attorneys specializing in life settlements. We attended two life settlement industry conferences.

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Scope and Methodology (continued)

For objective two, we

- Reviewed and analyzed state insurance laws and regulations; state and federal securities laws and regulations; federal and state court cases, as well as SEC and state securities enforcement actions involving life settlements or related investments; model acts or similar guidance created by NAIC, the National Conference of Insurance Legislators (NCOIL), and NASAA; academic, regulatory, and other studies on the regulation of life settlements; and related GAO reports.
- We conducted a survey of state regulators from 50 states and the District of Columbia to obtain information about their life settlement laws and regulations. We received responses from 45 states and the District of Columbia. For this objective, we generally interviewed the same entities identified in objective one.

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Scope and Methodology (continued)

For objective three, we synthesized the results from the studies and other materials collected for objectives one and two. In addition to the entities identified above, we interviewed officials from the Internal Revenue Service, two life insurers, the American Council of Life Insurers (ACLI), the National Association of Insurance and Financial Advisors, AARP, the Center for Economic Justice, and two credit rating agencies.

We conducted this performance audit from August 2009 to July 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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Background

Life settlements are the sale of existing, or in-force, life insurance policies by their owners.

- A U.S. Supreme Court decision in 1911 (Grigsby v. Russell, 222 U.S. 149) determined in effect that a valid life insurance policy is personal property that may be sold by its owner.
- Historically, policy owners who have had unneeded or unaffordable life insurance could surrender their policies to their life insurers for the cash surrender value. Life settlements provide owners with another option—the potential to sell their policies for an amount greater than the cash surrender value of the policies.
- Life settlements evolved from viatical settlements in the late 1990s. Viatical settlements involved the sale of insurance policies by terminally or chronically ill persons expected to live 2 years or less. Life settlements typically involve the sale of policies by healthier persons expected to live more than 2 years.

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Background (continued)

- The life settlement industry distinguishes between viatical and life settlements based on the insured's life expectancy, but some regulators do not. For example, some state insurance laws broadly define the term "viatical settlements" to include life settlements. We generally use the term "life settlements" to refer to sales of policies covering insured persons expected to live more than 2 years.
- Life settlements gave rise to stranger-originated life insurance (STOLI) around the early 2000s. STOLI generally is the origination of a life insurance policy for the benefit a person who has no insurable interest in the insured when the policy is issued. STOLI also has been referred to as investor-originated life insurance and speculator-initiated life insurance.

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Background (continued)

In a life settlement transaction, a policy owner sells a policy to an investor (or other buyer) for an agreed upon amount, typically for more than the policy's cash surrender value but less than the policy's face value (or death benefit). In exchange for the payment, the investor becomes the new policy owner—responsible for paying the policy's premiums and entitled to receive the policy's death benefit when the insured dies.

- Policy owners sell their policies because they no longer need the insurance or can no longer afford to pay the premiums. For example, a policy owner may no longer need the insurance because the intended beneficiary had died.
- Investors can profit from a life settlement by receiving a death benefit that is greater than the cost of acquiring and owning the policy. The amount of the death benefit is known when the policy is bought, but the date when the insured will die and the death benefit will be paid is not known.

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Background (continued)

State insurance regulators are responsible for enforcing state insurance laws and regulations.

- State insurance regulators oversee the insurance industry through the licensing of agents, approval of insurance products and their rates, and examination of insurers' financial solvency and market conduct.
- NAIC assists state regulators with various oversight functions, including maintaining databases and coordinating regulatory efforts by providing guidance, model laws and regulations, and information-sharing tools.

Federal and state securities regulators oversee the securities markets, in part to protect investors.

- The U.S. securities markets are subject to a combination of industry self-regulation (with SEC oversight) and direct SEC regulation. This regulatory scheme was intended to relieve resource burdens on SEC by giving self-regulatory organizations, such as FINRA, responsibility for much of the daily oversight of the securities markets and broker-dealers under their jurisdiction.
- State securities regulators administer state securities laws and regulations, which include registering nonexempt and noncovered securities before they are marketed to investors; licensing broker-dealers, investment advisers, and their agents; and taking antifraud and other enforcement actions.

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Summary

The life settlement market is organized largely as an informal network of specialized intermediaries that facilitate the sale of existing life insurance policies by their owners to third-party investors.

- Policy owners and investors can transact directly but commonly use intermediaries. Life settlement brokers represent policy owners and may solicit bids for their policies from multiple life settlement providers with the goal of obtaining the best price. In turn, providers sell policies to investors. The number of brokers and providers varies widely from state to state.
- No comprehensive life settlement data exist, but estimates indicate the market grew rapidly from 1998 until the recent financial crisis. Estimates of the total face value of policies settled in 2008 ranged from around $9 billion to $12 billion. Life settlements traditionally have involved high dollar amount policies insuring older Americans.
- Individuals and financial institutions, including some banks, hedge funds, and life insurers, have invested in life settlements by buying individual policies, fractionalized interests in individual policies, interests in pools of policies, or other products.

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Summary (continued)

State insurance and securities regulators, combined with federal securities regulators, oversee various aspects of the life settlement market.

- Life settlements typically comprise a front-end transaction—the sale of a policy by its owner (e.g., the insured) to a provider—and a back-end transaction—the sale of a policy by the provider to an investor.
- As of February 2010, 38 states have enacted insurance laws and regulations specifically to regulate life settlements.[1] State insurance regulators generally focus on regulating the front-end transaction to protect policy owners, such as by imposing licensing, disclosure, reporting, and other requirements on brokers and providers.
- State securities regulators and, in certain circumstances, SEC regulate investments in life settlements (the back-end transaction) to protect investors. Variable life policies are securities; thus, settlements involving these policies are securities subject to its jurisdiction. SEC also has asserted jurisdiction over certain types of investments in life settlements of nonvariable, or traditional, insurance policies, but their status as securities is unclear because of a split between two federal circuit courts.
- According to NASAA and our own independent research, all but two states regulate investments in life settlement as securities under their securities laws.

[1] As noted in the background, we generally use the term "life settlements" to refer to sales of policies covering insured persons expected to live more than 2 years and, thus, draw a distinction between life settlements and viatical settlements.

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Summary (continued)

Regulatory inconsistencies may pose a number of challenges.

- Life settlements can provide policy owners with a valuable option, but owners may face challenges obtaining adequate information. Twelve states and the District of Columbia have not enacted laws governing life settlements, and disclosure requirements can differ among the other states. In addition to the lack of uniformity, the potential exists for policy owners to complete a life settlement without knowing how much they paid their brokers or whether they received a fair price for their policies, unless such information is provided voluntarily to them.
- Some individual investors may face challenges obtaining adequate information about life settlement investments. Due to conflicting decisions by the U.S. Courts of Appeals for the District of Columbia and the Eleventh Circuit on whether investments in viatical settlements are securities and differences in state laws, individuals in different states investing in the same type of life settlement investment may be afforded different regulatory protections and receive different disclosures about their investment.
- Some life settlement brokers and providers may face challenges because of inconsistencies in the life settlement laws across states. For example, brokers and providers told us that some states have adopted laws that impede their ability to do business in those states.

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Summary (continued)

As Congress considers how best to reform the regulatory structure of the financial services sector, it may wish to consider taking steps to help ensure that policy owners involved in life settlement transactions are provided a consistent and minimum level of protection.

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Accountability * Integrity * Reliability

Objective 1:
Life Settlement Market Organized Largely as an Informal Network of Specialized Intermediaries

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Life Settlement Market Organized Largely as an Informal Network of Specialized Intermediaries

Policy owners may sell their policies directly to investors in some cases, but owners and investors commonly use intermediaries, including agents, life settlement brokers, and life settlement providers, to assist them with their life settlement transactions (see fig. 1). Often the provider transfers the commission payment to the broker from the proceeds of the sale.

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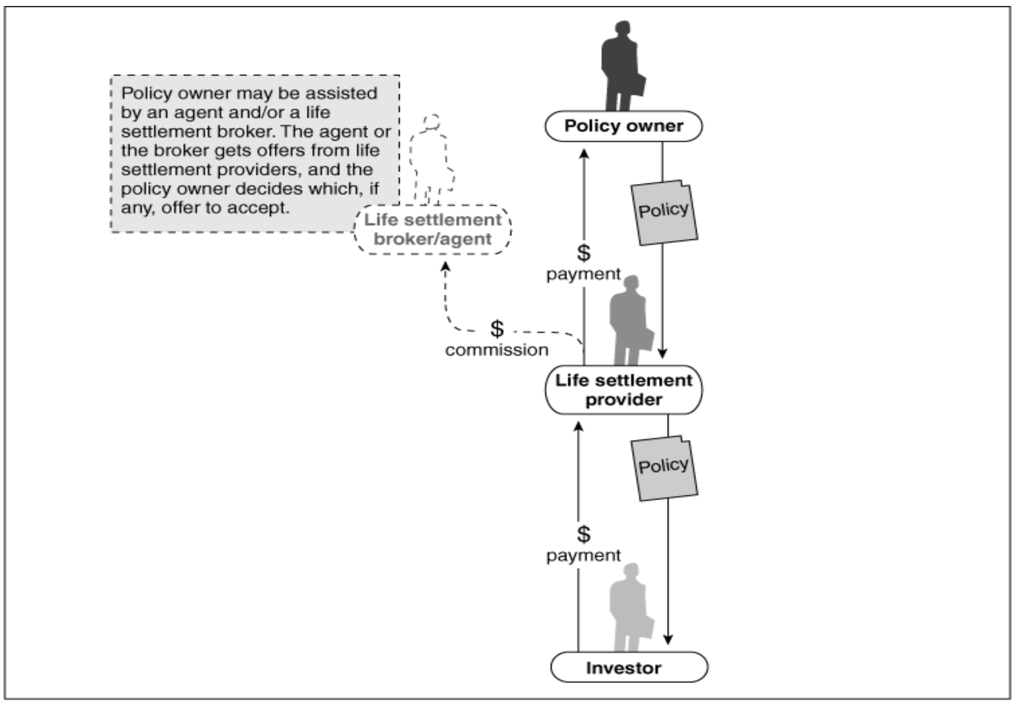
Life Settlement Market Organized Largely as an Informal Network of Specialized Intermediaries

Figure 1: Diagram of a Life Settlement Transaction and Its Participants



Source: GAO analysis of industry studies.

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Life Settlement Market Organized Largely as an Informal Network of Specialized Intermediaries

Agents typically are insurance agents who assist policy owners with their transactions for a fee or commission.

- Agents may help policy owners determine whether to sell their policies, complete a life settlement application, and hire a life settlement broker.
- Generally, in states that regulate life settlements, a life insurance agent licensed by the state may serve as a life settlement broker, subject to the duties and responsibilities imposed on such brokers, but does not have to register as one. In nonregulated states, an agent may not be subject to similar duties and requirements.
- In regulated states, financial planners, accountants, and attorneys retained and paid by the policy owner are not regulated as life settlement brokers.

Life settlement brokers negotiate the sale of a life insurance policy between the policy owner and buyer, namely a life settlement provider, for a fee or commission.

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Life Settlement Market Organized Largely as an Informal Network of Specialized Intermediaries

- Brokers represent policy owners, and policy owners can negotiate their broker's commission. State laws typically provide that regardless of the manner in which the broker is compensated, the broker owes a fiduciary duty to the policy owner.
- According to four providers we interviewed, commissions are negotiated between policy owners and their brokers, but providers pay brokers their commissions from the proceeds provided by investors. One provider said that this approach is similar to the way commissions are paid in real estate transactions.
- Broker services may include obtaining a life expectancy estimate on the insured, gathering required documents (such as medical forms), and soliciting offers for the policy from multiple providers with the goal of obtaining the best price for the policy.
- Based on our survey of state insurance regulators, we found that the number of licensed life settlement brokers varied considerably across the 29 states that imposed a licensing requirement on brokers and provided us with data on the number of their licensed brokers (see fig. 2).[2]

[2]We surveyed insurance regulators in all 50 states and the District of Columbia. Forty-five states and the District of Columbia completed our survey.

