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RECENT INNOVATIONS IN SECURITIZATION

HEARING

BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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RECENT INNOVATIONS IN SECURITIZATION

Thursday, September 24, 2009

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CAPITAL MARKETS,
INSURANCE, AND GOVERNMENT
SPONSORED ENTERPRISES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2:35 p.m., in room 2128, Rayburn House Office Building, Hon. Paul E. Kanjorski [chairman of the subcommittee] presiding.

Members present: Representatives Kanjorski, Sherman, Scott, Maloney, Minnick, Kosmas, Grayson, Himes; Garrett, Manzullo, Capito, and Jenkins.

Also present: Representatives Watt, Green, and Hirono.

Chairman KANJORSKI. This hearing of the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises will come to order.

I ask unanimous consent that Ms. Hirono of Hawaii have permission to participate in today's hearing. Pursuant to committee rules, each side will have up to 15 minutes for opening statements. Without objection, all members' opening statements will be made a part of the record.

We meet this afternoon to examine recent innovations in our securities markets, especially those related to life insurance settlements. While the life settlement industry is now well established and quickly growing, the securitization of life settlements remains in its infancy. Investors, however, have already gained access to securities products like life settlement funds, mortality indexes, and derivatives linked to life settlements.

Today's hearing offers us an incredible opportunity to employ the lessons that I hope we all learned, even though we paid too dear a price to learn them, about issuing toxic securities. By asking some fundamental questions about this industry, we can prevent trouble using foresight rather than later undergoing disaster in hindsight.

Specifically, we should ask how one would securitize life settlements, what is needed to properly securitize these products, and whether or not we should securitize them. We should also explore how we can protect those who invest in these products and better safeguard those who sell their life insurance policies.

Perhaps most importantly, we must examine whether or not securities products based on life settlements actually contribute to

economic growth or merely prolong the casino culture on Wall Street that got us into our current economic mess.

Generally, I see enormous value in securitization. Pooling assets together to create new products can effectively allocate limited economic resources. Securitization has mobilized trillions of dollars of capital from around the world to enable Americans to purchase cars and homes, obtain a college education, and start new businesses. Through securitization, we have also created new sources of liquidity and helped investors to diversify their portfolios. In short, the securitization of home mortgages and other assets still has the potential to produce enormous societal benefits.

That said, we must remember that securitization is only an engine and not an end in itself. Like other engines, for it to run as intended, securitization needs strong, reliable inputs, responsible operators, and clear rules of the road. In the case of the subprime crisis, we failed on all three fronts.

Wall Street's insatiable demand for subprime mortgages fueled a Frankenstein-like engine that allowed originators to hit full throttle and bundle tens of thousands of toxic mortgages without regard for the consequences.

At the same time, regulators ineptly monitored these activities, underwriters dangerously relaxed standards, and far too many investors failed to fully understand the purchases they made.

Perhaps most troubling, the gatekeepers to our markets, credit rating agencies, negligently if not recklessly stamped nearly everything with a AAA. Their widely inappropriate investment grades nearly drove our economy off a cliff.

Before life settlements have the chance to give securitization another black eye, we ought to consider the need for additional safeguards. Today's hearing will therefore focus on whether or not life settlements are an appropriate input for the securitization engine, or whether or not its operators can appropriately drive this vehicle.

Life settlements can provide retirees with a source of liquidity to fund unexpected expenses or to sell an asset that they no longer need at a better price. But this industry also has the potential for substantial abuse. Presently, States inconsistently regulate life settlements. Many States have also failed to require the registration of life settlement brokers.

Moreover, because of the opaqueness of life expectancy estimates, some investors in life settlement funds have already lost money on inaccurate predictions. The financial gains made by a select few middlemen from the transaction costs related to life settlements are also estimated to be 4 times that associated with the sale of masterpiece paintings.

In sum, we face many problems with this budding industry. The improper securitization of life settlements could ultimately leave countless seniors penniless and innumerable investors broke. The idea of institutional investors profiting from a person's death also seems, to say the least, unsettling and immoral. It leads us down a slippery slope that might eventually result in indexes based on divorce rates and swaps tied to gambling losses.

