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Study on Life Settlements Investments

On July 7, 2008, the Pensions Institute—an academic center in the UK devoted to researching pension-related issues—released a report on the benefits and risks of investing in the US life settlements market, including the ethical concerns of investing in a mortality-based product.

According to the report, which is entitled “And Death Shall Have No Dominion: Life Settlements and the Ethics of Profiting from Mortality,” the major risks and concerns associated with these investments are (1) “overly optimistic mortality assumptions” (i.e., inaccurate life expectancy reports), (2) inconsistent regulation by the states, (3) stranger-originated life insurance (“STOLI”) transactions and the need to examine states’ insurable interest and contestability laws, and (4) the lack of transparency in products such that investors may be unaware that their portfolio includes mortality-based products and that a higher return occurs with an early death.

The report states that life settlements are attractive to investors because they are a low risk alternative asset, they diversify portfolios because they are not correlated with returns in equity and bond markets, and some have estimated that the market will grow by \$160 billion over the next few years.

The report also discusses the use of synthetic products, which are products that reference lives (“life-linked”), compared with the purchase of or investment in the actual settled policies (“policy-linked”).

A copy of the report is available on the Pensions Institute’s website: <http://www.pensions-institute.org/reports.html>.

Ohio Amends Viatical Settlements Laws to Provide Greater Consumer Protection

On June 11, 2008, Governor Strickland signed House Bill 404, which amends Ohio’s viatical settlements laws. Ohio’s laws continue to be based upon the model viatical settlements act of the National Association of Insurance Commissioners (“NAIC”), but the laws also include a few provisions from the model life settlements act of the National Conference of Insurance Legislators (“NCOIL”) and some provisions that are not in either model act as well.

Notably, a significant portion of the amendments addresses STOLI transactions and, in particular, prevents the use of premium financing loans to circumvent insurable interest laws.

For example, Ohio now defines STOLI, which means:

[A] practice, arrangement, or agreement initiated at or prior to the issuance of a policy that includes both of the following: (a) The purchase or acquisition of a policy primarily benefiting one or more persons who, at the time of the issuance of the policy, lack insurable interest in the person insured under the policy; (b) The transfer at any time of the legal or beneficial ownership of the policy or benefits of the policy or both, in whole or in part, including through an assumption or forgiveness of a loan to fund premiums.

[STOLI] also includes trusts or other persons that are created to give the appearance of insurable interest and are used to initiate one or more policies for investors but violate insurable interest laws and the prohibition against wagering on life.

Ohio Rev. Code § 3916.01(W)(1)-(2).

Ohio's STOLI definition resembles the NCOIL model act definition, except Ohio specifically refers to transfers of legal or beneficial ownership of the policy or benefits of the policy, "*including through an assumption or forgiveness of a loan to fund premiums.*" This modification to the NCOIL definition reflects the interplay between STOLI transactions and premium financing loans.

In an effort to prevent STOLI transactions, the amendments impose practices and reporting requirements upon different participants in the viatical settlement industry.

First, an insurance company that issues life insurance policies must include questions in its life insurance applications that are "reasonably structured to identify and prevent stranger-originated life insurance." *Id.* § 3916.05(B). Furthermore, "any life insurer that has a good faith belief that a person is participating or has participated in a [STOLI] transaction shall report the person to the superintendent [of insurance] in a form and manner prescribed by the superintendent." *Id.* § 3916.18(C)(3). If the superintendent finds that the person is participating or has participated in a STOLI transaction, the superintendent will publish the order on the department's website and notify each insurance company licensed in Ohio that the person has been adjudicated as having participated in STOLI transactions. *Id.* Neither of these insurance company obligations is included in the NCOIL or NAIC model act.

Second, "a viatical settlement provider or a viatical settlement broker that is a party to a plan, transaction, or series of transactions to originate, renew, continue, or finance a policy with the insurer for the purpose of engaging in the business of viatical settlements at any time prior to or during the first five years after the insurer issues the policy shall fully disclose the plan, transaction, or series of transactions to the superintendent of insurance." *Id.* § 3916.16(G). This reporting obligation resembles section 9 of the NAIC

model act, but section 9 requires the viatical settlement provider or broker to disclose the plan, transaction, or series of transactions *to the insurer*, not the insurance superintendent.

Significantly, Ohio's amendments may adversely affect investors whose interest in the settled policy occurs after the initial settlement transaction. For example, Ohio provides that any contract, agreement, arrangement, or transaction, including any financing agreement or arrangement, that is entered into for the furtherance or aid of a STOLI act, practice, arrangement, or agreement is *void and unenforceable*. See Ohio Rev. Code § 3916.172. This provision is significant because investors may find themselves at a financial loss if they unknowingly purchased a settled policy that is later rendered void and unenforceable because it was determined that the policy was entered into in furtherance or aid of a STOLI transaction.

The Ohio legislature recognizes that persons may be harmed when others commit violations of the viatical settlements laws. Indeed, the laws provide that "[a]ny person damaged by any act of a person in violation of any provision of this chapter may bring a civil action against the person committing the violation in a court of competent jurisdiction." *Id.* § 3916.19(B). Furthermore, the insurance superintendent may order a "person found to be in violation of this chapter to make restitution to persons aggrieved by violations of this chapter." See *id.* § 3916.19(C).