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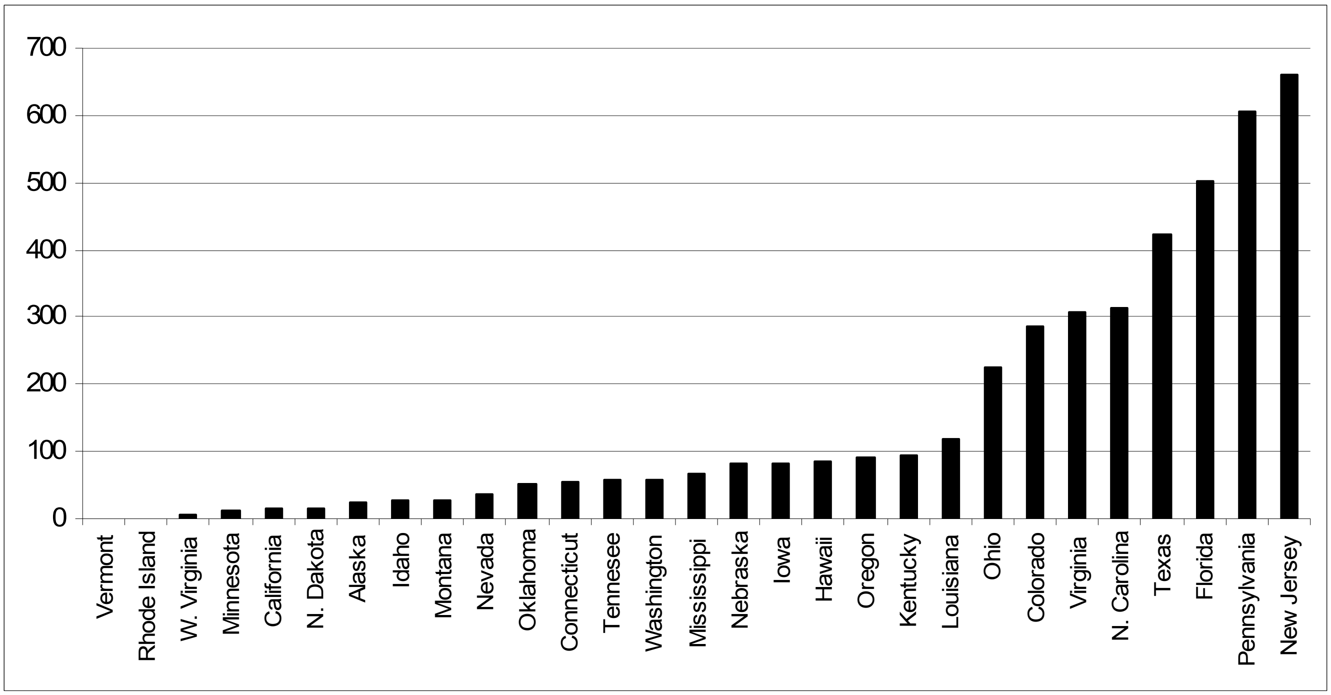
Life Settlement Market Organized Largely as an Informal Network of Specialized Intermediaries

Figure 2: Number of Licensed Life Settlement Brokers in States Responding to Our Survey



Source: GAO survey of state insurance regulators.

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Life Settlement Market Organized Largely as an Informal Network of Specialized Intermediaries

Life settlement providers purchase life insurance policies from policy owners, agents, or life settlement brokers on behalf of investors for a fee or commission or for their own account.

- Providers sell policies to investors.
- Provider activities may include ensuring that documents comply with applicable laws, representing investors in the bidding process, and servicing policies after transactions are completed.
- Based on our survey of state insurance regulators, we found that the number of licensed life settlement providers varied considerably across the 32 states that imposed a licensing requirement on providers and provided us with data on the number of their licensed providers (see fig. 3).

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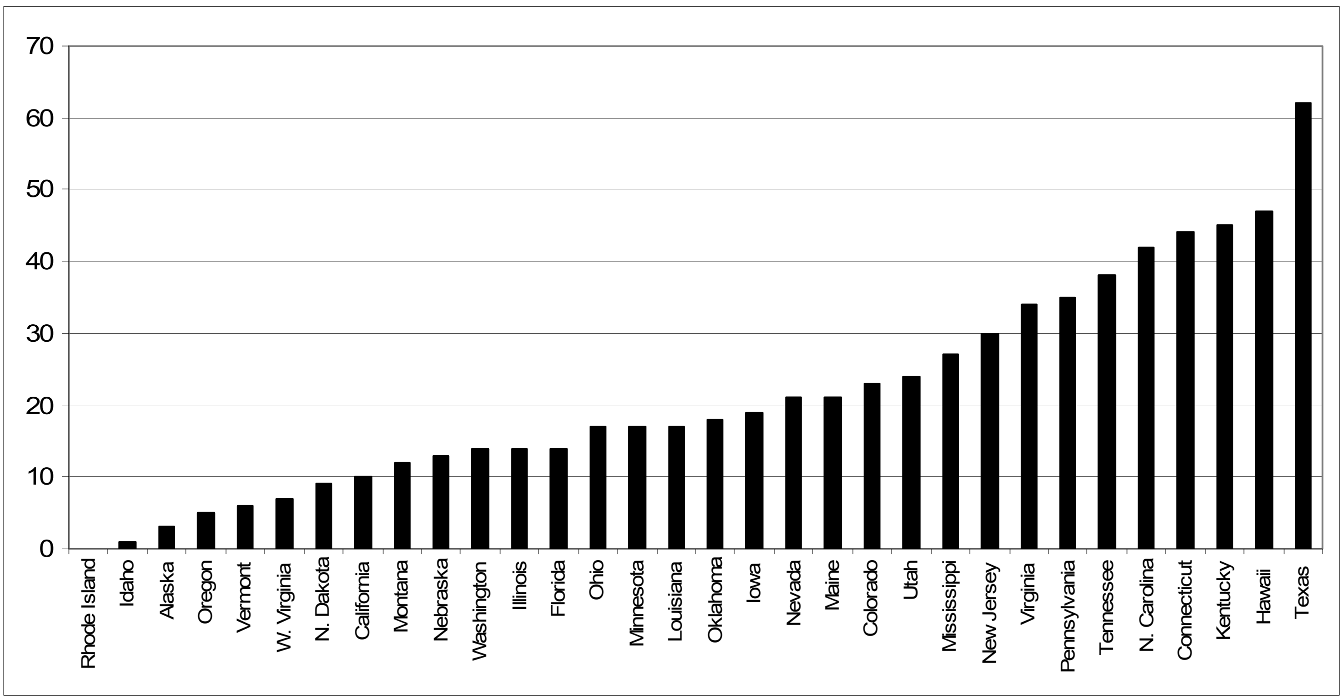
Life Settlement Market Organized Largely as an Informal Network of Specialized Intermediaries

Figure 3: Number of Licensed Life Settlement Providers in States Responding to Our Survey



Source: GAO survey of state insurance regulators.

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Life Settlement Market Organized Largely as an Informal Network of Specialized Intermediaries

Life settlement transactions also can involve other participants, such as life expectancy underwriters, life insurance companies, and escrow agents.

The life settlement market is organized largely as an informal network of specialized intermediaries that facilitate the sale of existing life insurance policies by their owners to investors.

- To sell their policies, owners or brokers typically solicit bids for the policies from providers.
  - The value of a policy depends on a range of factors, including the life expectancy of the insured and the policy's death benefit. Life settlement brokers can play a key role in settlement transactions by controlling which providers are permitted to bid on a policy.
  - Brokers establish working relationships with a number of providers and may have a process for reviewing and approving the providers with which they will do business. Likewise, providers may have a process for reviewing and approving brokers.
  - Brokers solicit bids on policies from one or more providers, in part depending on whether (1) the policy's parameters (for example, policy's face value and insured's life expectancy) match the specifications of the providers and (2) the providers are licensed, if required.
  - Providers value the policies and, if interested, bid on them.

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Life Settlement Market Organized Largely as an Informal Network of Specialized Intermediaries

- Some life settlement providers buy policies through other intermediaries, such as insurance agents, financial planners, or securities broker-dealers.
- Electronic trading platforms have been developed to help facilitate the buying and selling of life insurance policies. However, two brokers and three providers told us such platforms generally provide little cost savings and are not widely used.

No comprehensive life settlement data exist, but various estimates indicate that the market grew rapidly until the recent financial crisis.

- A securities research firm estimated that the total face value of policies settled in 1998, around the time life settlements emerged, was $0.2 billion.
- A provider and consulting firm separately estimated that the total face value of policies settled in 2008 was about $9 billion to $12 billion.
- Two brokers and three providers told us that the recent credit crisis generally has led to a reduction in investor demand for life settlements and an excess in supply of policies for sale in 2008 and 2009.

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Life Settlement Market Organized Largely as an Informal Network of Specialized Intermediaries

To compile data on the size of the life settlement market, we conducted a survey of 49 providers that were licensed in two or more states, and 25 providers responded to our survey.

- We identified 34 states that required providers to be licensed and obtained a list of providers licensed in each of these states (as of September 2009). Based on these lists, we identified 98 providers, of which 55 were licensed in two or more states. However, we were able to contact only 49 of these providers for our survey.

Because no comprehensive life settlement data exist, we were not able to estimate the share of the market held by 25 providers responding to our survey.

- Table 1 summarizes some of our survey results.

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Life Settlement Market Organized Largely as an Informal Network of Specialized Intermediaries

Table 1: Total Number of Policies Settled, Face Value of Policies Settled, Amount Paid to Policy Owners, and Commissions Paid to Brokers for 2006 – 2009

Year	Total number of policies settled	Total face value of policies settled (in billions)	Total amount paid to policy owners (in billions)	Total commissions paid to brokers (in billions)
2006	3,148	$5.50	$1.17	$0.20
2007	3,703	$9.03	$1.80	$0.26
2008	4,505	$12.95	$2.32	$0.28
2009	2,636	$7.01	$0.89	$0.09

Source: GAO survey of life settlement providers.

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Life Settlement Market Organized Largely as an Informal Network of Specialized Intermediaries

Various data indicate that life settlements traditionally have involved high-face-value policies insuring older Americans.

- Based on a sample of 1,020 policies settled in 2008, Life Policy Dynamics, a consulting firm, found that the average face value per policy was nearly $2.3 million and the average age of the insured male and female were 76.8 years and 81.1 years, respectively.
- Based on a sample of 3,138 policies settled in 2006, LISA reported that the average face value per policy was nearly $2.1 million.
- Based on our review of 29 provider Web sites, we found these providers were interested in buying policies with the following parameters:
  - Minimum age of the insured ranged from 60 to 70 years old,
  - Minimum face value of the policy ranged from $25,000 to $1 million,
  - Maximum face value of the policy ranged from $5 million to $100 million,
  - Minimum life expectancy ranged from 2 to 4 years,
  - Maximum life expectancy ranged from 10 to 21 years, and
  - Types of life insurance policies included universal, whole, convertible term, and variable policies.

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Life Settlement Market Organized Largely as an Informal Network of Specialized Intermediaries

Individuals and financial institutions, including banks, hedge funds, and life insurance companies, have invested in life settlements through several different products or instruments.

- Investors may chose life settlements to diversify their portfolios (viewing life settlement returns as not being correlated with returns on equities and other traditional investments) or for other purposes.
- However, returns on life settlements depend on when the insured persons die, which cannot be predicted precisely. If the insured persons live longer than estimated, investors may pay more than expected in policy premiums—reducing their return.

Products or instruments through which investors can invest in life settlements include individual policies; portfolios of individual policies; fractionalized interests in individual policies; and interests in pools of policies, such as life settlement funds and asset-backed securities.

- Institutional investors tend to buy individual policies or portfolios of policies, and individual investors tend to buy fractionalized interests in individual policies or interests in pools of policies.