We are hopefully now emerging from the worst recession of our time. This committee is also working diligently to strengthen the regulation of our financial system to withstand future crises. It is

in this spirit of reform that we should examine the life settlement industry and its connections to our securities markets. By doing so today, and before we face another crisis, we may also decide that the best policy is to keep this Pandora's box shut.

I will now recognize Mr. Garrett for 5 minutes.

Mr. GARRETT. Thank you, Mr. Chairman.

And thank you to all the members of the panel and on the additional end table of the panel here as well.

I thank the chairman for holding this hearing today.

You know, due to the problems that we have experienced over the last couple of years in the secondary mortgage market, it is really timely and appropriate that this subcommittee fulfill its role and conduct proper oversight over any new advances in securitization and how these new advances in securitization might affect consumers and investors.

Now, the main asset class that we are focusing on today is life insurance settlements. These products have been around, as you all know, since the 1980's, and the industry has continued to grow since its inception. As I understand it from talking to some of the folks in industry, that looking at an industry around $31 billion in size, and it is slated to grow even more.

I believe that the number one focus of this hearing today should be the well-being of our senior citizens and their families. It is these people that we want to make certain that we are looking out for.

While we want to do our best to protect the seniors and their families from any harmful financial products, we really don't want to limit their consumer choices and deprive the elderly of ways for them to enhance the current quality of life.

Prior to the development of the life insurance settlement marketplace, policyholders really had two options before them for dealing with their life insurance policies: they could stop paying the premiums and allow the policies to lapse; or simply surrender the policy for the cash value that life insurance would offer. Well, life insurance settlement provides seniors a third option that they consider while they try to maximize the value of the assets that they hold.

In some studies I have seen, they have shown that life insurance settlements routinely offer 3 or 4 times the return to the policyholder in comparison to simply surrendering it in for cash value.

So while there are numerous stories out there about seniors benefiting from this type of settlement, there are other stories out there we read in the paper about fraud and malfeasance in the industry.

So I look forward to this hearing today, Mr. Chairman, about any ongoing initiatives by the States to enhance both consumers' and investors' protection as well as their privacy rights of anyone selling these policies.

I am also interested to learn from the NAIC more about their model life settlement act and how States are applying it, and whether we need—or whether they need to do anything else to update that as well. I do believe that transparency and accountability in this industry must continue to improve.

The other main focus of this hearing today should be to delve into the concerns that the chairman has mentioned about securitization of these assets, because, in the wake of the recent financial market collapse where large problems occurred and are really still occurring in the mortgage securitization market, it is really appropriate that we examine other new forms of securitization that at least have the potential, we think, to grow and expand.

Now, there is that recent New York Times article, that I am sure we are all familiar with on this topic, that led a few people to believe that there is an imminent chance for explosion of life insurance settlement securitization. But as I understand it, there have been, to date, only a couple of real specific securitizations that have occurred in this area of around $3 billion. And when you consider that the total outstanding dollar amount of life insurance policies in general is around $27 trillion, I find it hard to believe that these few securitizations pose a threat to the broader life insurance market and industry.

With that said, I do recognize the potential for growth in this market and this industry, and I do feel it is appropriate that we take time right now to learn more about these products before it potentially, if it could, get out of hand, much like Fannie Mae and Freddie Mac and the GSEs did in the secondary mortgage market, and Congress just didn't act in time.

I know the SEC recently announced the formation of a task force to examine these issues, and I do look forward to hearing what they are doing and considering on a regulatory front, because, at the end, protecting consumers and investors and ensuring the integrity of our capital markets are critical tasks before this subcommittee and this Congress, and I believe we are moving in the right direction by having this hearing today. That is why I thank this panel, and I thank the chairman for doing so.

I yield back.

Chairman KANJORSKI. Thank you very much, Mr. Garrett. We will now hear from Mr. Sherman of California for 3 minutes.

Mr. SHERMAN. I look at this from four directions.

First, from the standpoint of investors in the securities, do they understand the investment? Are they marketed correctly? I would rely on the SEC to make sure that is the case.

Unlike everything else we are doing in this committee, at least what we are talking about today does not pose a systemic risk to the entire economy. I would say an investment in a pool of life insurance policies is no more difficult to understand than buying the common stock of a life insurance company.

