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Insurance / The fight for your life insurance

Insurers, states seek changes in secondary market for policies

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Usually, insurance companies try to encourage folks to buy more insurance.

But John Paulson of Golden Valley, who bought millions of dollars worth of insurance and then sold the policies to a third party for a profit, is being sued by his insurer for fraud.

The case, pending in U.S. District Court, puts a spotlight on a growing, but little-understood aspect of the life insurance business: the sale of policies on the secondary market. Increased demand for such policies from investors is leading to abuses, insurers and regulators say, particularly the practice of stranger-originated life insurance, known as STOLI.

It's not clear who initiated Paulson's policies, but according to Sun Life of Maine, he took out $17 million in policies between 2002 and 2004, and sold them to third parties within a few years.

Sun Life has sued Paulson, the independent agents that sold him the policies and the third parties that bought his policies, saying that SunLife was misled about how much insurance he had in force.

Paulson's attorney, Thomas Brever, says that his client, in his mid-80s and in failing health, never intended to defraud anyone. Attorneys for the other defendants did not return calls seeking comment.

Though not yet common, STOLI is raising alarms with regulators and insurers. The Minnesota Department of Commerce and insurers intend to back a bill in the next state legislative session that would put curbs on STOLI.

Regulators say seniors, the primary target for such policies, can easily be duped by brokers pitching the complex transactions. Insurers argue that stranger-initiated policies distort the purpose of life insurance and could encourage regulators to revoke its tax-preferred status.

Opponents of the bill say that insurers are more worried about how such deals cut into their profits. And although no one claims to be in favor of STOLI, they argue the proposed law would kill the legitimate secondary market for life insurance, hurting people like Carl Wolk.

Legislation proposed across the United States would bar consumers from selling their life insurance policies on the secondary market for five years after purchase, with certain exceptions.

This spring, Wolk, of Minnetonka, testified at a state House committee hearing that such limits would have put him in the poorhouse.

Now 75, Wolk spent 40 years building up his business, the Twin Cities retail chain Seasonal Concepts. He thought when he sold a chunk of his business a few years ago that he'd have enough money to retire.

But the company went bankrupt and Wolk's net worth, almost completely tied up in the assets of his business, tanked. And the payments he was supposed to receive for the business, spread out over five years, didn't come.

Though he says had a small amount in savings, it wasn't enough. He had taken out a couple of life insurance policies a few years earlier, but now he couldn't even afford to pay the monthly premiums. So, last year, Wolk sold the policies. Although a stranger will now collect the death benefit Wolk had hoped to leave his family, he says he had little choice.

"Without it I just don't know what we would have done," he said.

Michael Freedman, a vice president with Coventry First, a big life settlement company, says the insurers' support for a five-year ban "is all about protecting their profits," and takes away the value of the insurance policy to consumers.

But insurers say folks like Wolk needn't worry about the proposed changes.

"Based on the facts presented, Wolk's policies would not be subject to the (proposed law) because he bought the policy for a legitimate purpose — to protect his family," said Robyn Rowen of the Minnesota Insurance and Financial Services Council.

Backers of the bill say that they are focused on trying to stop policies that are initiated by strangers for investment purposes.

Bob MacDonald, former CEO of Allianz Life of North America calls stranger-originated life insurance "a bastardization" of the life insurance buying and selling process. Though not illegal, it may be immoral, he says.

Pitch To Consumers / Stranger-originated life settlements are uncommon in Minnesota. The Pioneer Press was not able to find anyone who would admit to being involved in one.

"I can't honestly say it's a big issue with the consumers yet," said Glenn Wilson of Commerce Department. "They are by and large unaware. ... But the industry is just cranking up."

Out of nearly 30,000 resident agents licensed to sell life insurance in Minnesota, and nearly as many nonresident agents, only 12 brokers in the state are licensed by the Department of Commerce to do life settlement deals.