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Objective 2:
State and Federal Regulators Oversee Various Aspects of the Life Settlement Market

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State and Federal Regulators Oversee Various Aspects of the Life Settlement Market

Life settlements typically comprise two transactions: (1) the sale of a policy by the owner to a provider, which itself is the life settlement contract, and (2) the sale of the policy or an interest in the policy or its proceeds by providers to investors.

- The majority of states regulate the first transaction, called the front-end transaction, under their insurance laws. However, in at least one circumstance, when the life settlement involves the sale of a variable life insurance policy, the front-end transaction also is regulated under the federal securities laws.
- The second transaction, called the back-end transaction, is regulated under state securities laws and, in certain circumstances, federal securities laws.

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State and Federal Regulators Oversee Various Aspects of the Life Settlement Market

To protect policy owners involved in life settlements, NAIC and NCOIL have developed model acts to help states craft legislation to regulate viatical and life settlements.

- In 1993, following the emergence of viatical settlements, NAIC developed the Viatical Settlements Model Act. Viatical settlements did not precisely fit within the definition of insurance activity on which regulators usually focused, but insurance consumers were being harmed in these transactions, leading state insurance regulators to develop a model act.
- In 2000, following the emergence of life settlements, NCOIL developed the Life Settlements Model Act and revised the act in 2004 to address the growing life settlement market.
- In 2001, NAIC extensively revised its model act and expanded the act's definition of viatical settlement to include life settlements.

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State and Federal Regulators Oversee Various Aspects of the Life Settlement Market

In 2007, following the emergence of stranger-originated life insurance (STOLI), NAIC and NCOIL revised their model acts to prohibit, in effect, life settlements involving STOLI policies.

- STOLI generally is the origination of a life insurance policy for the benefit of a person who has no insurable interest in the insured when the policy is issued. Such arrangements attempt to circumvent state insurable interest laws—under which many states require a person to be related by blood or law, have an interest engendered by affection, or have an economic interest in the continued life of the insured.
- According to life insurance officials and others, STOLI emerged around 2003, when the supply of existing life insurance policies eligible for life settlements could not meet investor demand for such policies.
- Unlike life settlements, STOLI involves the issuance of a new policy without an insurable interest, but STOLI policies subsequently can be sold and, thus, become life settlements.

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State and Federal Regulators Oversee Various Aspects of the Life Settlement Market

Over time, the majority of states have enacted laws or modified existing regulations to regulate life settlements under their insurance laws and regulations—many of which were based on a version of the NAIC model act, a version of the NCOIL model act, or a combination of both.

- As of February 2010, 38 states have enacted insurance laws or regulations to regulate life settlements, and 12 states and the District of Columbia have not.
- State insurance laws and regulations covering life settlements focus primarily on protecting policy owners by regulating activities and professionals involving the sale of a policy by its owner to a provider (front-end transaction).
- State life settlement laws and regulations generally (1) require licensing of providers and brokers; (2) require filing and approval of settlement contract forms and disclosure statements; (3) describe the content of disclosures that must be made by brokers and providers; (4) impose periodic reporting requirements on providers; (5) prohibit certain business practices deemed to be unfair; and (6) provide insurance regulators with examination and enforcement authority.

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State and Federal Regulators Oversee Various Aspects of the Life Settlement Market

Although state insurance laws regulating life settlements generally share the same basic elements, differences exist between state laws. Based on the 34 states that responded to our survey and reported regulating life settlements, some of the differences between their life settlement laws or regulations include the following (see tables 2 through 7).[3]

Table 2: Licensing and Bond Requirements

	Yes	No
Does your state require the policy owner's broker to be licensed?	33	1
Does your state require the policy owner's provider to be licensed?	33	1
Does your state require the policy owner's broker to complete continuing education requirements related to life settlements on a periodic basis?	16	17
Does your state impose a fiduciary duty on brokers to their clients?	31	2
Does your state require the policy owner's broker to demonstrate evidence of its financial responsibility through a surety bond or similar means?	11	21

Source: GAO survey of state insurance regulators.

[3]Although 34 states responded that they have life settlement laws, the responses to each survey question did not always total to 34 responses. For example, one state does not require brokers or providers to be licensed. For some questions, states responded “don’t know” or “not applicable” instead of “yes” or “no.”

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State and Federal Regulators Oversee Various Aspects of the Life Settlement Market

Table 3: Reporting Requirements

	Yes	No
Does your state require providers to submit data periodically on settlement transactions executed within your state?	31	3
Does your state require providers to submit data periodically on settlement transactions executed outside of your state?	15	19
Does your state require providers to submit data periodically on enforcement actions in which they are involved within or outside of your state?	22	12

Source: GAO survey of state insurance regulators.

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State and Federal Regulators Oversee Various Aspects of the Life Settlement Market

Table 4: Disclosure Requirements

	Yes	No
Does your state require brokers to provide policy owners with a written disclosure of the risks associated with a life settlement?	32	2
Does your state require brokers to provide policy owners with a written disclosure of the risks associated with a life settlement at the time of application or at least when the application is signed?	26	6
Does your state require brokers to disclose to policy owners the amount of their compensation in writing?	22	10
Does your state require brokers to disclose to policy owners the method for calculating their compensation in writing?	19	13
Does your state require providers to disclose to policy owners the amount of the broker's compensation in writing?	21	13
Does your state require providers to disclose to policy owners the method for calculating the broker's compensation in writing?	19	15

Source: GAO survey of state insurance regulators.

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State and Federal Regulators Oversee Various Aspects of the Life Settlement Market

Table 5: Disclosure Requirements (Continued)

	Yes	No
Does your state require brokers to disclose to policy owners all offers, counter-offers, acceptances, and rejections relating to a proposed life settlement contract?	20	12
Does your state require brokers to disclose any affiliation between the broker and the person making an offer for the life settlement contract?	23	9
Does your state require brokers or providers to disclose that brokers owe the policy owners a fiduciary duty?	22	11
Does your state require brokers or providers to disclose that the proceeds for a life settlement may be taxable?	33	0
Does your state require brokers or providers to disclose that a life settlement can affect the insured's ability to purchase life insurance in the future?	19	14

Source: GAO survey of state insurance regulators.

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State and Federal Regulators Oversee Various Aspects of the Life Settlement Market

Table 6: Approval of Disclosure Statements

	Yes	No
Does your state require brokers to have their disclosure statements (provided to policy owners) approved by an appropriate regulator?	30	4
Does your state require providers to have their disclosure statements (provided to policy owners) approved by an appropriate regulator?	33	1

Source: GAO survey of state insurance regulators.

Table 7: Other Requirements and Rules

	Yes	No
Does your state require marketing materials by entities soliciting potential policy owners for life settlements to be approved by an appropriate regulator?	14	20
Does your state prohibit brokers from conducting sales with any provider, financing, entity, or related provider trust, that is controlling, controlled by, or under common control with such broker?	15	19

Source: GAO survey of state insurance regulators.

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State and Federal Regulators Oversee Various Aspects of the Life Settlement Market

In addition to state insurance regulators, state securities regulators and, in certain circumstances, SEC oversee investments in life settlements under their securities laws to protect investors.

- Sales of variable life insurance policies—in both the front- and back-end transactions—are securities transactions under the federal securities laws.
  - Variable life insurance policies build cash value through the investment of premiums into separate investment options and offer an income tax-free death benefit to the beneficiaries. The cash value and death benefit vary based on the performance of the underlying investment choices. These policies are similar to traditional, or nonvariable, life insurance, except that the policy owners have investment choices in connection with the underlying assets.
  - Because policy owners assume investment risk under their variable policies, these policies are securities. As a result, life settlements and related investments involving variable policies are securities transactions subject to SEC jurisdiction.

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State and Federal Regulators Oversee Various Aspects of the Life Settlement Market

Investments in nonvariable life policies do not expressly fall under the definition of a security but still can be subject to securities laws.

- As noted above, investors can invest in life settlements by buying individual policies, a portfolio of policies, fractionalized interests in individual policies, or interests in a pool of policies. These policies can include variable or nonvariable insurance policies.
- Under the federal securities laws, the statutory definition of a security does not expressly include life settlement investments but does include the term "investment contract." In *SEC v. W.J. Howey Co.*, the Supreme Court held that an investment contract is a security if the investors expect profits from a common enterprise that depends upon the efforts of others.[4] This definition is used to determine whether an instrument is an investment contract (called the investment contract test).
- Providers or other third parties may seek to structure investments in life settlements in a way that makes them fall outside the definition of an investment contact and, thus, not subject to the federal securities laws.

[4]See *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946).

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State and Federal Regulators Oversee Various Aspects of the Life Settlement Market

Applying the investment contract test, SEC has asserted that certain life settlement investments involving nonvariable insurance policies are investment contracts and, thus, subject to its jurisdiction, but the federal courts have not reached a uniform decision on this issue.

- In *SEC v. Life Partners*, SEC brought an enforcement action against a provider for selling fractionalized interests in viatical settlements without registering them as securities.[5] In 1996, the D.C. Circuit Court concluded that the interests were not investment contracts and, thus, not subject to the federal securities laws.
- In *SEC v. Mutual Benefits Corp.*, SEC brought an enforcement action against a provider for fraud in connection with its sale of fractionalized interests in viatical settlements.[6] In 2005, the Eleventh Circuit found the interests were investment contracts and subject to the federal securities laws.
- The federal courts have not addressed whether the sale of an individual nonvariable policy by a provider to an investor is a security under the federal securities laws.

[5]See *SEC v. Life Partners, Inc.,* 87 F.3d 536 (D.C. Cir. 1996).
[6]See *SEC v. Mutual Benefits Corp.*, 408 F.3d 737 (11th Cir. 2005).

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State and Federal Regulators Oversee Various Aspects of the Life Settlement Market

Life settlement investments that are securities under the federal securities laws must be registered, unless they qualify for an exemption. Moreover, entities selling these investments must be registered as securities broker-dealers and are subject to FINRA's sales practice rules (discussed below).

SEC and FINRA have used various tools to monitor life settlements and related investments.

- FINRA has issued various notices, reviewed applications by broker-dealers to add life settlements to their business activities, and examined broker-dealers involved in life settlements.
- SEC has taken enforcement actions to protect investors.
- SEC recently formed a life settlement task force to examine emerging issues in the life settlement market and advise SEC on whether market practices and regulatory oversight can be improved. According to SEC staff, the task force may issue a public report based on its work and, if warranted, include recommendations.

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State and Federal Regulators Oversee Various Aspects of the Life Settlement Market

According to NASAA and our own independent research, all but two states regulate investments in life settlements under their state securities laws.

- Because of the Life Partners decision, NASAA issued guidelines in 2002 for states to regulate viatical investments under their securities laws.
- NASAA noted that state securities regulators were not bound by the decision and took the position that investments in viatical settlements, broadly defined to include life settlements, were securities.
- Under NASAA's guidelines, a viatical investment is defined as the right to receive any portion of the death benefit or ownership of a life insurance policy for consideration that is less than the death benefit. The guidelines exclude sales of policies by their owners to providers from the definition.

Thirty-five states have statutes defining a "security" or "investment contract" to expressly include investments in life settlements under their securities laws. These states generally exempt from the definition sales of policies by their owners to providers.

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State and Federal Regulators Oversee Various Aspects of the Life Settlement Market

Thirteen other states and the District of Columbia, like SEC, apply the investment contract test to life settlement investments to determine whether these investments fall within the definition of a security and are subject to their securities laws.

- The majority of state authorities applying the investment contract test have found that their states' securities laws include viatical or life settlement investments.
- In a 2004 decision (*Griffitts v. Life Partners, Inc.*), the Texas Court of Appeals concluded that viatical settlements are not securities under the Texas securities law and instead fall within the law's exception for insurance products.[7]

Investments in life settlements that are subject to state securities laws must be registered, and entities or persons selling these investments must be registered.

[7]See *Griffitts v. Life Partners, Inc.,* 2004 Tex. App. LEXIS 4844 (Tex. Ct. App. May 26, 2004).

