Client Advisory

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Katten Muchin Rosenman LLP

Insurance Capital Markets

June 3, 2009

Recently Proposed New York Life Settlement Regulation May Have a Significant Impact Upon Those Conducting Business in the State

On March 23, the New York State Insurance Department (the "Department") issued a press release covering its proposed legislation regulating life settlements, which are defined as "financial transactions that occur when individuals sell their life insurance policies for more than the surrender value, but less than the death benefits." The press release identified the primary purpose of the proposed regulations as the protection of consumers by establishing a transparent marketplace with specific licensing, registration and disclosure requirements in order to provide consumers with the critical information they need to make a decision in a life settlement transaction, including the value of offers and counteroffers, the fees paid to life settlement brokers and the contractual arrangements among the parties in a transaction.

The release noted that the Department would have the authority to "issue, revoke, suspend or non-renew" the licenses of life settlement providers and brokers, as well as to grant or withhold approval for the forms of contracts used in life settlement transactions. The Department pointed out that the proposed legislation specifically prohibits life settlement providers and brokers from engaging in "stranger-owned life insurance" ("STOLI"), a practice in which "a life insurance policy is purchased for the benefit of someone, who at the time of policy issuance, has no insurable interest in the life of the insured individual."

While similar in many respects to the laws adopted in the past few years by other states, New York's proposed legislation contains certain unique features, such as the life settlement intermediary registration requirement applicable to certain parties which trade in policies, that make the law particularly noteworthy. This advisory summarizes the provisions of the proposed law and provides some legal and historical context for the Department's action.

I. Overview of Life Settlement and Viatical Settlement Regulation

At present, 44 states and Puerto Rico regulate life and/or viatical settlements in some manner, and several of the rest are considering such regulation.[1] The vast majority of states that have passed life settlement laws since 2007 have based their legislation on the National Conference of Insurance Legislators Viatical Settlement Model Act (the "NCOIL

[1] While definitions vary, a life settlement is generally similar to the definition stated above and refers to the sale to a third party investor of a life insurance policy by a policy owner for an amount less than the expected death benefit under the policy but more than the cash surrender value that the relevant insurance carrier would pay for such policy. A viatical settlement is essentially the same as a life settlement except the insured is chronically or terminally ill.

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Model"), the National Association of Life Insurance Commissioners Life Insurance Settlements Model Act (the "NAIC Model") or a combination of the two. While New York is currently one of the minority of states that regulates viatical settlements without regulating life settlements, the subject has been under discussion for several years. It now appears likely, based on the comprehensive proposal issued in March 2009 by the Department, that New York will soon regulate life settlements as well.

II. Background—the 2008 Proposal

In April 2008 the Department drafted legislation to regulate life settlements that was submitted to both the Senate and Assembly (the "2008 Bill"). The 2008 Bill adopted the position reflected in the NCOIL Model and proposed a two-year prohibition on the sale of a policy (absent certain specified circumstances), rejecting the NAIC Model's five-year ban. Although the 2008 Bill resembled recent life settlement laws passed by other states in many respects and included a proscription on transactions that indicate the presence of STOLI, it also included a provision unpopular with many in the life settlement industry that would have required certain investors in life settlements to be registered with the Department. In response to concerns raised by the life settlement industry, the 2008 Bill was brought closer to the NCOIL Model by eliminating the investor registration requirement.

While this bill failed to become law following the attempt to reach a consensus among regulators and those in the life settlement industry, the Department responded by holding public hearings on the topic of life settlements and soliciting the views of life settlement providers, life settlement brokers, life insurers, life insurance agents, investors and trade associations with the intention of gathering information to develop new legislation. On March 23, the Department proposed Bill Number A7131 (the "2009 Bill"), which was sponsored by Assemblyman Joseph D. Morelle, the Democratic chairman of the Assembly's Insurance Committee and one of the co-sponsors of the 2008 Bill. A select group of provisions of the 2009 Bill is discussed more fully below.

