



You Bet Your Life: Insurable Interest in Life Insurance

Session 94

Our Topics

- Premium financing: Investor Owned Life Insurance and its variations
- Insurable interest from a legal perspective
- Insurable interest from an underwriting perspective
- Industry implications

Our Speakers

- Diana Chafey, DLA Piper Rudnick
- Kevin Oldani, Scottish Re
- John Tiller, Unified Life
- Your host: Mark Swanson, Transamerica Reinsurance

AIOLI

- is a cold sauce made of garlic, egg, acid (lemon juice or vinegar), and olive oil, basically a garlic-flavored mayonnaise. (-- Wikipedia)



IOLI

- stands for Investor Owned Life Insurance: an investment vehicle involving an insured life, a life insurance company, a lender, and investors.

Background

- SOLI, IOLI, etc. distinct from life settlements
 - Life insurance procured for *purpose* of resale/assignment in secondary market
- Financing of premiums
 - recourse vs. nonrecourse

Background

- Industry positions
 - Direct companies
 - Reinsurers
 - Others
- Regulator positions

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Society of Actuaries
Annual Meeting and Exhibit 2006

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Insurable Interest

- History and Purpose of Insurable Interest in Life Insurance
 - 1774 Life Assurance Act (England) – prohibited the making of any policy on the life of a person by anyone with no interest in the insured life or for gaming or wagering purposes
 - Prevent wagering on the life of the insured
 - Most U.S. states have adopted statutes codifying the concept

Insurable Interest

- Generally Defined As:
 - An interest based upon a reasonable expectation of pecuniary advantage through the continued life, health and bodily safety of another person, and, consequently, loss by reason of their death or disability; or
 - A substantial interest engendered by love and affection if closely related by blood or by law

Insurable Interest

- Who Has An Insurable Interest
 - The insured, in the insured's own life
 - Corporations/Employers
 - Officers, directors, key employees
 - Employees insured by benefit plans
 - 501(c)(3) Organizations (charitable, religious, educational)
 - Parties to a contract
 - Trustee
 - Guarantor of debt

Insurable Interest

- When Required
 - At the time of policy issue;
 - At the time of death; or
 - Both
- Beneficiaries may also be required to have an insurable interest
- Consequences of no insurable interest
 - Policy void ab initio/return premium; or
 - Proceeds paid to insured's estate

Stranger/Investor Owned Life Insurance (SOLI/IOLI)

- Premium Financing Arrangements
 - Initiation by third party investor/stranger
 - Non-recourse financing of premiums for a period of time
 - At end of period, insured may:
 - Assign the policy to the financing source in exchange for forgiveness
 - Pay off the loan with interest and keep the policy
 - Incentives at policy inception
 - Target high net worth insureds

SOLI/IOLI

- Distinguish from:
 - Viatical and Life Settlements – insured purchases policy and later circumstances arise that prompt re-sale (terminal illness; need for liquidity; no longer necessary, etc.)
 - Premium financing that does not contemplate re-sale at policy inception

SOLI/IOLI – Con't

- Charities
 - Investors/strangers “borrow” insurable interest of charity
 - Funds raised by sale of securities deposited into a trust and used to purchase single premium annuity on donor
 - Annuity stream used to purchase life insurance
 - Investors get fixed return during life
 - Investors made whole upon death, with difference going to the charity/beneficiary
 - Promoted as facilitating charitable giving

Questions

- Violate insurable interest statutes?
- Promote “gaming” on people’s lives?
- Violate anti-rebating statutes?
- Tax Issues?
- SEC Issues?

Recent Developments

- Amendments to insurable interest laws
- Companies/reinsurers refusing to insure
- Department of Insurance bulletins
- NAIC Life Insurance and Annuities Hearings/Proposals to amend model laws
- Federal excise tax proposals



Scottish Re™

SOLI/IOLI
“You Bet Your Life”
An Underwriter’s Prospective

Presented by...

Kevin Oldani
Scottish Re



Topics

- What is SOLI/IOLI (Stranger owned, Investor owned life insurance)
- “Does it make sense”
- Procedures
- Pricing/underwriting implications
- Life Settlements

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What is SOLI/IOLI

- Life insurance program purchased by someone who has a financial need
- Investor owns the insurance
- Investor is the beneficiary

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Acronyms in Market Place

- SOLI: Stranger Owned Life Insurance
- IOLI: Investor Owned Life Insurance
- BOLI: Bank Owned Life Insurance
- ChOLI: Church Owned Life Insurance/Charitable Owned
- COLI: Corporate Owned Life Insurance
- FOLI: Foundation Owned Life Insurance
- MOLI: Mortgage Owned Life Insurance
- TOLI: Trust Owned Life Insurance

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Types of SOLI/IOLI

- Charitable programs
- Funding programs
- Death Benefit Only Plans

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Why is IOLI/SOLI Market Attractive?