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Objective 3:
Regulatory Inconsistencies May Present Challenges for Policy Owners, Investors, and Life Settlement Intermediaries

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Regulatory Inconsistencies May Present Challenges for Policy Owners, Investors, and Life Settlement Intermediaries

Policy owners may face challenges obtaining adequate information about their life settlement transactions.

Although life settlements can provide policy owners with a valuable option, policy owners can face challenges with these transactions, such as

- assessing whether a life settlement is suitable or the best option for them;
- knowing whether they are being offered a fair price for their policy, because little information about the market value of policies is publicly available;
- understanding the potential risks or implications associated with life settlements, including that the proceeds may be taxable or the transaction could limit their ability to obtain insurance in the future; or
- protecting themselves from potential abuse, such as excessive broker commissions.

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Regulatory Inconsistencies May Present Challenges for Policy Owners, Investors, and Life Settlement Intermediaries

Regulators and others have raised concerns about the potential for policy owners to be subject to abuse in life settlements.

- The New York Attorney General and Florida Office of Insurance Regulation separately took action against a provider for allegedly working with brokers to manipulate the bidding process and not disclosing commissions paid to the brokers. The provider settled both cases without any admission of liability or violation of any laws or regulations.
- SEC and FINRA have expressed concern about high broker commissions. Moreover, FINRA has examined six broker-dealers believed to be engaged in life settlements and found problematic practices, primarily with regard to commissions, at two firms.
- Some industry observers and participants have commented that one of the significant risks faced by consumers is not being adequately advised about whether they should sell their life insurance or pursue another option.
- Some industry participants identified excessive commissions and not obtaining bids from multiple buyers as bad practices.

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Regulatory Inconsistencies May Present Challenges for Policy Owners, Investors, and Life Settlement Intermediaries

Based on the data provided by the 25 providers responding to our survey, we found that broker commissions appear to have declined in the past 4 years. Specifically, the share of the total gross proceeds (or amount paid for the policies) received by brokers declined from around 15 percent in 2006 to around 9 percent in 2009.

In our survey of state insurance regulators, 26 states reported that they track consumer complaints about life settlements, but such complaints have been limited in number.

- Of the 26 states, 22 of them provided us with the number of complaints they received about life settlements in 2007, 2008, and 2009.
- Fourteen states reported that they did not receive any complaints during the 3 years.
- Eight states reported receiving a total of 35, 47, and 36 complaints in 2007, 2008, and 2009, respectively. Figure 4 shows the complaints received by these states.

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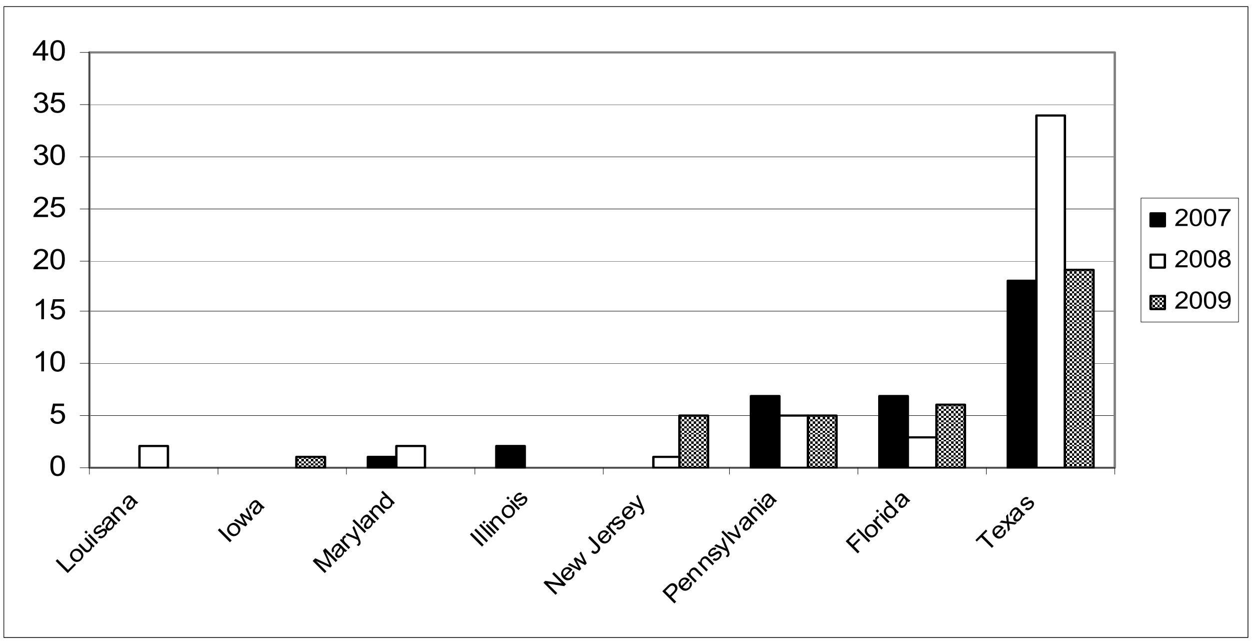
Regulatory Inconsistencies May Present Challenges for Policy Owners, Investors, and Life Settlement Intermediaries

Figure 4: Life Settlement-Related Complaints Received by States in 2007, 2008, and 2009 Based on Survey Responses



Source: GAO survey of state insurance regulators.

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Regulatory Inconsistencies May Present Challenges for Policy Owners, Investors, and Life Settlement Intermediaries

Thirty-eight states (regulated states) have enacted life settlement laws and regulations to protect policy owners, but 12 states and the District of Columbia have not (unregulated states). As discussed above, regulatory protections provided by some regulated states to policy owners include requiring

- brokers and providers to be licensed;
- brokers to owe their clients a fiduciary duty;
- brokers or providers to disclose in writing the risks associated with a life settlement;
- brokers or providers to disclose in writing the amount of broker compensation; and
- brokers to disclose in writing all offers, counter-offers, acceptances, and rejections relating to a proposed life settlement contract.

Based on our survey of state insurance regulators, 34 regulators reported that they have the authority to examine licensed brokers, and 33 regulators reported that they have the authority to examine licensed providers. However, these regulators generally have examined a limited number of their licensed brokers and providers (see fig. 5).[8]

[8]Although 34 and 33 states reported providing their regulators with the authority to examine brokers and providers, respectively, not all of them provided us with data about the examinations they have conducted.

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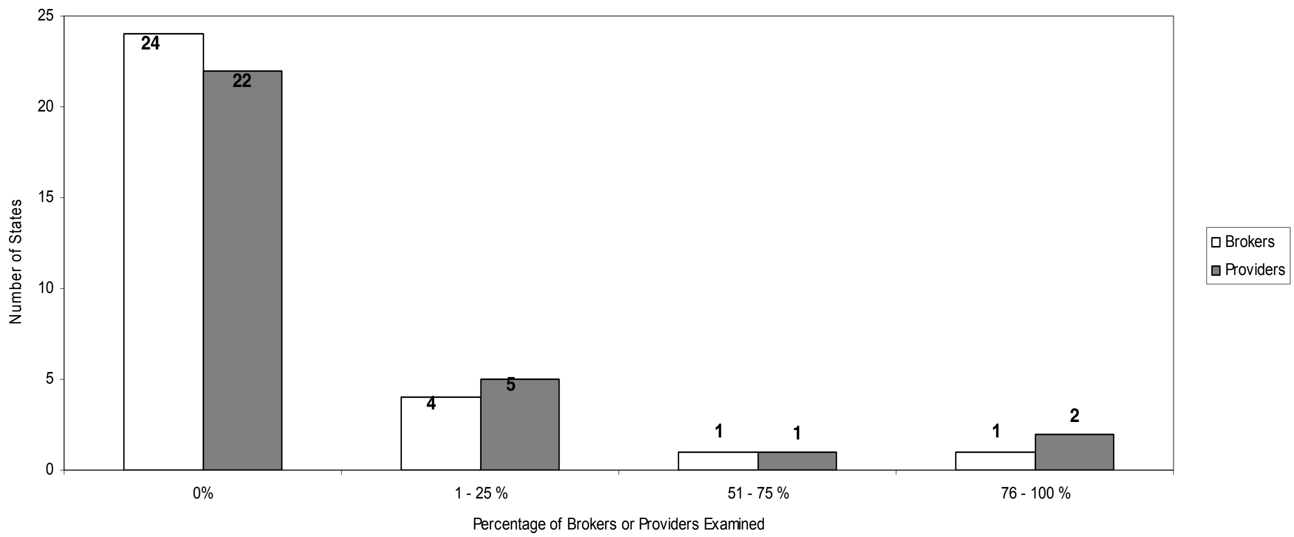
Regulatory Inconsistencies May Present Challenges for Policy Owners, Investors, and Life Settlement Intermediaries

Figure 5: Percentage of Brokers and Providers Licensed in a State That Were Examined by the State's Regulator in the Past 5 Years



Source: GAO survey of state insurance regulators.

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In addition to state life settlement laws, FINRA imposes sales practice requirements on securities broker-dealers or their representatives recommending or facilitating life settlement transactions involving variable life policies.

- Suitability: FINRA requires firms to have a reasonable basis for believing that the transaction is suitable for the customer. It has noted that a variable life settlement is not necessarily suitable for a customer simply because the settlement price offer exceeds the policy's cash surrender value.
- Due diligence: FINRA requires firms to understand the confidentiality policies of providers and brokers and the ongoing obligations that customers will incur.
- Best execution: FINRA requires firms to use reasonable diligence to ascertain the best market for a security and obtain the most favorable price possible. FINRA notes that firms should make reasonable efforts to obtain bids from multiple providers, either directly or through a broker.
- Supervision: FINRA requires firms to establish an appropriate supervisory system to ensure that their employees comply with all applicable rules.
- Commissions: FINRA prohibits firms from charging customers more than a fair and reasonable commission in any securities transaction.

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- Policy owners in some states may be afforded less protection than policy owners in other states due to regulatory inconsistencies and, thus, face greater challenges obtaining information needed to protect their interests.
  - Policy owners can ask brokers or providers for information they need to protect their interests. Nonetheless, as recognized by NAIC's and NCOIL's adoption of model acts and, in turn, some states' adoption of life settlement laws, some policy owners may not do so because they might not know to ask for such information or for other reasons. Likewise, some brokers or providers may not provide policy owners with certain information unless asked or required.
  - Policy owners could complete a life settlement without being informed about risks or implications of such a transaction. Many brokers disclose potential implications to policy owners in their application forms, but some do not in unregulated states and regulated states that have not imposed the requirement. Some providers buy policies directly from owners but do not include disclosures in their application forms. Brokers or providers may voluntarily disclose such information later in the process (e.g., as part of the closing documents) but are not required to do so in all states.

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Policy owners could complete a life settlement without knowing how much they paid their brokers or whether their brokers solicited bids from multiple providers.

- Institutional investors formed ILMA, in part to promote transparency about broker commissions and bids received by brokers. Since 2008, ILMA members have required their providers to disclose broker commissions. ILMA officials told us that about half the settlement transactions are completed with the level of disclosure required by ILMA.
- Three providers told us that some brokers have not solicited bids from providers because those providers disclose commissions, and some policy owners have renegotiated commissions once disclosed. One provider told us that it does not disclose broker commissions in unregulated states, unless asked, to avoid being disadvantaged.
- Brokers may voluntarily disclose information about their commissions or bids received from providers but are not required to do so in unregulated states and regulated states that have not imposed the requirement.

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Policy owners selling variable life insurance may be afforded greater protection in terms of suitability than policy owners selling nonvariable policies.

- Regulated states generally hold brokers to a fiduciary duty to policy owners, but do not specifically impose a suitability requirement. In contrast, FINRA specifically imposes a suitability requirement on securities broker-dealers with respect to variable life settlements. SEC also has broad antifraud authority over these transactions.
- According to an attorney who specializes in nonvariable life settlements, few brokers perform a suitability analysis, but the attorney said such analysis should be required. Similarly, a broker told us the lack of a suitability requirement for brokers should be addressed.
- According to a life settlement provider, life settlements generally have involved policies owned by high-net-worth individuals, who are financially sophisticated and able to protect their own interest.