III. Analysis of Selected Provisions of the 2009 Bill

A. Section 11 of the 2009 Bill

New York currently regulates viatical settlements under Article 78 of the Insurance Law.[2] Article 78 imposes licensing, contractual, reporting, examination and disclosure obligations on any entity acting as a viatical settlement company.[3] Section 11 of the 2009 Bill would repeal existing Article 78 of the Insurance Law and would replace it with a new Article 78 which:

- sets forth the license requirements for life settlement providers;[4]
- sets forth the registration requirements for life settlement intermediaries;[5]
- provides the Superintendent of Insurance (the "Superintendent") with the authority to refuse to renew, revoke or suspend the license of any life settlement provider or the registration of any life settlement intermediary, subject to notice and a hearing;
- requires life settlement providers to obtain approval by the Superintendent of life settlement contract forms prior to use;
- requires each licensee to file an annual statement with the Superintendent, and authorizes the Superintendent to examine or investigate the affairs of any licensee, registrant or applicant;

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[2] NY Insurance Law § 7801 (c) defines a **viatical settlement** as "an agreement entered into between a viatical settlement company and a viator." Under § 7801 (b) a **viator** "means the owner of a life insurance policy insuring the life of a person who enters into an agreement under which the viatical settlement company will pay compensation or anything of value, which compensation or value is less than the expected death benefit of the insurance policy, in return for the viator's assignment, transfer, sale, devise or bequest of the death benefit of the insurance policy, in return for the viator's assignment, transfer, sale, devise or bequest of the death benefit or ownership of the insurance policy to the viatical settlement company."

[3] Under NY Insurance Law § 7801 (a) a **viatical settlement company** "means an individual, partnership, corporation or other entity not prohibited from acting as a viatical settlement company ... that enters into an agreement with a person owning a life insurance policy insuring the life of a person who has a catastrophic or life threatening illness or condition, under the terms of which the viatical settlement company pays compensation or anything of value, which compensation or value is less than the expected death benefit of the insurance policy, in return for the policyowner's assignment, transfer, sale, devise or bequest of the death benefit or ownership of the insurance policy to the viatical settlement company."

[4] Proposed NY Insurance Law § 7802 (m) would define **life settlement provider** as "a person who enters into a life settlement contract with the owner."

[5] For a more detailed discussion of the meaning of the term "life settlement intermediary," see Section A3 below.

- prohibits licensees and registrants from disclosing the identity of the insured or owner of a policy in connection with a proposed or actual life settlement unless the disclosure is necessary for specifically identified purposes;
- prohibits any person who obtains or may obtain a settled policy from disclosing the identity of the individual insured under, or the owner of, the policy;
- requires specific disclosure to be provided by the life settlement provider and the life settlement broker, including the amount of compensation to be paid to the broker;
- identifies prohibited practices;
- sets forth penalties and civil remedies; and
- sets forth provisions addressing nonconforming life settlement contracts and the applicability of the provisions of the new Article 78.

1. Definition of a "Life Settlement Contract"

The 2009 Bill defines a "life settlement contract" more broadly than do the laws in most other states. While the first part of the term is consistent generally with these laws, (i.e., an agreement under which compensation less than the expected death benefit of the policy is provided in return for the sale, assignment or transfer of any portion of the death benefit, the ownership of the policy or any interest therein, including a trust or other entity that owns the policy), the last part of the definition includes "any other agreement that the Superintendent determines is substantially similar to any of the foregoing," which gives the Department great discretion in exercising its regulatory authority in the event it considers any agreement to have as its goal the transfer of an interest in a life insurance policy. Excepted from the definition of "life settlement contract," however, is any agreement "to assign, transfer or pledge a settled policy, or an interest therein, to a licensed life settlement provider, an accredited investor[6] or a qualified institutional buyer,"[7] which would appear to permit affluent individuals, hedge funds, investment funds and other financial institutions to acquire and transfer properly originated policies without regulatory supervision.[8]

2. STOLI Provision

One of the most important additions of Section 11 of the 2009 Bill is the prohibition of those required to be licensed under the statute from facilitating the issuance of a policy for the intended benefit of a person who has no insurable interest in the life of the insured.[9] Specifically, proposed § 7815 states:

> (a) No life settlement provider, life settlement broker, or any representative thereof, shall directly or indirectly engage in any act, practice or arrangement, at or prior to policy issuance, to facilitate the issuance of a policy for the intended benefit of a person who, at the time of policy origination, has no insurable interest in the life of the insured.
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> (b) The failure to follow the provisions of this section shall be a defined violation under article twenty-four of this chapter.[10]

The Statement in Support of the 2009 Bill provides an example of a STOLI situation. It explains the structure as follows:

> A life insurance policy is initially purchased by an individual for the primary purpose of transferring it to a third party stranger and arrangements are made so that the policy owner does not pay or is effectively reimbursed for any policy premiums paid, the third party has no insurable interest in the life of the insured, and the policy is transferred to the third party.

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6 An "accredited investor" would be defined in the new law by reference to the definition in Rule 501 under Regulation D of the Securities Act of 1933, as amended (hereafter, the "Securities Act").

7 A "qualified institutional buyer" would have the meaning set forth in Rule 144A under the Securities Act.

8 Proposed NY Insurance Law § 3205 (k) defines "life settlement contract."

9 Under NY Insurance Law § 3205, "The term, 'insurable interest' means: (A) in the case of persons closely related by blood or by law, a substantial interest engendered by love and affection; (B) in the case of other persons, a lawful and substantial economic interest in the continued life, health or bodily safety of the person insured, as distinguished from an interest which would arise only by, or would be enhanced in value by, the death, disablement or injury of the insured."

10 Article 24 of the Insurance Law covers unfair methods of competition or unfair or deceptive acts or practices, and authorizes the Superintendent to conduct investigations and to levy fines for violations.

The Statement in Support of the 2009 Bill concludes by saying that in such a situation, it may be determined that there was no insurable interest at the inception of the policy if "it can be shown that there was a prior plan or arrangement for the individual to purchase the policy for the purpose of selling it to the third party."

This language is ambiguous and the Statement does not amplify what is meant by the phrase "plan or arrangement." The Statement suggests that if an original policy owner purchases a policy with the intention or "plan" to sell the policy to a third party investor but does not have an actual agreement with any person to do so, the insurance company which issues the policy could nevertheless challenge a subsequent purchaser's claim under the policy for lack of insurable interest. However, the settled law in New York is that after the expiration of the two-year contestability period, an insurance carrier cannot challenge, for lack of insurable interest, the right of the owner of a fully paid-up life policy to collect the policy proceeds upon the death of the insured. *See* New York Life Insurance Law, Section 3203(a)(3), McKinney's Cons. Laws of New York, Book 27, as cited in New England Mutual Life Ins. Company v. Caruso, 73 N.Y.2d 74 (1989). The proposed 2009 Law does not on its face purport to change this statutory provision or to undermine the case law, which reflects "a balancing of society's interest in enforcement of a particular provision in a contract, the incontestability clause in this case, against its interest in prohibiting gambling," 73 N.Y.2d at 81, and places on the insurer the obligation "to investigate the insurable interest of its policyholders promptly within the two-year period." 73 N.Y.2d at 83. Based upon the Statement in Support of the 2009 Bill, it is possible that the New York Legislature might revisit the assumptions underlying the existing case law in light of the concern expressed in the 2009 Bill about STOLI and the relationship between STOLI and insurable interest. [11]

3. Definition of "Life Settlement Intermediary"

As discussed above, one of the most controversial provisions of the 2008 Bill required that a purchaser of settled policies register with the Department. The 2009 Bill requires registration by a newly created category of person: the "life settlement intermediary." Under the 2009 Bill, a "life settlement intermediary" is "a person who maintains an electronic or other facility or system for the disclosure, through a forum of offers and counteroffers, to sell or purchase a policy or a settled policy; and delivers to: (1) a life settlement provider an offer from a life settlement broker or owner to sell a policy; (2) an owner or life settlement broker an offer from a life settlement provider to purchase a policy; or (3) a life settlement provider an offer to sell or purchase a settled policy."[12] Thus, a life settlement intermediary is a party that acts as a facilitator for the transfer of policies between life settlement providers and brokers, or between policy owners or brokers and providers, or acts as principal with respect to the sale or purchase of a settled policy from a life settlement provider. The 2009 Bill would require all life settlement intermediaries to register with the Superintendent, and each registration would be valid for a two-year period, subject to renewal. Although, as noted above, the definition of "life settlement contract" would appear to exempt from regulation the purchase by financial institutions and other sophisticated participants in the life settlement market by virtue of the exclusion for "accredited investors" or "QIBs" who acquire interests in previously settled policies, the registration requirement for life settlement intermediaries could now bring them within the scope of the law.