- Agent commissions
- Investor returns
- Potential payment to buyer
- Large Cash premiums
- Lower underwriting expenses

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Does it Make Sense

DOES IT MAKE SENSE?

Charles A. Will

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Does it Make Sense?

- Targets older age insured's
- Insurable Interest
- Ownership issues
- Mortality Assumptions
- Is this a win/win?
- Regulatory Risks/Tax issues-erosion of tax favored status
- Small % of proceeds benefit charity/beneficiary

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Procedures/Underwriting/Pricing

- Review Plan documents
- Who is insured? "Lend a Life"
- Review Illustrations for mortality expectations
- Insurable interest
- Owner/Investor information
- Age spreads
- Payouts to buyer other than investors
- Agents commission and management of case

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Life Settlements

- **Large and growing market**
 - Multi billion dollar industry
 - Real benefit for the policy holder
- **Life industry response**
 - Pricing implications-lapse rates
 - Older age mortality
 - Table shaving programs
 - Applications revised
 - Jumbo Limits reviewed
 - Policy change reviews after issue
 - Notifying producers
 - Premium financing

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Life Settlements (Continued)

- **Life industry response**
 - **Life insurance/reinsurance companies should capitalize**
 - ♦ Use mortality experience
 - ♦ Do not ignore market

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Insurable Interest in Life Insurance

Society of Actuaries

John Tiller
Butterfly Financial Consultants
October 17, 2006

A Little European/English History*

- “Insurable interest” first surfaced in the middle ages as part of “lex mecatoria” - pure indemnity idea
- English common law until 1774 & Life Assurance Act
 - Intended to prevent wagering under the guise of insurance
 - Still applicable today
 - Court decided in 1854 (*Dalby v. India and London Life Assurance Co*) that insurable interest need exist only at issue
 - Since determined that an individual has unlimited interest in own life

*Thanks to Phil Bieluch

The 19th Century

- Elizur Wright of Massachusetts
 - London, 1854
 - Told “Go to the Royal Exchange, Thursday afternoon at three o’clock ...”
 - Saw “a sale of several old policies on very aged men”
 - Led to US legal reserve system & mandatory cash values
- Two observations
 - No apparent prohibition to speculators buying policies on newly insureds
 - Widely accepted freedom to buy & sell insurance results

US Supreme Court, 1911

Grigsby v. Russell, 222 U.S. 149

- Interpleader case
 - Burchard (insured & owner) needed money for surgery
 - Sold life policy to Dr. Grigsby for \$100 & Grigsby would pay premiums
 - Argued to limit Grigsby’s collection to amounts paid by him
- Opinion authored by Oliver Wendell Holmes, Jr.
- Court held the transfer was proper
 - “To deny the right to sell except to persons having such an interest is to diminish appreciably the value of the contract in the owner’s hands.”

Observations on Grigsby v. Russell

- Explicit that life insurance be treated like other property
 - Not specified if Grigsby treating Burchard – interest not limited to relationship
 - “... when the question arises upon an assignment, it is assumed that the objection to the insurance as a wager is out of the case.”
- Interest could be for entire face amount
 - Previously thought to be limited to price plus premiums*
- Recognized the practice of insurable interest at issue
 - Concern for **criminal activity**, not economic speculation
- Was the door left open for different standards at issue?
 - **“So far as reasonable safety permits, it is desirable to give life policies the ordinary characteristics of property.”**

*Transactions Actuarial Society of America Vol. XIII 1912 pp 92-93

What Is Insurable Interest?

- Traditional view – accept Diana’s wording
 - “An interest based upon a reasonable expectation of pecuniary advantage through the continued life, health and bodily safety of another person, and, consequently, loss by reason of their death or disability; or
 - A substantial interest engendered by love and affection if closely related by blood or by law”
- Considerations (no disagreement intended with Diana)
 - How does this explain insurance purchased to guarantee corporate loans?
 - How does this apply to COLI, BOLI, etc?
 - Is buy-sell insurance a derivative of this definition?
 - Does credit insurance paying off the TV really meet the standards of “pecuniary advantage” in someone staying alive? Maybe the family would sooner have the TV without Dad?