Investors should also note that the viatical settlements laws have been amended to specifically state that "any transaction related to the sale or financing of an interest or investment in a viatical settlement" is subject to Ohio statutes and rules relating to securities, see *id.* § 3916.19(D), although the Ohio Department of Commerce has treated viatical settlements as securities since 1998.

The effective date of the amendments is September 11, 2008, except the changes made to section 3916.02, which addresses the licensure of viatical settlement providers and brokers, will be effective on December 10, 2008.

To view the amendments discussed herein and the other modifications to Ohio's viatical settlements laws, go to the following website: http://www.legislature.state.oh.us/bills.cfm?ID=127_HB_404.

California Governor Schwarzenegger Vetoes Life Settlements Bill

On September 30, 2008, Governor Schwarzenegger vetoed SB 1543, a bill that was based upon the NCOIL model act and would have significantly changed California law.

In his veto message, Governor Schwarzenegger stated he did not sign the bill because the provisions were amended late in the legislative session and “some of the provisions are still subject to worthwhile debate.” He was concerned that the bill did not provide adequate disclosure and notification to consumers. He was also “concerned that the final version of the bill may unfairly exclude some companies from participating in the legitimate life settlement market.”

Governor Schwarzenegger’s veto message is available at: http://gov.ca.gov/pdf/press/SB1543_Machado_Veto_Message.pdf.

Rhode Island Governor Carcieri Vetoes Life Settlements Legislation

In July, Rhode Island Governor Carcieri vetoed two bills—HB 7442 and SB 2603—that would have regulated life settlements. As a result, Rhode Island will continue to have no laws that specifically regulate life settlements. The bills were based on the NCOIL model act.

Rhode Island Representative Brian Patrick Kennedy, who is the president of NCOIL, wrote a commentary on the governor’s vetoes. In Representative Kennedy’s opinion, by vetoing life settlements legislation, the governor continues to put consumers at risk and allows STOLI transactions to occur in Rhode Island. His commentary may be viewed at: <http://www.rilin.state.ri.us/News/settlementsoped.asp>.

Louisiana Reorganizes Insurance Code

Effective January 1, 2009, Louisiana Act 415 reorganizes the insurance code, Title 22 of the Revised Statutes, into a new format and number scheme. The statutes that govern viatical settlements will be renumbered as sections 1791 to 1805. The substance of the provisions was not changed.

Act 415 may be viewed in its entirety at: <http://www.legis.state.la.us/billdata/streamdocument.asp?did=503058>.

Some Pending Legislation

On June 4, 2008, the **District of Columbia** Council held a public hearing regarding the proposed viatical settlements act. This act was introduced on July 6, 2007. The District of Columbia currently does not regulate life settlements.

New York Senate Bill 8593 passed the Senate and was delivered to the Assembly on June 24, 2008. This bill proposes significant changes to the current viatical settlement legislation.

Noteworthy Administrative Decision

On June 27, 2008, the Office of the Attorney General for Texas issued an informal letter ruling to the Texas Department of Insurance that addressed whether annual reports filed with the Insurance Department by viatical and life settlement providers are accessible to the public as “public information” held by a governmental body. *See* Tex. Atty. Gen. Op. OR2008-05492A.

Like most other states, Texas requires life and viatical settlement providers and brokers to file annual reports that provide detailed information on the entities’ settlement transactions. *See* 28 Tex. Admin. Code § 3.1705. The department requested the letter ruling after receiving a request for certain providers’ information because disclosing the reports may have implicated one of the provider’s proprietary interests.

The Attorney General’s office ruled that certain information within the reports implicated the provider’s proprietary interests because competitors could determine the provider’s pricing model. In particular, the “release of the net death benefit purchased, the net amount paid to the owner, and the estimated total premiums to keep the policy in force for the mean life expectancy would reveal its pricing model and cause it substantial competitive injury.” Because disclosure could cause “substantial competitive injury,” it fell within an exclusion provided by law to the public’s general right to access “public information” held by a governmental entity. *See* Tex. Gov’t Code § 552.110(b). However, all other information could be released to the public as “public information.”

Although the letter ruling is limited to the particular records at issue and the facts presented, it raises interesting points for life settlements investors to consider. In Texas, the wording of the life and viatical settlements regulations conceivably could allow the Insurance Department to request information about investors in the provider’s annual reports that, in

turn, may become accessible to the public as “public information.” Texas law states: “In addition to the information required in this section, the department may request *any other information* the department deems necessary to conduct a complete review of the viatical or life settlement provider’s, provider representative’s, or broker’s conduct of business *related to the assignment, negotiation, purchase, sale, or other business related to viatical and life settlements.*” 28 Tex. Admin. Code § 3.1705(d) (emphasis added). Investors therefore should be aware of state laws regarding reporting requirements and “open records” laws to determine if settlement providers may be required to disclose information relating to investors and, if so, whether such information would be available to the public as an “open record.”

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