Second is the overall ghoulishness, which is why I think we are here. But we should keep in mind that there are many investments in which you benefit from a misfortune. You buy oil futures, and if Iran blocks the Strait of Hormuz, you sell the S and P short; and if our economy goes down or you sell short the stock of a life insurance company; and if people don't live as long as we currently suspect, you make money. There are plenty of investments in which the investor makes money due to the misfortune of others.

Third is from the policy owner's perspective. Let's face it, life insurance companies are selling whole life and similar policies as in-

vestments, and then when you want to surrender the policy, they provide you far less than the actuarial value as the cash surrender value. Policy owners who bought these investments should try to get as much of the actuarial value of their investment as possible. The way to do that is to have people—well, the real way to do it is to have the life insurance industry dramatically increase cash surrender value to something approaching actuarial value. But if they won't, then we have to allow or ought to allow policy owners to sell their policies to the highest bidder. The more bidders, the more they will get. And if some of those bidders are involved in securitization, that brings in more bidders. Otherwise, people who have paid for decades are going to get only a small fraction of what their policy is worth.

Finally, from the insurance company's standpoint, I am told that roughly 90 percent of the policies are surrendered or abandoned. Obviously, if the cash surrendered value is far less than the actuarial value, the insurance company makes more money. Do they pass this on to consumers, or is this just a profit center for the insurance industry?

I don't know whether Congress should intervene in the markets to prevent policy owners from getting fair value on the expectation that means life insurance companies will make more money and that is somehow good for consumers.

I yield back.

Chairman KANJORSKI. Thank you very much, Mr. Sherman.

We will now hear from Mr. Scott of Georgia for 2 minutes.

Mr. SCOTT. Thank you, Mr. Chairman.

There are certain concerns with the interaction of the life settlement industry and the securities markets, so this hearing is very timely, how this interaction will have an impact on investors and how those investors will actually benefit from those life settlement deals regarding life insurance. I am concerned with the standards of underwriting that I believe, as we move forward in looking at all areas of the financial service industry, we must remain focused on the very important aspect of transparency. Also, when assets are securitized, it gives investors new hurdles in addressing the authenticity of the policy.

Securities and Exchange Commission Chairman Mary Schapiro has expressed her own concerns over the role of securitization in life settlements and believes that there are many questions to be asked relating to sales and practice and privacy rights, serious questions. The interaction of the life settlement industry with securities markets raises the question of, how will investors be protected? We certainly need answers to that question. Should we more intently focus on the transparency of underwriting standards used as well as mortality estimates? Does the securitization of life settlement produce unintended consequences for the State guarantee funds, especially if more policyholders obtain life settlements and fewer life insurance policies lapse? These are very serious questions that we have to examine. The hearing is very timely, and I look forward to each of your presentations.

Thank you, Mr. Chairman.

Chairman KANJORSKI. Thank you very much.

I will now recognize the gentleman from Florida, Mr. Grayson, for 3 minutes.

Mr. GRAYSON. Santayana said, "Those who cannot remember the past are condemned to repeat it." So it certainly is important that we learn from history, but it is also important that we learn the real lessons of history and not delude ourselves.

For instance, some people have adopted the view that securitization must be evil, because when we started to securitize, we ended up with great economic problems.

I have a really different point of view about that. I don't think there is anything inherently wrong with securitization at all. I don't think there is inherently anything wrong with securitizing any kind of asset. It depends on how you do it.

So if those people who believe that securitization is evil come to dominate our economy, then the result of that will be that we will miss out on the economic opportunities that good financial reform can provide to us. So if you came here today to try to convince us that we should shut down life settlement securitization, I am not going to be with you.

However, we do need to learn from our experiences. And one thing we have learned is that monopoly is not good.

In the case of life insurance policies, there has a monopoly buyer of life insurance policies that are in existence. It is the issuer. The issuer is the only one who can buy back from you except for the life settlement companies. They are the only competition that is provided to the issuer in a situation like that. So when we have a monopoly, when we have a monopsony, actually, the result of that is that the policyholder doesn't get fair value for that policy. And we have seen that over and over and over again.

What we want is we want an industry that provides competition. Life settlement actually is an industry that promotes and provides competition and provides value to the holders of these insurance policies they wouldn't otherwise have.

When we look back on the experience of the last couple of years, the real enemy, as I see it, is the enemy of leverage. It is the enemy of zero capital requirements or insignificant capital requirements. In the case of AIG, there were no capital requirements. They could issue anything they want and call it some kind of insurance policy, and they didn't have to have any reserve requirements at all. No capital requirements, no reserve requirements. AIG blew up, and it cost each one of us, every American, substantial amounts of money.