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Some market participants we spoke to have called for a federal role in the laws regulating life settlements to protect policy owners.

- According to a provider, federal law should set minimum standards for state regulation of life settlements, and the proposed Consumer Financial Protection Agency should supervise life settlement activity in those states that do not provide the minimum level of regulation.
- Three providers told us that federal regulation of life settlements would promote greater uniformity, but this approach also has potential negatives. For example, one provider told us that it is not clear that a federal regulatory agency would be better than the states in enforcing the standards and protecting consumers.

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Regulatory Inconsistencies May Present Challenges for Policy Owners, Investors, and Life Settlement Intermediaries

Over the years, we have made a number of recommendations to encourage state regulators to implement a consistent set of insurance regulations.[9]

We also recently developed a framework comprised of nine elements to help Congress and others evaluate proposals for financial regulatory reform.

- One of these elements is consistent consumer and investor protection: market participants should receive consistent, useful information, as well as legal protections for similar financial products and services, including disclosures, sales practice standards, and suitability requirements.
- Given the difficulties of harmonizing insurance regulation across states through the NAIC-based structure, we reported that Congress could consider the advantages and disadvantages of providing a federal charter option for insurance and creating a federal insurance regulatory entity.[10]

[9]See, for example, GAO, *Insurance Reciprocity and Uniformity: NAIC and State Regulators Have Made Progress in Producer Licensing, Product Approval, and Market Conduct Regulation, but Challenges Remain*, GAO-09-372 (Washington, D.C.: Apr. 6, 2009).

[10]See GAO, *Financial Regulation: A Framework for Crafting and Assessing Proposals to Modernize the Outdated U.S. Financial Regulatory System,* GAO-09-216 (Jan. 8, 2009).

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Regulatory Inconsistencies May Present Challenges for Policy Owners, Investors, and Life Settlement Intermediaries

Individual investors may face challenges obtaining adequate information about investments in life settlements.

Life settlement investments raise a number of risks for investors. Some of these risks include the following.

- Longevity risk: Persons whose lives are insured in life settlements may live significantly longer than expected because of medical advances or other factors. In this case, investors would have to pay more policy premiums than expected, resulting in lower returns than expected.
- Life expectancy underwriting risk: Medical underwriters use different methodologies to estimate the life expectancies of the insured persons. If a an underwriter underestimated the life expectancies of the insured persons, the effect for investors generally would be the same as under longevity risk.
- Legal risk: Life insurance companies could contest the policy and refuse to pay the death benefit because of a lack of insurable interest. If a company was successful, the investor would suffer a loss on the policy.
- Liquidity risk: Investors may need to liquidate their investment but may not be able to do so in a timely manner. If they could not continue to pay policy premiums to keep the policies in force, they may have to let the policies lapse.

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Regulators also have raised concerns about the risks associated with life settlement investments.

- In a 2009 speech, the SEC Chairman commented that investors may not have a complete understanding of the investment risks associated with a life settlement, including the risks related to the health and life expectancy of the insured.
- In a 2009 release, FINRA expressed concern about retail investors who purchase these life settlement products because they may not fully understand the risks of such investments.
- In 2009, NASAA included life settlements in its list of top investment traps.

According to SEC staff, the agency received 54 complaints regarding viatical or life settlements between July 2007 and January 2010.

- Thirty-seven complaints involved two providers for failing to pay investors and other abuses.
- Seventeen complaints alleged misrepresentation, lack of suitability, theft of funds, and other abuses.

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State and federal securities regulators have taken various actions to protect investors investing in life settlements and related investments.

- Nearly all states have brought life settlement investments under their securities laws.
- According to NASAA, state securities regulators have taken enforcement actions against providers for selling unregistered investments and committing fraud and abuse against individual investors. The types of targeted abuses have included life settlement entities:
  - Deliberately selling nonexistent policies and keeping the investment proceeds (e.g., Ponzi schemes),
  - Misrepresenting the medical condition of the policy owners, and
  - Making unsupportable claims about the performance of the investment or failing to adequately disclose information about the risks to prospective investors.
- Since 1994, SEC has brought 19 enforcement cases related to the sale of viatical and life settlement investments. These include actions against providers for making misrepresentations to investors and actions against funds for operating Ponzi schemes involving viatical settlements.

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Some individual investors may face challenges obtaining sufficient information about life settlement investments because of the potential for such investments not to be subject to state or federal securities laws.

- Because of a split between two federal circuit court decisions, a lack of uniformity exists as to whether investments in life settlements on nonvariable policies are securities, creating a potential obstacle for SEC and state securities regulators to protect investors. For example, two state securities regulators told us that they often are confronted with defenses based on the D.C. Circuit Court's *Life Partners* decision when trying to establish jurisdiction over life settlement investments in enforcement actions.
- A Texas state court has found certain life settlement products sold by a provider not to be securities, but a Colorado state court has found the same products to be securities. As a result, investors investing in the same product could be provided different protections and, in turn, different disclosures about the product.
- In 2002, LSI testified and more recently NASAA and a life settlement provider told us that the federal securities laws should be amended to deem life settlement investments as securities in light of the D.C. Circuit Court's Life Partners decision.

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Regulatory Inconsistencies May Present Challenges for Policy Owners, Investors, and Life Settlement Intermediaries

Some life settlement brokers and providers may face challenges because of inconsistencies in the life settlement laws or regulations across states.

Brokers and providers generally told us that keeping abreast of the ongoing changes in life settlement laws and regulations across the different states and complying with these laws and regulations is challenging.

- Some states began regulating life settlements in the early 2000s but changes are ongoing. For example, California, Illinois, and New York recently modified their laws and regulations to enhance their oversight of life settlements.
- Following the NAIC's and NCOIL's amendment of their model acts in 2007 to address STOLI, numerous states have amended their life settlement laws and regulations.
- Two providers told us that they spend significant resources tracking changes being made by states to their life settlement laws and regulations.

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Two brokers and four providers told us that differences in regulatory requirements among or between states are burdensome to them or increase their compliance costs.

- Entities operating in multiple states may need to (1) maintain different application, disclosure, and other forms for different states, (2) obtain approval for such forms from different regulators, and (3) file different data in different states, for example in annual reports.
- According to ACLI and industry observers, life insurance companies in the broader insurance market can face similar challenges that life settlement market participants face in obtaining licenses, reporting information, and obtaining approvals for their products and forms in 51 different jurisdictions, and that this increases costs and hampers competition.

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Brokers and providers told us that some states have adopted laws or regulations that impede their ability to do business in those states. With fewer brokers or providers available to solicit or make bids, policy owners could receive lower offers, according to market participants.

- Three brokers and one provider told us that some states require brokers to obtain surety bonds to be licensed, but such bonds can be costly or may not be available. One broker told us that this requirement is unnecessary, because brokers do not handle customer funds. Some regulators have recognized that the requirement might be difficult to comply with but consider it important to protect policy owners.
- Two brokers told us that one state limits broker commissions to 2 percent of the gross proceeds, which is too low given their costs. According to our survey of state insurance regulators, no brokers are licensed in that state.
- Two providers told us that they do not do business in certain states because it is too difficult to comply with their regulations.

ILMA, two providers, and a bank involved in life settlements said that they support greater uniformity in the laws regulating life settlements, in part to lower transaction costs or increase operational efficiencies.

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Regulatory Inconsistencies May Present Challenges for Policy Owners, Investors, and Life Settlement Intermediaries

STOLI may pose challenges for life insurers, as well as for policy owners and investors, despite various efforts to prevent STOLI.

No universally accepted definition of STOLI exists, but the term generally refers to 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.

- According to ACLI, states require the buyer of insurance on the life of another person to have an insurable interest in the life of that person. Despite this requirement, some individuals have been induced to purchase life insurance for the benefit of investors (called STOLI).
- Although STOLI involves the origination of new policies, STOLI policies can be sold by their owners to providers or investors and, thus, become life settlements.
- No reliable data exist to measure STOLI, but various industry observers and participants told us that STOLI grew rapidly from around 2003 to 2008.

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Regulatory Inconsistencies May Present Challenges for Policy Owners, Investors, and Life Settlement Intermediaries

STOLI can pose risks to policy owners, life insurance companies, and investors, including the following risks.

- Policy owners participating in STOLI can face a number of risks, including incurring taxes on income generated from the transaction, becoming involved in disputes about the validity of the policy, being unable to purchase additional life insurance (because insurers sometimes will not offer coverage to individuals with total outstanding coverage above certain limits), and facing potential legal liability from the transaction. Some of these risks are similar to the risks raised in a life settlement transaction.
- According to ACLI and insurers we interviewed, life insurance companies may suffer damage to their reputation from STOLI and losses on STOLI policies, and they could incur costs in deterring, detecting, or litigating STOLI policies.
- Investors investing in life settlements involving STOLI policies face the risk that such policies could be rescinded for violation of the insurable interest laws or fraud.

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STOLI generally is prohibited under insurable interest laws, but approximately half of states have enacted additional laws or regulations specifically prohibiting STOLI transactions.

- In 2007, NAIC and NCOIL modified their model acts to include provisions to address STOLI, but the acts take different approaches.
  - NAIC imposes a 5-year moratorium on the settlement of policies with STOLI characteristics, subject to some exceptions.
  - NCOIL defines STOLI and prohibits such transactions.
  - LISA generally supports NCOIL's approach, because it does not interfere with the property rights of policy owners.
  - Various insurance associations support using NAIC's approach as the basis for state legislation but also including aspects of NCOIL's approach.
- Based on responses to our survey of state insurance regulators, 26 states have laws that include specific provisions to deter or prohibit STOLI. Of these states, 20 explicitly have defined STOLI transactions and prohibited such transactions.

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Regulatory Inconsistencies May Present Challenges for Policy Owners, Investors, and Life Settlement Intermediaries

Life insurers and others also have taken action to detect or prevent STOLI, and they and others have indicated that STOLI appears to have decreased due to various factors.

- Some life insurance companies have sought to prevent STOLI by (1) tightening underwriting standards and developing screening procedures to identify potential STOLI; (2) disciplining or terminating business arrangements with agents selling STOLI policies; (3) and initiating legal actions to rescind STOLI policies.
- According to life insurers, brokers, and providers, several factors have reduced STOLI—including the recent credit crisis, which reduced investor demand for life settlements and the availability of credit to finance STOLI; efforts taken by life insurers to detect STOLI and prevent the issuance of such policies; and the increase in life expectancy estimates by several life expectancy underwriters, which reduced investor demand for life settlements involving STOLI policies.

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Life insurance companies may continue to face challenges in detecting and preventing STOLI.

- Two life insurers and ACLI told us that STOLI promoters are continuing to develop new ways to evade efforts to detect or prevent the issuance of STOLI, such as by using trusts.
- Two life insurers told us that separating life settlements that involve STOLI policies from life settlements that involve legitimate life insurance policies is difficult because of the difficulty in distinguishing which policies are STOLI policies.
- The courts recently have found that a person may legitimately buy a policy while planning to sell it, as long as no agreement exists to sell the policy to a third party when the policy is purchased.
- ACLI supports banning the securitization of life settlements, because securitization would encourage promoters to elicit STOLI, but ILMA, LISA, and others disagree.

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Regulatory Inconsistencies May Present Challenges for Policy Owners, Investors, and Life Settlement Intermediaries

Based on our survey of licensed providers, the number of policies settled within 2 years of their issuance has declined and the number of policies settled within 2 to 5 years of their issuance generally has increased (see table 8).

Table 8: Time between the Issuance and Settlement of Policies for 2006 – 2009

Time between the issuance and settlement of a policy	2006	2007	2008	2009
Less than 2 years	37	21	10	3
2 to 5 years	844	1,366	1,790	780
Greater than 5 years	880	1,296	1,301	609
Total[11]	1,761	2,683	3,101	1,392

Source: GAO survey of life settlement providers.