Compliance with the registration requirement would require a life settlement intermediary to provide material disclosure to the Department regarding its business and operations. In addition to submitting a fee, designating the Superintendent of Insurance as an agent for service of process and undergoing a fingerprint and criminal history record check, proposed NY Insurance Law § 7804 would require life settlement intermediaries to disclose information such as the state in which they are domiciled, their principal place of business, all states in which they are doing or intend to do business, and the identities of key officers and certain stockholders, partners, members, directors and persons with a controlling interest. The Superintendent would also be authorized

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[11] The Fourth Circuit Court of Appeals, adopting the view reflected in current New York case law, recently rejected the proposition that a policy owner's intent to sell a policy at the policy's inception was sufficient to invalidate his insurable interest. First Penn-Pacific Life Ins. Co. v. Evans (2009). Quoting from the brief of amicus curiae, the Life Insurance Settlement Association ("LISA"), the court stated: "evaluating insurable interest on the basis of the subjective intent of the insured at the time the policy issues ... would be unworkable and would inject uncertainty into the secondary market for insurance." Nat Shapo, a partner in Katten's Chicago office, represented LISA as amicus curiae in the appeal.

[12] Proposed NY Insurance Law § 7802 (l).

to request information from the life settlement intermediary to verify the life settlement intermediary's qualifications and determine compliance with any applicable state law. These qualifications include a determination by the Superintendent that the life settlement intermediary is "trustworthy and competent to act as a life settlement intermediary," although the statute does not provide an explanation of how a registrant would satisfy these criteria.

In addition, Section 7804 of the 2009 Bill authorizes the Superintendent to revoke or suspend the registration of a life settlement intermediary if, after notice and a hearing, he determines that the intermediary or any member of its management has violated any insurance or other laws or engaged in any of a number of activities, including the following:

(i) provided materially incorrect or incomplete information in its registration application;

(ii) used fraudulent, coercive or dishonest practices;

(iii) demonstrated financial irresponsibility, or improperly withheld or misappropriated any monies or properties received, in the conduct of its business in New York *or elsewhere* [emphasis added];

(iv) intentionally misrepresented the terms of any insurance contract or life settlement contract or been found to have committed any insurance unfair trade practice; or

(v) knowingly conducted the business of life settlements with a person who is not licensed or registered unless such person is not required to be licensed or registered.

B. Other Sections of the 2009 Bill

In addition to Section 11 discussed above, the sections of the 2009 Bill described below would make the following changes to New York law:

- Section 1—would amend Insurance Law § 308 to add life settlement providers and life settlement intermediaries to the list of entities that are required to provide written responses to Department inquires.
- Section 2—would add a new subsection to Insurance Law § 2101 (the definitions section of the Article covering Agents, Brokers, Adjusters, Consultants and Intermediaries).
- Sections 3 and 4—would amend Insurance Law § 2102 and § 2110 to add life settlement brokers to the list of those persons required to obtain a license, and whose licenses may be revoked, suspended or not renewed by the Superintendent.
- Section 5—would add a new subsection (e) to Insurance Law § 2119 requiring life settlement brokers to receive compensation only pursuant to a written contract, and would prohibit excess charges.
- Section 6—would amend the continuing education requirements of Insurance Law § 2132 to also apply to persons licensed to sell life settlements, and would exclude certain insurance producers with a life line of authority from the requirement to take an examination.
- Section 7—would add a new Insurance Law § 2137, which specifies the licensing requirements (both initial and renewal) applicable to life settlement brokers and would exclude certain individuals from the requirements for pre-licensing education and an examination.
- Section 8—would amend Insurance Law § 2401 to include life settlements within the category of insurance subject to the prohibitions of unfair methods of competition or unfair or deceptive acts or practices.
- Section 9—would amend the definitions of "person" and "defined violation" contained in Insurance Law § 2402 to include the business of life settlements and certain acts committed with respect to that business.
- Section 10—would amend subsection (c) of Insurance Law § 3220 with respect to group life insurance policies to require that a group policy that permits assignment of an insured person's rights by gift shall also allow assignment for value to the same extent that it allows assignment by gift.