In the case of Fannie Mae, Fannie Mae had 200 to 1 leverage and that is why Fannie Mae blew up. Not because Fannie Mae was securitizing mortgages, but rather because Fannie Mae was abusing the concept of leverage by 200 to 1 leverage.

Now, ask yourself, how does that apply here to the life settlement industry? What is the leverage in the life settlement industry? It is zero. The life settlement industry doesn't revolve around borrowed money at all. So it simply doesn't present to us the same kind of policy issues as the unbridled abuses that came with 200 to 1 leverage and estimated leverage.

So as I look at this, I say to myself, what this industry is doing is it is helping people get the full value of their policies. And I don't

think that this industry should be called upon to answer for the serious abuses that pervaded this economy in other areas over the past 2 years. And the sins of others should not descend on you.

Thank you, Mr. Chairman.

Chairman KANJORSKI. Thank you very much, Mr. Grayson.

Now we will have an introduction of the panel.

Thank you all for appearing before the subcommittee today, and without objection, your written statements will be made a part of the record. You will each be recognized for a 5-minute summary of your statement.

First, we have Ms. Paula Dubberly, Associate Director, Division of Corporation Finance, United States Securities and Exchange Commission.

Ms. Dubberly.

STATEMENT OF PAULA DUBBERLY, ASSOCIATE DIRECTOR, DIVISION OF CORPORATION FINANCE, U.S. SECURITIES AND EXCHANGE COMMISSION

Ms. DUBBERLY. Good afternoon, Chairman Kanjorski, Ranking Member Garrett, and members of the subcommittee.

I am pleased to testify on behalf of the United States Securities and Exchange Commission on the topic of life settlements and new developments in securitization. I appreciate the opportunity to discuss with you the Commission's work in this area.

We recognize that securitization plays an important role in the financial markets. However, recent experience with securitization in the mortgage markets argues for the careful review and analysis of all developing securities activities. In this regard, the Commission is taking steps to address issues with securitization. The staff currently is engaged in a broad review of the Commission's regulation of asset-backed securities, including disclosure, offering process, and reporting by asset-back issuers. The securitization market continues to develop, and we recognize that securitization of life settlement appears to be a growing practice.

Life settlements generally are considered securities when a third-party purchaser sells a fractional interest in a single policy or pools the life settlements and sells interests in the pool through securitization. To date, we are not aware of any securitized life settlement pools being registered with the SEC and publicly sold to investors. But securitized pools are sold as private placements, and we will continue to monitor this developing area. The SEC has the ability to use its civil enforcement authority to combat fraud and other unlawful securities-related activity in this market and has done so. The Commission has brought a number of cases in this area since the mid-1990's.

In light of the potentially far-reaching consequences of the recent movement towards securitization of life settlements, Chairman Schapiro has established a multidisciplinary Life Settlements Task Force comprised of senior officials from throughout the SEC. The task force will examine emerging issues in life settlements and advise the Commission whether market practices and regulatory oversight can be improved. The task force will consider, among other things, the application of the Federal Securities laws to life settlements, the emerging role of securitization, the life settlements

marketplace, including trading platforms, and market intermediaries.

Various groups of investors are affected by life settlement securitizations, including investors and the companies that sponsor the securitizations, investors in insurance companies, and investors that purchase securities backed by life settlements. Not only will the staff be looking at the issues raised with respect to these groups, but we will also be looking at the disclosure provided to these groups of investors.

We also will consider sales practices regarding both the sale of existing life insurance policies by contract holders and the sale of interest in life settlement pools to investors. The Commission is especially concerned that life settlement brokers may be targeting policyholders who are particularly vulnerable to abusive sales practices, including seniors and the seriously ill. We will consider possible issues raised by the business model of creating securitized pools of life settlements, how that model relates to the interest of investors, and what kinds of fees are generated for securitizers. We also will consider whether securities offerings that purport to rely on exemptions from registration under the Federal Securities laws are doing so properly.

Life settlement issues draw on the expertise of regulators throughout the United States. Thus, Chairman Schapiro has asked the task force to reach out to regulators and other interested parties to coordinate regulatory efforts and analyze whether gaps in oversight exist that could be filled through legislation or other action.