[11]The total policies settled do not match the total policies settled shown in table 1, because not all providers provided us with data on the age of their settled policies.

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Conclusions

Because life settlements and related investments can have characteristics of both insurance and securities, their regulatory structure involves multiple state and federal regulators.

- State insurance regulators have played a primary role in protecting policy owners by regulating the sale of in-force policies by their owners to life settlement providers.
- In turn, state and federal securities regulators have played the primary role in protecting investors by regulating the sale of life settlement investments.

We recently developed a framework for assessing proposals for modernizing the financial regulatory system.

- One of the elements of that framework is consistent consumer and investor protection: market participants should receive consistent, useful information, and legal protection for similar financial products and services, including disclosures, sales practice standards, and suitability requirements.
- Another element is consistent financial oversight: the regulatory structure should ensure that similar institutions and products are subject to consistent regulation, oversight, and transparency, in part to help minimize negative competitive outcomes.

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Conclusions (continued)

These two elements have not been fully achieved under the current regulatory structure of the life settlement market.

- First, not all states have enacted life settlement laws to provide policy owners with a minimum level of protection.
- Second, licensing, disclosure, and other requirements differ between or among some states that have enacted life settlement laws, resulting in different protections for different policy owners.
- Third, policy owners also can be afforded different protections, depending on whether the policy being sold is a variable policy subject to FINRA and federal sales practice rules or a nonvariable policy. Although variable policies, unlike nonvariable policies, expose their policy owners to investment risk, life settlements involving both types of policies generally raise the same potential risks for policy owners.

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Conclusions (continued)

A potential federal role in the regulation of insurance has been the subject of debate, and the current financial crisis has renewed the debate.

- For example, the House Financial Services Committee proposed a bill to create a Federal Insurance Office to monitor all aspects of the insurance industry including identifying regulatory gaps. More recently, the Senate Committee on Banking, Housing, and Urban Affairs proposed a bill to create an Office of National Insurance, in part to monitor the insurance industry.
- In the last decade, we have made a number of recommendations to encourage state regulators to implement a consistent set of insurance regulations.
- In providing a framework for assessing proposals to modernize the financial regulatory system, we recently reported that Congress could consider the advantages and disadvantages of providing a federal charter option for insurance and creating a federal insurance regulatory entity, given the difficulties to harmonize insurance regulation across states through the NAIC-based structure.[12]

[12]GAO-09-216.

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Matter for Congressional Consideration

As Congress considers how best to reform the regulatory structure of the financial services sector, life settlements offer another example of products that may lack clear comprehensive regulation. Therefore, Congress may wish to consider taking steps to help ensure that policy owners involved in life settlement transactions are provided a consistent and minimum level of protection.

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Appendix II: Results of GAO's Survey of State Insurance Commissioners Regarding Their Regulation of Life Settlements

As part of our life settlement review, we surveyed insurance regulators of the 50 states and the District of Columbia to document their laws and regulations applicable to life settlements. Our survey focused on state regulation of life settlements and excluded viatical settlements from our definition of life settlements. We defined a life settlement generally as the sale of a life insurance policy by an individual who is not terminally or chronically ill to a third party, namely a settlement provider. We define a viatical settlement generally as the sale of a life insurance policy by an individual who is terminally or chronically ill to a third party.

Forty-five states and the District of Columbia completed our survey. Five states did not complete our survey: Delaware, Georgia, Indiana, Kansas, and South Carolina. California, Illinois, New York, and Rhode Island recently passed life settlement laws that had not yet taken effect. California, Illinois, and Rhode Island completed our survey as if their recently passed laws had taken effect; New York did not.

For each question below, we provide the total responses to each possible answer in parentheses.

State Viatical and/or Life Settlement Laws

1. Which of the following best describes your state's laws and regulations covering viatical and/or life settlements?

   a. Only viatical settlements, generally defined as the sale of a life insurance policy by an individual with a terminal or chronic illness or condition are covered (5–Massachusetts, Michigan, New Mexico, New York, and Wisconsin)

   b. Only life settlements, generally defined as the sale of a life insurance policy by an individual without a terminal or chronic illness or condition are covered (1–Idaho)

   c. Both viatical and life settlements are covered (33–Alaska, Arkansas, California, Colorado, Connecticut, Florida, Hawaii, Illinois, Iowa, Kentucky, Louisiana, Maine, Maryland, Minnesota, Mississippi, Montana, Nebraska, Nevada, New Jersey, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, Tennessee, Texas, Utah, Vermont, Virginia, Washington, and West Virginia)

d. Neither viatical nor life settlements are covered (7–Alabama, Arizona, District of Columbia, Missouri, New Hampshire, South Dakota, and Wyoming)

License and Bond Requirements

Definition of Broker - Throughout our survey, we use the term "brokers" to refer to persons or entities that negotiate the sale of a life insurance policy between a policy owner and provider or other buyer.

2. Does your state require the policy owner's life settlement brokers to be licensed?

   a. Yes (33)

   b. No (1)

   c. Don't know (0)

   d. Not applicable (0)

3. Does your state require the policy owner's life settlement brokers to complete continuing education requirements related to life settlements on a periodic basis?

   a. Yes (16)

   b. No (17)

   c. Don't know (0)

   d. Not applicable (0)

4. Does your state require the policy owner's life settlement brokers to demonstrate evidence of their financial responsibility through a surety bond or similar means?

   a. Yes (11)

   b. No (21)

   c. Don't know (0)

   d. Not applicable (1)

5. How many life settlement brokers are currently licensed in your state?

State	Number of brokers
Alaska	23
Arkansas	[a]
California	15
Colorado	287
Connecticut	54
Florida	503
Hawaii	84
Idaho	26
Illinois	[a]
Iowa	82
Kentucky	93
Louisiana	118
Maine	[a]
Maryland	0
Minnesota	11
Mississippi	67
Montana	28
Nebraska	81
Nevada	37
New Jersey	661
N. Carolina	312
N. Dakota	16
Ohio	225
Oklahoma	52
Oregon	92
Pennsylvania	607
Rhode Island	0
Tennessee	57
Texas	424
Utah	[a]
Vermont	0
Virginia	308
Washington	59
W. Virginia	6

Source: GAO survey of state insurance regulators.

[a]Indicates no response was provided.

6. Does your state impose a fiduciary duty on life settlement brokers to their clients (i.e., policy owners) who are selling their policies?

   a. Yes (31)

   b. No (2)

   c. Don't know (1)

   d. Not applicable (0)

Definition of Provider - Throughout our survey, we use the term "providers" to refer to persons or entities that purchase a life insurance policy from the policy owner for their own account or on behalf of a third party.

7. Does your state require life settlement providers to be licensed?

   a. Yes (33)

   b. No (1)

   c. Don't know (0)

   d. Not applicable (0)

8. Does your state require life settlement providers to demonstrate evidence of their financial responsibility through a surety bond or similar means?

   a. Yes (24)

   b. No (10)

   c. Don't know (0)

   d. Not applicable (0)

9. How many life settlement providers are currently licensed in your state?

State	Number of providers
Alaska	3
Arkansas	[a]
California	10
Colorado	23
Connecticut	44
Florida	14
Hawaii	47
Idaho	1
Illinois	14
Iowa	19
Kentucky	45
Louisiana	17
Maine	21
Maryland	0
Minnesota	17
Mississippi	27
Montana	12
Nebraska	13
Nevada	21
New Jersey	30
N. Carolina	42
N. Dakota	9
Ohio	17
Oklahoma	18
Oregon	5
Pennsylvania	35
Rhode Island	0
Tennessee	38
Texas	62
Utah	24
Vermont	6
Virginia	34
Washington	14
W. Virginia	7

Source: GAO survey of state insurance regulators.

[a]Indicates no response was provided.

10. Does your state require that life expectancy underwriters or consultants (e.g., those companies that conduct analyses of an insured's life expectancy) be licensed?

    a. Yes (1)

    b. No (33)

    c. Don't know (0)

Approval of Settlement Contracts and Disclosure Statements

11. Does your state require life settlement brokers to have their disclosure statements (provided to policy owners) approved by an appropriate regulator (e.g., insurance commission)?

    a. Yes (30)

    b. No (4)

    c. Don't know (0)

12. Does your state require life settlement providers to use a settlement contract form that has been approved by an appropriate regulator (e.g., insurance commission)?

    a. Yes (33)

    b. No (1)

    c. Don't know (0)

13. Does your state require life settlement providers to have their disclosure statements (e.g., forms providing risk or fee disclosures) provided to policy owners approved by an appropriate regulator (e.g., insurance commission)?

    a. Yes (33)

    b. No (1)

    c. Don't know (0)

Reporting and Privacy Requirements

14. Does your state require life settlement providers to submit data (e.g., aggregate face value and proceeds of policies settled) periodically on their settlement transactions executed within your state (i.e., executed either on the basis of the location of the policy owner's residence, or on location where business is conducted)?

    a. Yes (31)

    b. No (3)

    c. Don't know (0)

15. Does your state require life settlement providers to submit data (e.g., aggregate face value and proceeds of policies settled) periodically on their settlement transactions executed outside of your state (i.e., executed either on the basis of the location the policy owner's residence, or on location where business is conducted)?

    a. Yes (15)

    b. No (19)

    c. Don't know (0)

16. Does your state require life settlement providers to submit data periodically on enforcement actions in which they are involved within or outside of your state?

    a. Yes (22)

    b. No (12)

    c. Don't know (0)

17. Does your state require life settlement providers to report information on policies settled within a prescribed period of policy issuance (e.g., within 5 years)?

    a. Yes (24)

    b. No (10)

    c. Don't know (0)

18. Does your state prohibit life settlement brokers, providers, and other life settlement entities with knowledge of the insured's identity from disclosing the insured's financial or medical information, except under expressly enumerated circumstances?

    a. Yes (34)

    b. No (0)

    c. Don't know (0)

Examinations and Investigations–Life Settlement Brokers

19. Does your state's appropriate regulator (e.g., insurance commission) have the authority to examine licensed life settlement brokers?

    a. Yes (34)

    b. No (0)

    c. Don't know (0)

20. In the past 5 years, has your state conducted any examinations of life settlement brokers based solely on the passage of time and not based on cause (e.g., a customer complaint)?

    a. Yes (3)

    b. No (27)

    c. Don't know (1)

    d. Not applicable (3)

21. In the past 5 years, has your state conducted any investigations (or "cause exams") of a life settlement broker?

    a. Yes (9)

    b. No (21)

    c. Don't know (1)

    d. Not applicable (3)

22. In the past 5 years, has your state conducted any on-site examinations of life settlement brokers?

    a. Yes (5)

    b. No (25)

    c. Don't know (1)

    d. Not applicable (3)

23. In the past 5 years, has your state conducted any off-site examinations of life settlement brokers?

    a. Yes (6)

    b. No (24)

    c. Don't know (1)

    d. Not applicable (3)

24. In the past 5 years, has your state assessed the controls that life settlement brokers use to protect the confidentiality of an insured's personal information and to comply with privacy requirements?

    a. Yes (7)

    b. No (22)

    c. Don't know (1)

    d. Not applicable (4)

25. In the past 5 years, has your state assessed controls that life settlement brokers use to ensure that life settlement advertisements are not unfair, deceptive, or misleading?

    a. Yes (9)

    b. No (21)

    c. Don't know (0)

    d. Not applicable (4)

26. In the past 5 years, has your state assessed controls that life settlement brokers use to detect, investigate, and report possible acts of fraud?

    a. Yes (8)

    b. No (21)

    c. Don't know (1)

    d. Not applicable (4)

27. Of the currently licensed life settlement brokers in your state, what percentage of them has been examined in the last 5 years?

    a. 0 % (24)

    b. 1 – 25 % (4)

    c. 26 – 50 % (0)

    d. 51 – 75 % (1)

    e. 76 – 100 % (1)

    f. Don't know (1)

    g. Not applicable (3)

