



STOLI and Life Settlement Transactions Soon to be Regulated in California



Life settlements, also known in the industry as “stranger-owned life insurance” (“STOLI”) transactions have existed for several years but most states have not regulated them, at least until recently. The life insurance industry has for years attempted to eliminate such transactions as they typically are not in the insurer's best financial interest. However, in recent years the industry has increased their support for efforts to differentiate between legitimate life settlements and STOLI. Both sides agree to the following general definition: A life settlement is the legitimate liquidation of a life insurance policy by an owner who has outlived the insurable interest upon which the policy was originally purchased. On the other hand, a STOLI transaction is initiated by a third party who offers monetary inducements to entice someone to purchase a life insurance policy with no legitimate insurable interest. The intended recipient of the policy's value is the third party actually paying the premiums.

Legislative activity in the various states has substantially increased over the years as states have passed laws designed to stop, or at least regulate, STOLI transactions. This occurred recently in California. In October 2009, the California legislature enacted, and the governor signed, Senate Bill 1543 that regulates life settlement and STOLI transactions. The new law is known as the [Life Settlements Act](#) (“Act”) and it becomes effective **on July 1, 2010**. It is noteworthy that this bill provides that, with certain exceptions, it does not apply to any life settlement contract entered into **on or before July 1, 2010**. This bill would provide that it would apply to any transaction involving any life insurance policy in effect, or entered into, on or after the operative date of the bill.

The Act defines STOLI transactions as “an act, practice, or arrangement to initiate the issuance of a life insurance policy in this state for the benefit of a third-party investor who, at the time of policy origination, has no insurable interest, under the laws of this state, in the life of the insured.” The new law proscribes STOLI transactions as fraudulent. However, certain life settlement transactions are legal under the Act. It also restricts most transactions within the first two years of a policy. Finally, the new law mandates specific disclosures to consumers, including alternatives to life settlements, and requires the licensing of professionals who transact life settlement contracts. The law – California's first STOLI legislation – makes California one of 26 states to enact laws regulating STOLI.

The Act further provides that:

STOLI practices include, but are not limited to, cases in which life insurance is purchased with resources or guarantees from or through a person or entity, that, at the time of policy inception, could not lawfully initiate the policy himself, herself, or itself, and where, at the time of inception, there is an arrangement or agreement, to directly or indirectly transfer the ownership of the policy or the policy benefits to a third party. Trusts that are created to give the appearance of insurable interest and that are used to initiate policies for investors violate insurable interest laws and the prohibition against wagering on life.

The Act explains that STOLI arrangements do not include lawful life settlement contracts as permitted by the Act. The Act defines a “Life settlement contract” as:

(k) “Life settlement contract” means a written agreement solicited, negotiated, or entered into in this state between a provider and an owner, establishing the terms under which compensation or anything of value will be paid, which compensation or thing of value is less than the expected death benefit of the insurance policy or certificate, in return for the owner’s assignment, transfer, sale, devise, or bequest of the death benefit or any portion of an insurance policy or certificate of insurance for compensation, provided, however, that the minimum value for a life settlement contract shall be greater than a cash surrender value or accelerated death benefit available at the time of an application for a life settlement contract. “Life settlement contract” also includes the transfer for compensation or value of ownership or beneficial interest in a trust or other entity that owns such policy if the trust or other entity was formed or availed of for the principal purpose of acquiring one or more life insurance contracts, which life insurance contract is owned by a person residing in this state.

As noted above, the Act precludes a life settlement transaction within the first two years of the policy. The Act states:

(m) No person at any time prior to, or at the time of, the application for, or issuance of, a policy, or during a two-year period commencing with the date of issuance of the policy, shall enter into a life settlement regardless of the date the compensation is to be provided and regardless of the date the assignment, transfer, sale, devise, bequest, or surrender of the policy is to occur.

There still may be time to enter into a life settlement transaction before this law goes into effect. Even as to those transactions that predate the effect date of the Act, it would be a good idea to read it carefully and follow the requirements of the Act.



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