By incorporating a multidisciplinary approach and working with fellow regulators and other interested parties, the Life Settlement Task Force will make a fresh in-depth analysis of the issues raised in the securitization and life settlements market so that we can make sure investors are informed and protected.

Thank you again for inviting me to appear before you today and for the subcommittee's support of the agency at this critical time for the Nation's investors. I would be happy to answer any questions you may have.

[The prepared statement of Ms. Dubberly can be found on page 51 of the appendix.]

Chairman KANJORSKI. Thank you very much, Ms. Dubberly.

Next, we will hear from the Honorable Susan E. Voss, commissioner, Iowa Department of Insurance, on behalf of the National Association of Insurance Commissioners.

Ms. Voss.

STATEMENT OF THE HONORABLE SUSAN E. VOSS, COMMISSIONER, IOWA INSURANCE COMMISSION, ON BEHALF OF THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

Ms. VOSS. Chairman Kanjorski, Ranking Member Garrett, and members of the subcommittee, thank you for this opportunity to testify at today's hearing.

My name is Susan Voss and I am the commissioner of the Iowa Insurance Division. We have jurisdiction over insurance and securities regulation through my division. I am also the vice president of

the National Association of Insurance Commissioners, and I am here today on behalf of the fellow regulators of the NAIC. I want to commend the subcommittee for today's hearing assessing the impact of securitization on life settlements.

The first life insurance settlement was developed as a viatical settlement during the 1980's in response to the HIV/AIDS patients who wished to sell their life insurance policies in order to raise much-needed funds for personal and health care expenses. Today, the marketplace has expanded to roughly $3 billion to $4 billion annually, so that individuals who no longer need or want their coverage for economic or personal reasons can sell their policies as an alternative to surrendering it for its cash value or letting it lapse.

Life settlements are necessary transactions for some consumers, but they require appropriate regulation with a focus on disclosure and consumer protection. As such, nearly all States have moved to pass regulations or laws specifically establishing strong oversight of life settlement transactions. But it is important to note that all States have the authority to protect consumers from fraud and misrepresentation in this area.

All State insurance regulators enforce licensing and form requirements and have examination enforcement authority and require mandatory disclosures to the consumers about his or her rights. This oversight is critical, particularly as stranger-originated or owned life insurance, or STOLI, has emerged in recent years. Under STOLI, investors solicit a healthy and high net worth individual, who is typically at least 70 years of age, to obtain a life insurance policy with a certain minimum death benefit. The individual buys the insurance with the specific intent of selling it to those investors. And after a minimum period of incontestability ends, ownership of the policy is transferred in exchange for a taxable lump sum. The investors then receive the death benefit when the insured individual dies.

This concept violates State insurable-interest laws that require a direct interest and relationship between a policyholder and beneficiary, but it is difficult to determine a policyholder's true intent when purchasing a policy, making it challenging to distinguish between STOLI and a legitimate life insurance settlement.

As such, the States are implementing requirements to target the timing of these transactions to make them unappealing to would-be STOLI investors while preserving a policyholder's right to sell his or her policy. Likewise, insurers are improving their underwriting guidelines to better determine a policyholder's intent when purchasing life insurance.

As you can see, State regulators already conduct significant oversight of life settlement transactions. However, the concept of securitizing life settlements is a relatively new phenomenon. While such securitization is outside the jurisdiction of insurance regulators, we are concerned that securitization of life insurance settlements would incentivize would-be STOLI investors to attempt to expand the marketplace, much as securitization of mortgages helped dramatically expand that marketplace.

It is also important to note that life settlements in general and securitization of them in particular would diminish the number of

life insurance policies that would otherwise lapse, requiring insurers to raise their premiums.

Finally, we would want to ensure that any securitization of life insurance settlements does not compromise the original policyholder's rights and privacy. We commend the SEC for creating their agency-wide task force regarding life settlements, and we would like to work with them on this critical issue. This issue is a clear example of where securities and insurance regulators need to work collaboratively to ensure that policyholders and investors are informed and protected.

Mr. Chairman, thank you again for the opportunity to testify before this subcommittee, and I welcome any questions. Thank you.

[The prepared statement of Ms. Voss can be found on page 97 of the appendix.]