28. Have any of your examinations or investigations found instances in which a life settlement broker had improperly disclosed the identity (e.g., name and address) of an insured in the past 5 years?

    a. Yes (2)

    b. No (12)

    c. Don't know (2)

    d. Not applicable (18)

Examinations and Investigations–Life Settlement Providers

29. Does your state's appropriate regulator (e.g., insurance commission) have the authority to examine licensed life settlement providers?

    a. Yes (33)

    b. No (0)

    c. Don't know (0)

30. In the past 5 years, has your state conducted any examinations of life settlement providers based solely on the passage of time and not based on cause (e.g., a customer complaint)?

    a. Yes (3)

    b. No (27)

    c. Don't know (0)

    d. Not applicable (3)

31. In the past 5 years, has your state conducted any investigations (or "cause exams") of a life settlement provider?

    a. Yes (9)

    b. No (21)

    c. Don't know (0)

    d. Not applicable (3)

32. In the past 5 years, has your state conducted any on-site examinations of life settlement providers?

    a. Yes (3)

    b. No (27)

    c. Don't know (0)

    d. Not applicable (3)

33. In the past 5 years, has your state conducted any off-site examinations of life settlement providers?

    a. Yes (7)

    b. No (23)

    c. Don't know (0)

    d. Not applicable (3)

34. In the past 5 years, has your state assessed the controls that life settlement providers use to protect the confidentiality of an insured's personal information and to comply with privacy requirements?

    a. Yes (8)

    b. No (21)

    c. Don't know (0)

    d. Not applicable (3)

35. In the past 5 years, has your state assessed controls that life settlement providers use to ensure that life settlement advertisements are not unfair, deceptive, or misleading?

    a. Yes (9)

    b. No (21)

    c. Don't know (0)

    d. Not applicable (3)

36. In the past 5 years, has your state assessed controls that life settlement providers use to detect, investigate, and report possible acts of fraud?

    a. Yes (12)

    b. No (18)

    c. Don't know (0)

    d. Not applicable (3)

37. Of the currently licensed life settlement providers in your state, what percentage of them has been examined in the last 5 years?

    a. 0 % (22)

    b. 1 – 25 % (5)

    c. 26 – 50 % (0)

    d. 51 – 75 % (1)

    e. 76 – 100 % (2)

    f. Don't know (0)

    g. Not applicable (3)

38. Have any of your examinations or investigations found instances in which a life settlement provider had improperly disclosed the identity (e.g., name and address) of an insured in the past 5 years?

    a. Yes (1)

    b. No (13)

    c. Don't know (1)

    d. Not applicable (18)

Complaints

39. Do you track the number of complaints made by consumers about life settlements?

    a. Yes (26)

    b. No (6)

    c. Don't know (1)

40. How many complaints were made by consumers concerning life settlements in calendar years 2007, 2008, and 2009?

	Number of complaints		
State	2007	2008	2009
Alaska	0	0	0
Arkansas	[a]	[a]	[a]
California	[a]	[a]	[a]
Colorado	0	0	0
Connecticut	0	0	0
Florida	7	3	6
Idaho	[a]	[a]	[a]
Iowa	0	0	1
Kentucky	[a]	[a]	[a]
Louisiana	0	2	0
Maryland	1	2	0
Mississippi	0	0	0
Montana	0	0	0
Nebraska	0	0	0
N. Carolina	0	0	0
N. Dakota	0	0	0
Oklahoma	[a]	[a]	[a]
Oregon	0	0	0
Pennsylvania	7	5	5
Rhode Island	0	0	0
Texas	18	34	19
Utah	0	0	0
Vermont	[a]	[a]	[a]
Virginia	0	0	0
Washington	0	0	0
W. Virginia	0	0	0

Source: GAO survey of state insurance regulators.

[a]Indicates no response was provided.

Disclosure Requirements of Life Settlement Brokers

41. When does your state require life settlement brokers to provide policy owners with a written disclosure of the risks associated with a life settlement contract (e.g., tax liability, ability to purchase future insurance, effects on the eligibility for public assistance)?

    a. Not applicable (2)

    b. At the time of application (13)

    c. No later than the date the application for the settlement contract is signed by all parties (13)

    d. No later than the date the life settlement contract is signed (4)

    e. By another date (2)

    f. Don't know (0)

42. Does your state require life settlement brokers to provide policy owners with information on the method (e.g., such as the percentage of the policy's face value or gross proceeds) for calculating the broker's compensation?

    a. Required verbally (0)

    b. Required in writing (19)

    c. Required both verbally and in writing (0)

    d. Not required (13)

    e. Don't know (0)

43. Does your state require life settlement brokers to provide policy owners with information on the amount of the broker's compensation?

    a. Required verbally (0)

    b. Required in writing (22)

    c. Required both verbally and in writing (0)

    d. Not required (10)

    e. Don't know (0)

44. Does your state require life settlement brokers to provide policy owners with information on all offers, counter-offers, acceptances, and rejections relating to the proposed settlement contract?

    a. Required verbally (0)

    b. Required in writing (20)

    c. Required both verbally and in writing (0)

    d. Not required (12)

    e. Don't know (0)

45. Does your state require life settlement brokers to provide policy owners with information on any affiliation between the broker and any person making an offer for the proposed settlement contract (e.g., a life settlement provider or investor)?

    a. Required verbally (0)

    b. Required in writing (23)

    c. Required both verbally and in writing (0)

    d. Not required (9)

    e. Don't know (0)

Disclosure Requirements of Life Settlement Providers

46. When does your state require life settlement providers to provide policy owners with a written disclosure of the risks associated with a life settlement contract (e.g., tax liability, ability to purchase future insurance, effects on the eligibility for public assistance)?

    a. Not applicable (1)

    b. At the time of application (11)

    c. No later than the date the application for the settlement contract is signed by all parties (11)

    d. No later than the date the life settlement contract is signed (10)

    e. By another date (1)

    f. Don't know (0)

47. Does your state require life settlement providers to notify the insured in the event of transfer of ownership of the policy or change in the beneficiary?

    a. Required verbally (1)

    b. Required in writing (22)

    c. Required both verbally and in writing (0)

    d. Not required (10)

    e. Don't know (0)

48. Does your state require life settlement providers to provide policy owners with information on any affiliation between the provider and the issuer of the policy?

    a. Required verbally (0)

    b. Required in writing (30)

    c. Required both verbally and in writing (0)

    d. Not required (4)

    e. Don't know (0)

49. Does your state require life settlement providers to provide policy owners with information on the method for calculating the compensation paid to the broker?

    a. Required verbally (0)

    b. Required in writing (18)

    c. Required both verbally and in writing (1)

    d. Not required (15)

    e. Don't know (0)

50. Does your state require life settlement providers to provide policy owners with information on the amount of compensation paid to the broker?

    a. Required verbally (1)

    b. Required in writing (20)

    c. Required both verbally and in writing (1)

    d. Not required (12)

    e. Don't know (0)

Information Disclosure for Brokers or Providers in Life Settlement Transactions

51. Does your state require life settlement providers or brokers to provide policy owners with information that alternatives to life settlement contracts exist?

    a. Required verbally (0)

    b. Required in writing (33)

    c. Required both verbally and in writing (0)

    d. Not required (0)

    e. Don't know (0)

52. Does your state require life settlement providers or brokers to provide policy owners with information that settlement brokers owe a fiduciary duty to the policy owners?

    a. Required verbally (0)

    b. Required in writing (22)

    c. Required both verbally and in writing (0)

    d. Not required (11)

    e. Don't know (1)

53. Does your state require life settlement providers or brokers to provide policy owners with information that some or all of the proceeds of the life settlement contract may be taxable?

    a. Required verbally (0)

    b. Required in writing (33)

    c. Required both verbally and in writing (0)

    d. Not required (0)

    e. Don't know (0)

54. Does your state require life settlement providers or brokers to provide policy owners with information that the proceeds from a settlement contract may adversely affect the recipient's eligibility for public assistance or other government benefits?

    a. Required verbally (0)

    b. Required in writing (32)

    c. Required both verbally and in writing (0)

    d. Not required (0)

    e. Don't know (1)

55. Does your state require life settlement providers or brokers to provide policy owners with information that the owner has the right to terminate or rescind a life settlement contract within a prescribed period after the contract is executed?

    a. Required verbally (0)

    b. Required in writing (34)

    c. Required both verbally and in writing (0)

    d. Not required (0)

    e. Don't know (0)

56. Does your state require life settlement providers or brokers to provide policy owners with information that entering into a settlement contract may cause other rights or benefits, including conversion rights or waiver of premium benefits under the policy, to be forfeited?

    a. Required verbally (0)

    b. Required in writing (32)

    c. Required both verbally and in writing (0)

    d. Not required (2)

    e. Don't know (0)

57. Does your state require life settlement providers or brokers to provide policy owners with information that the insured may be asked to renew his or her permission to disclose all medical, financial, or personal information in the future to someone who buys the policy?

    a. Required verbally (0)

    b. Required in writing (27)

    c. Required both verbally and in writing (1)

    d. Not required (5)

    e. Don't know (1)

58. Does your state require life settlement providers or brokers to provide policy owners with information that any person who knowingly presents false information in an application for a life insurance or life settlement contract is guilty of a crime?

    a. Required verbally (0)

    b. Required in writing (25)

    c. Required both verbally and in writing (0)

    d. Not required (8)

    e. Don't know (1)

59. Does your state require life settlement providers or brokers to provide policy owners with information that the insured may be contacted for the purpose of determining the insured's health status?

    a. Required verbally (0)

    b. Required in writing (31)

    c. Required both verbally and in writing (1)

    d. Not required (1)

    e. Don't know (1)

60. Does your state require life settlement providers or brokers to provide policy owners with information that a change in ownership could in the future limit the insured's ability to purchase future insurance on the insured's life?

    a. Required verbally (0)

    b. Required in writing (19)

    c. Required both verbally and in writing (0)

    d. Not required (14)

    e. Don't know (1)

Issuer Disclosures

61. Does your state require providers or brokers to provide life insurance companies with information about settlement transactions involving policies that were issued within the past 5 years?

    a. Yes (7)

    b. No (26)

    c. Don't know (1)

62. Does your state require providers or brokers to provide life insurance companies with a written notice to the issuer when its policy has become subject to a settlement?

    a. Yes (24)

    b. No (10)

    c. Don't know (0)

63. Does your state require life insurance companies to disclose information about other options (such as life settlements) to their policy holders who want to terminate their policy?

    a. Yes (3)

    b. No (31)

    c. Don't know (0)

General Rules

64. Does your state require advertisements or marketing materials by entities soliciting potential policy owners for life settlements to be approved by an appropriate regulator (e.g., insurance commission)?

    a. Yes (14)

    b. No (20)

    c. Don't know (0)

65. Does your state prohibit life settlement brokers from conducting sales with any provider, financing entity, or related provider trust, that is controlling, controlled by, or under common control with such broker?

    a. Yes (15)

    b. No (19)

    c. Don't know (0)

66. Does your state prohibit providers from entering in a life settlements contract, if, in connection to such contract, anything of value will be paid to a broker that is controlling, controlled by, or under common control with such provider?

    a. Yes (16)

    b. No (17)

    c. Don't know (0)

67. Does your state require providers entering into a life settlement contract to obtain a written statement from a licensed physician that the policy owner is of sound mind and under no constrain or under influence to enter into a settlement contract?

    a. Yes (28)

    b. No (5)

    c. Don't know (1)

68. Does your state require the life settlement provider to obtain a document in which the insured consents to the release of his or her medical records to a licensed provider, broker, or insurance company?

    a. Yes (31)

    b. No (2)

    c. Don't know (1)

69. Does your state require the life settlement provider to obtain a witnessed document, prior to the execution of the settlement contract, in which the policy owner consents to the contract, represents that the policy owner has a full and complete understanding of not only the contract but also the benefits of the insurance policy, and acknowledges he or she is entering into the contract freely and voluntarily?