Wall Street is ratcheting up the demand for life settlements, according to a legislative analyst who spoke at the same hearing at which Wolk testified. Investment firms are pooling several policies together, then dividing the pools into individual securities that are sold to big institutional investors like foundations, colleges and pension funds, said Tom Pender, an analyst with the Minnesota House of Representatives. The new securities are often called "death bonds."

Coventry's Freedman says the growth of the secondary market has increased the value of life insurance policies, which is good for consumers. Freedman says Coventry opposes STOLI, but believes insurers are inflating the problem to attack life settlements.

But insurers say there aren't enough legitimate life settlements to keep pace with investors' appetite for the death bonds, so companies that buy the policies are offering brokers and agents big incentives to originate more of the transactions. And of course, brokers and agents make money on any policy they sell.

Here's how the pitch to consumers works, according to the insurance industry:

Insurance agents or the third-party investors themselves hold "free life insurance" or "estate maximization" seminars targeting seniors usually over the age of 70.

Seniors who buy the pitch are asked to take a physical and/or provide extensive information about their health and medical history.

Those deemed to have limited life expectancies are encouraged to apply for life insurance and told if they qualify, a third party will pay their premiums for two years, after which the policyholder will sell the policy to the third party. The senior usually receives an upfront payment.

The sum the consumer gets selling the policy is greater than what he or she would get by surrendering the policy to the life insurance company, but less than the death benefit.

The third party becomes the owner of the policy and therefore has the right to name a beneficiary

When the senior dies, the stranger collects. The sooner the policyholder dies, the sooner investors get paid.

Overhyped Problem? / MacDonald, the former life insurance executive, says insurers are overhyping the dangers of stranger-originated life insurance.

"The crux of the reason why the companies are against it ... (is) they do lose more money on those policies," MacDonald said.

Some policyholders surrender their policies to their insurers for a moderate amount of money. Others let their policies lapse. In either case, the insurer does not pay the death benefit on those policies, though they may have collected premiums for many years.

But when a policy is sold on the secondary market, the buyer takes over paying the premiums, and the insurer remains on the hook for a death benefit.

Insurers deny that they are fighting stranger-originated life insurance because they worry about a drop in policy lapse rates.

"People, after they've owned a policy for 10 to 20 years, have a financial asset and you should not put strings around that financial asset," said Bob Senkler, chairman and CEO of Securian Financial Group in St. Paul. "We're not going to take away anyone's right outside of those that are buying it for investment-only purposes and selling it to a third party."

Right now, insurance companies have a two-year period in which to review new policies to ensure a customer applied for the insurance in good faith. If they determine someone lied on their application, they can rescind the policy.

Policyholders must also wait two years to sell their policies.

The bill proposed for Minnesota aims to ban life settlements within five years of a policy being issued if a third party was involved in the original purchase. The proposed law would allow settlements any time in the case of divorce, disability, bankruptcy, the loss of a job, chronic or terminal illness. It would also continue to allow people who purchased their policies in good faith to sell them after two years.

But all that five-year ban succeeds in doing, argues Freedman of Coventry, is keeping seniors from cashing in on a valuable asset for a longer period of time.

Insurers are perfectly capable of guarding against

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STOLI without a change in the law, Freedman said. They can ask more pointed questions and review applications more closely, he said.

Securian's Senkler says his company is looking at policies more closely.

But he still supports the Minnesota bill.

He worries that a surge in stranger-originated policies could encourage regulators to remove the tax-exempt status of life insurance benefits, making life insurance more expensive for everyone. And the idea of strangers profiting from someone's death bothers him.

Consumers considering selling a life insurance policy should be cautious, says Sally Hurme, of AARP Financial Security.

"The concept, on its face, of being able to cash in on unneeded life insurance policies to produce immediate cash or income has a superficial appeal," she said. "But the complexity and all the layers of money that are skimmed off of it in the process ... creates issues that I don't think are fully explained to consumers.

"Our advice would be, before anyone considers entering into selling their own life insurance policy . .. that the consumer thoroughly investigate the terms of the contract and discuss the options with the state insurance commissioner."

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