- Sections 12, 13 and 14—would amend Insurance Law § 403 to: (1) make the commission of a fraudulent life settlement act a violation of the Insurance Law; (2) define a fraudulent life settlement act by reference to Penal Law § 176.40; and (3) add "fraudulent life settlement act" as one of the actions for which the Superintendent is empowered to impose a civil penalty.[13]
- Section 15—would amend Insurance Law § 404(a) to include the business of life settlements within the activities that the Superintendent may investigate.
- Section 16—would amend Insurance Law § 405 (which requires insurers who have reason to believe that an insurance transaction may be fraudulent to report the transaction to the Department) to include life settlement, life settlement acts, fraudulent settlement acts, and life settlement providers.
- Section 17—would amend Insurance Law § 406 (which, in the absence of fraud or bad faith, provides civil immunity for information relating to suspected fraudulent insurance transactions) to add provisions relating to attorneys' fees and the status of documents and evidence obtained by the Superintendent during an investigation.
- Section 18—would add a new Insurance Law § 410 detailing the required parameters of life settlement fraud prevention plans that must be implemented and reported annually by life settlement providers to the Superintendent.
- Section 19—would add seven (7) new sections to the Penal Law to create new crimes of life settlement fraud and aggravated life settlement fraud.
- Section 20—would amend Banking Law § 570 to integrate its provisions governing premium finance agreements with the requirements of amended Article 78 of the Insurance Law.
- Section 21—sets forth the effective date of the proposed bill, which is generally 180 days after enactment except that the privacy, disclosure and STOLI insurance provisions are effective immediately.

IV. Conclusion

As proposed, the New York law governing life settlements could have a significant impact upon those conducting business in the state. Among other things, its adoption would provide greater transparency for the owner of a life insurance policy contemplating a sale to permit him or her to more readily understand the amounts being paid to the broker and would protect his or her identity and the privacy of his or her personal information. The new law would not only require life settlement providers to submit detailed information to the Superintendent on an annual basis, but would also give the Superintendent investigatory power and the power to deny a license or deny renewal thereof, thereby enabling the Insurance Department to effectively shut down a non-compliant provider's operations. By requiring the approval of the Superintendent for life settlement forms used by a licensed life settlement provider, the law would bring greater uniformity to the documentation of these transactions. It would also give the Superintendent the power to police and penalize certain actions deemed fraudulent, thereby further limiting abuses in life settlement transactions. It is not clear what effect, if any, the new law will have on hedge funds and larger financial institutions that have become actively involved in the life settlement business in recent years, but the law could potentially subject them to the registration requirements for life settlement intermediaries, thereby opening their operations to regulatory scrutiny.

This advisory was authored by Rachel B. Coan and Henry Bregstein with assistance from Bradley Clair.

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[13] Proposed Penal Law § 176.40 states, "A fraudulent life settlement act is committed by any person who, knowingly and with intent to defraud, presents, causes to be presented, or prepares with knowledge or belief that it will be presented to, or by, a life settlement provider, life settlement broker, life settlement intermediary, or purchaser of a settled life insurance policy or any interest therein, or any agent thereof, or to any owner any written statement or other physical evidence as part of, or in support of, an application for a life settlement contract, a claim for payment or other benefit under a life settlement contract or the sale of a settled life insurance policy or any interest therein, which the person knows to: (1) contain materially false information concerning any material fact thereto; or (2) conceal, for the purpose of misleading, information concerning any fact material thereto."

We note that STOLI is not expressly included, but it could be inferred that the legislation may have intended to bring STOLI within the ambit of a "fraudulent life settlement act" by virtue of the breadth of the term.

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6/2/09