An Intriguing Question, Part 1

- Can an individual sell his/her insurability?
 - Grigsby v. Russell – “**So far as reasonable safety permits, it is desirable to give life policies the ordinary characteristics of property.**”
 - Why would this desirability not apply to insurability as well as a inforce policy?
 - Supreme Court’s concern was criminal activity, not economic effects
- Holmes stated that transferring life insurance is a property right you purchase when you purchase life insurance
 - Assuming each of us has an unlimited insurable interest in our own life, premium financing appears to be a legitimate process

An Intriguing Question, Part 2

- The 21st century is an era where it appears that every possible asset or cash flow is becoming a derivative investment class
 - Insurers fast moving with securitizations, contingent capital, et al
- If reasonable safety controls exist, there may be no legal impediment to premium financing, especially with recourse
 - Quality professional investors investing in a large number of policies unlikely to be confused with “criminal activity” such a murder
 - States may lack authority to regulate this activity

Where Is This Going?

- Insurable interest & ability to sell various insurance rights have changed over time
- In era of derivative products, is insurability just another derivative?
 - Appears to address the Supreme Courts desire to “give life policies the ordinary characteristics of property”
 - It just starts earlier than an inforce policy
 - Insurance industry unlikely to prevail on parochial view – investors are speedy & well-financed
- Murder for insurance benefits is not unknown, but extremely rare
 - Laws deny economic benefits to murderers
 - Difficult to imagine current investors “putting out contracts” on insureds
 - Life insurers cannot hide behind this concern
- Expect definition of insurable interest be expanded to include economic interests not based on income or affection, but other economic concepts

Actuarial Considerations

- Our assumptions will be wrong!
 - Get over it
 - Assumptions go wrong all the time
 - Persistency of ART products in 1980s – too low
 - Persistency of level premium term 1995 - 2006 – too high
 - Mortality level & improvement – today?
 - Guaranteed interest rates in 1980s
 - Expense overruns – when not?
- Could be a problem with inforce, but new business can be priced appropriately
 - Adjust dividend scales or COI rates on inforce
- That is why we have reasonable conservatism

New Business Considerations

- **Persistency**
 - Persistency effects drive other effects
 - OILI expected to have better persistency
 - Can you identify OILI before issue & place in different class?
 - Offer a specially priced policy
 - Commissions on life settlement much larger than on life insurance
 - Allow for higher persistency in pricing
- **Expenses**
 - Higher persistency – good for acquisition costs
 - Should be good for renewal expenses
- **Investment income**
 - Longer term investments possible
 - However, anticipate policies will not build positive account values

Mortality Concerns

- **More insureds will survive to point of death**
 - Isn't that the purpose of insurance?
 - Can not complain about this
 - Actuaries have considered antiselection on renewals for decades
 - There will be more premium
- **Some possible alternatives**
 - Assume higher percentage of unhealthy lives renew & price accordingly
 - Avoid lapse-supported products
 - Develop product specifically for this market
 - Offer less restrictive premium rate guarantees
 - Improve underwriting controls
- **Expect different experience & factor into assumptions**

Its Really About Risk Selection

- IOLI investors & agents shopping for underwriting arbitrage
- Primary insurers have been doing that to reinsurers for decades
- Possibly legitimate differences in underwriting assessments
- Possible advantages in cost of capital or availability of debt

Underwriting Alternatives

- Demand full information for underwriting
- “No exception” underwriting standards, no favors
 - If the industry endorses unrealistically competitive underwriting (e.g., table shaving), then process lacks integrity
 - Do not abdicate responsibilities to reinsurers hoping for their mistakes
 - Minimize “informal submissions”
 - Establish placement ratio standards for agents
- Lower policy size limitations, both issue & participation
 - Expect the buyer/advisors of a \$50 million policy to be alert to more favorable options – if not IOLI at issue, strong candidate to become life settlement
 - Issue only if true economic need making life settlement sale unlikely
- Is participating business an answer?


Conclusions

- “Insurable interest”
 - Has changed
 - Is changing, and
 - Will change again
- Better to join discussion & affect outcome than fight & lose more
- Appropriate assumptions can be developed
- Tighter controls needed on sales & underwriting

*The train is coming
Get on (& navigate) or get off the track*

Concluding Observation

- Average premium per policy, according to LIMRA 2Q06 US Individual Life Sales report, growth rate 2Q06 over 2005
- Agency building: UL +21% (\$3,453) Term +8% (\$910)
- Multiline: UL -1% (\$955), Term +3% (\$554)
- PPGA: UL -8% (\$11,935), Term +4% (\$1,140)
- Brokerage: UL +79% (\$12,888), Term +5% (\$1,041)
(production in terms of number of policies actually decreased)



ANNUAL MEETING & EXHIBIT
SOA⁰⁶ **The Power of Ideas**

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