    a. Yes (28)

    b. No (5)

    c. Don't know (1)

70. Which of the following best describes your state's provisions on a policy owner's right to terminate (i.e., rescind) a life settlement contract after entering it?

    a. Policy owner does not have the right to terminate a contract after entering it (0)

    b. Policy owner generally has 15 days or less to terminate a contract after entering it (15)

    c. Policy owner generally has 16 to 60 days to terminate a contract after entering it (17)

    d. Policy owner generally has more than 60 days to terminate a contract after entering it (0)

    e. Don't know (0)

71. Does your state require fees, commission, or other compensation paid by the provider or owner to the broker in connection with a settlement contract be computed as a percentage of the offer obtained, not the face value of the policy?

    a. Yes (6)

    b. No (27)

    c. Don't know (1)

Stranger-Originated Life Insurance (STOLI) Transactions

72. Do your state's laws include any specific provisions intended to deter or prohibit STOLI or similar types of transactions?

    a. Yes (26)

    b. No (8)

    c. Don't know (0)

73. Does your state explicitly define STOLI transactions and prohibit such transactions?

    a. Yes (20)

    b. No (14)

    c. Don't know (0)

74. Within how many years of issuance of a life insurance policy does your state prohibit a life settlement contract on that policy, except under specific enumerated circumstances?

    a. Our state does not prohibit a life settlement contract based on the amount of years from issuance of that policy to deter or prevent STOLI transactions (3)

    b. 2 years (22)

    c. 3 years (0)

    d. 4 years (1)

    e. 5 years (7)

    f. 6 or more years (0)

    g. Don't know (1)

75. In efforts to deter or prohibit STOLI transactions, does your state have another approach to deter and prohibit STOLI transactions, aside from those approaches listed in the previous two questions?

    a. Yes (16)

    b. No (16)

    c. Don't know (2)

Fraud Prevention and Controls

76. Does your state require life settlement brokers to have an anti-fraud plan or initiatives to detect, investigate, and report possible fraudulent acts?

    a. Yes (22)

    b. No (12)

    c. Don't know (0)

77. Does your state require life settlement providers to have an anti-fraud plan or initiatives to detect, investigate, and report possible fraudulent acts?

    a. Yes (29)

    b. No (5)

    c. Don't know (0)

Appendix III: Results of GAO's Survey of Licensed Life Settlement Providers

As part of our life settlement review, we surveyed life settlement providers licensed in two or more states about their life settlement transactions. We identified 34 states that required providers to be licensed and obtained a list of providers licensed in each of these states (as of September 2009). Based on these lists, we identified 98 providers, of which 55 were licensed in two or more states. However, we were able to contact only 49 of these providers for our survey.

Of the 49 life settlement providers we surveyed, 25 of them completed our survey. For each question below, we provide the aggregated responses of the providers. Some providers did not answer every question on the survey (as noted below where applicable). Because no comprehensive life settlement data exist, we were not able to estimate the share of the market held by the providers responding to our survey.

1. What was the total number of life insurance policies purchased by your firm in calendar year?

   a. 2006 – 3,148

   b. 2007 – 3,703

   c. 2008 – 4,505

   d. 2009 – 2,636

2. What was the total face value of the policies purchased by your firm in calendar year?

   a. 2006 – $5,501,932,247

   b. 2007 – $9,025,862,851

   c. 2008 – $12,946,270,383

   d. 2009 – $7,005,574,470

3. What was the total amount paid to policy owners (exclusive of broker compensation, such as commissions) for the policies purchased by your firm in calendar year?

   a. 2006 – $1,170,878,009

   b. 2007 – $1,801,390,695

   c. 2008 – $2,319,081,754

   d. 2009 – $888,003,867

4. What was the total amount of associated cash surrender value of the policies purchased by your firm in calendar year? (Note: Three providers did not provide us with data on the cash surrender value of their settled policies for years 2006 through 2009. The providers did provide us with data on number of policies settled, face value of the policies, and amount paid to policy owners for the policies for years 2006 through 2009.)

   a. 2006 – $99,965,301

   b. 2007 – $199,300,307

   c. 2008 – $149,741,970

   d. 2009 – $109,432,850

5. What was the total amount of compensation (e.g., commissions) paid to brokers for the policies purchased by your firm in calendar year?

   a. 2006 – $202,774,451

   b. 2007 – $263,454,952

   c. 2008 – $275,676,198

   d. 2009 – $92,229,350

6. What was the total number of policies purchased by your firm, based on the age of policy at the time of settlement (i.e., the time between policy's issuance and settlement), for calendar year

   a. 2006? (Note: Three providers provided us with incomplete or no data on the number of policies purchased based on the age of the policy at time of issuance.)

      1. less than 2 years old – 37

      2. 2 to 5 years old – 844

      3. greater than 5 years old – 880

   b. 2007? (Note: Four providers provided us with incomplete or no data on the number of policies purchased based on the age of the policy at time of issuance.)

      1. less than 2 years old – 21

      2. 2 to 5 years old – 1,366

      3. greater than 5 years old – 1,296

   c. 2008? (Note: Three providers provided us with incomplete or no data on the number of policies purchased based on the age of the policy at time of issuance.)

      1. less than 2 years old – 10

      2. 2 to 5 years old – 1,790

      3. greater than 5 years old – 1,301

   d. 2009? (Note: Three providers provided us with incomplete or no data on the number of policies purchased based on the age of the policy at time of issuance.)

      1. less than 2 years old – 3

      2. 2 to 5 years old – 780

      3. greater than 5 years old – 609

7. What was the median face value for all policies purchased by your firm in calendar year

   a. 2006? Reported values ranged from $150,000 to $5,000,000

   b. 2007? Reported values ranged from $200,000 to $5,000,000

   c. 2008? Reported values ranged from $225,000 to $6,000,000

   d. 2009? Reported values ranged from $247,500 to $8,000,000

8. What was the median total amount paid to a policy owner (exclusive of broker compensation, such as commissions) for all policies purchased by your firm in calendar year

   a. 2006? Reported amounts ranged from $7,200 to $765,000

   b. 2007? Reported amounts ranged from $11,500 to $5,775,000

   c. 2008? Reported amounts ranged from $46,000 to $1,072,000

   d. 2009? Reported amounts ranged from $37,780 to $992,618

Appendix IV: Comments from the Securities and Exchange Commission

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

THE CHAIRMAN

June 25, 2010

Orice Williams Brown
Director
Financial Markets and Community Investment
United States Government Accountability Office
Washington, D.C. 20548

Dear Ms. Williams Brown:

Thank you for the opportunity to comment on the Government Accounting Office's (GAO) draft report titled Life Insurance Settlements: Regulatory Inconsistencies May Pose a Number of Challenges. The report provides a comprehensive overview of the life settlements market, which is comprised of an "informal network of intermediaries facilitating the sale of life insurance policies by owners to third-party investors." As your report notes, state and federal regulators oversee various aspects of the life settlements market. However, there is no comprehensive or uniform, nationwide regulation of the major participants in the life settlements market.

As you are aware, I established an SEC Life Settlements Task Force in August 2009 in light of concerns about the developing life settlements market and the prospect of securitization of life settlements. The purpose of the Task Force was to examine emerging issues in the life settlements market and to advise the Commission whether market oversight and regulatory oversight can be improved. It was important to me that the SEC get ahead of issues related to life settlements, rather than reacting to them after the possible development of publicly offered life settlement securitizations. I understand that the staff comprising the SEC Life Settlements Task Force benefitted greatly from their discussions and interactions with your professional study team. The SEC Task Force's review is stronger and better informed as a result.

Your report recommends that Congress may wish to consider taking steps to help ensure that policy owners involved in life settlement transactions are provided consistent and minimum level of protection. Based on the work of the SEC's Life Settlements Task Force, I agree with this recommendation and further believe that enhanced investor protections should be introduced into the life settlements market. The SEC's Life Settlements Task Force has been focused on enhancing investor protections and addressing regulatory gaps in the life settlements market. I expect the Task Force will be making a set of recommendations to the Commission along these lines.

Orice Williams Brown
June 25, 2010
Page 2 of 2

As your report indicates, regulatory inconsistencies may pose challenges for policy owners, investors, and life settlement intermediaries. Investors, in particular, often face challenges obtaining adequate information about life settlement investments. In addition, your report notes that individuals in different states investing in the same life settlement investment may be afforded different regulatory protections and receive different disclosures about their investments. These are issues that should be addressed through clarification of regulatory authority, and I thank you for identifying them as challenges in your report.

In conclusion, the GAO report on the life settlements market is a significant contribution to the understanding of this market and the challenges that result from the regulatory inconsistencies that exist. We greatly appreciate your focus on these issues and the thoughtfulness and comprehensive nature of your review.

Sincerely,

Mary L. Schapiro

Mary L. Schapiro
Chairman

Appendix V: Comments from the National Association of Insurance Commissioners

NAIC
National Association of Insurance Commissioners
& The Center for Insurance Policy and Research

June 7, 2010

Orice Williams Brown
Director, Financial Markets and Community Investment
U.S. Government Accountability Office
441 G. Street, NW
Washington, DC 20548

Dear Ms. Williams Brown:

The NAIC appreciates the GAO's interest in life settlements, as they are part of a complex and evolving secondary market for life insurance products. Thank you for the opportunity to comment on the GAO's draft report titled "Life Insurance Settlements: Regulatory Inconsistencies May Pose a Number of Challenges" (GAO-10-775).

We note the recommendation is for Congress to take steps to ensure consistent protections for policy owners involved in life settlement transactions. As the draft report mentions, the majority of states regulate the sale of a policy by the owner to a provider under insurance laws, and those state laws are consistent in their focus on policyholder protection. Key elements of state laws regulating life settlements include the licensing of brokers and providers, disclosure and reporting. We believe the NAIC Model Law on Viatical Settlements provides the appropriate consumer protections for policyholders in life settlement transactions and will continue to support adoption of the Model in additional states.

The NAIC disagrees an option for a federal charter for insurance is an appropriate solution for the life settlements market and objects to inclusion of a discussion of federal chartering for insurers or the creation of a federal insurance regulatory entity, as neither proposal has ever included any federal role in the secondary market for life insurance products.

Upending the existing system of state-based insurance regulation in favor of a federal charter option makes no sense given the success of the state regulatory system in the face of the ongoing financial crises. State officials have been effective stewards of the U.S. insurance marketplace, updating and retooling insurance supervision to meet the needs of the modern economy while preserving and enhancing consumer protections. Federal chartering of insurance companies would dismantle comprehensive state protections, confuse and disrupt insurance markets, undo reforms and harm insurance consumers. Federal chartering would create a new federal bureaucracy from scratch and allow insurance companies to "opt out" of comprehensive consumer protections and state oversight. Current proposals would gut consumer protection while outsourcing most critical regulatory functions to industry-run self-regulatory organizations.

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We are also surprised your report does not mention one of the obvious results from your survey of Licensed Life Settlement Providers. If one were to compare the total amount paid to policyholders to the total face value of the policies purchased by the firms, the results are stunning. Policyholders are receiving between 12.7% (2009) and 21.3% (2006) of the face value of the policy for giving up their right to collect at time of death. Even factoring in the time value of money, it appears that entering into a life settlement agreement is a very poor financial choice for most consumers.

Again, we appreciate the opportunity to review this report and submit comments. The NAIC and its members will continue to promote consumer protection in the area of life insurance settlements.

Sincerely,

Andrew J. Beal
Chief Operating Officer and
Chief Legal Officer

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Appendix VI: GAO Contact and Staff Acknowledgments

GAO Contact

Orice Williams Brown, (202) 512-8678 or williamso@gao.gov

Staff Acknowledgments

In addition to the contacts named above, Pat Ward (Assistant Director), Joseph Applebaum, Meghan Hardy, Stuart Kaufman, Marc Molino, Barbara Roesmann, Andrew Stavisky, Jeff Tessin, Paul Thompson, and Richard Tsuhara made important contributions to this report.

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