Chairman KANJORSKI. Thank you very much, Ms. Voss.

And now, Mr. Green of Texas will introduce our next witness.

Mr. Green?

Mr. GREEN. Thank you, Mr. Chairman. I thank you for allowing me to be a part of the subcommittee.

I am honored today, Mr. Chairman, to introduce Mr. Brian Pardo, who is the founder, the president, the chief executive officer, as well as the chairman of the Board of Life Partners Holdings. He is also a person who has served his country, having been a veteran in the Vietnam war.

Mr. Chairman, I believe we will find his testimony to be informative, insightful, and engaging.

And I will yield back to you, Mr. Chairman.

Chairman KANJORSKI. We are a little out of order here, but that is the way it goes. We will be right back to Mr. Dorsett.

Mr. Pardo.

STATEMENT OF BRIAN D. PARDO, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, LIFE PARTNERS HOLDINGS, INC.

Mr. PARDO. Thank you, Mr. Chairman, and Ranking Member Garrett. It is a privilege for me to be here. It is a privilege to be here to provide you with our company's insight into the need, especially in today's financial environment, for uniform regulations with Federal oversight of this asset class to provide older Americans unimpeded access to the market and to provide investors with a reliable asset-based investment which is not correlated to financial markets and/or other types of indices. I am going to skip part of this.

The severe recession and the meltdown has caused severe financial problems, especially in IRA, 401(k), and other retirement accounts for senior Americans. The purpose of life settlements as we see it is simply to provide these people access to cash many never knew was available to them. Of all the life insurance in force today, only approximately 8 percent make up these kinds of policies. So we do not see that this is a problem to the life insurance industry. These special-purpose policies are usually universal life policies. Since they are not purchased for wealth accumulation, policyholders usually only pay a minimum amount of premiums to keep their policies in effect. The surrender value on these types of policies is typically 1 percent or less of the value of the policy.

The Wall Street Journal reported last fall that, with a life settlement, policyholders can typically net more than is available by surrendering a policy to the insurer for a lump sum payment, or in the case of letting it go entirely, letting it lapse, in other words, getting nothing for it.

This has been a policyholder's right since the 1911 court ruling of Grigsby *v.* Russell, which allowed people to sell their life insurance policies and consider life insurance policies personal private property. And along that regard, I would like to point out that as a personal property asset, the sale of this asset has been ruled by the courts as not the business of insurance.

Currently, life settlements are regulated by a patchwork of State insurance departments. Each claims jurisdiction to regulate the transactions with inconsistent and frequently conflicting statutes which vary from State to State. Some States have regulations which effectively prevent insurance consumers from any access to the secondary life insurance market, while a few have no regulations at all.

Life Partners is domiciled and registered in the State of Texas, and as a life settlement provider, we are licensed and regulated by the Texas Department of Insurance. All forms are approved and require us to file annual copies.

On top of that, the lack of uniformity in State regulation creates another problem. A lot of times the participants in the life settlement transaction may involve persons or entities throughout the United States. For example, the life settler who may be selling the policy may be a trust under the laws of New York with a trustee in Connecticut, while the insured may live in Arizona. Determining which State has jurisdiction over the transaction can be very confusing. Federal oversight regulation can remedy this problem.

Life settlement transactions are not derivatives, and when the investor actually obtains ownership of the policy or a fraction of the policy, life settlements are not a security either, as the lady pointed out here. It is merely an assignment of the value of a contract right. However, as with many types of assets, the securitization of life settlements is very possible, and indicated by the recent news articles in the Wall Street Journal, Wall Street is looking at life settlements as a replacement for mortgage-backed securities.

This is nothing particularly new. In 2000 through 2003, the industry—Wall Street, that is, opted out of this class because it couldn't see how to transform it into a derivative. To the extent life settlements are bundled and transformed into derivative securities, they would be subject, of course, to the statutes and regulations governing securities.

In order to provide older Americans with unfettered access to the valuable secondary market for the life insurance policies, a uniform minimum level of Federal regulation for life settlement transactions in the United States, in our opinion, is advisable. Life insurance and settlement providers should not shy away from Federal regulation. Life Partners actually went public in 2000, not to raise capital, but to voluntarily bring itself under meaningful oversight and regulation required by public companies. We are the only public company as a life settlements provider in the United States, and as such, we are subject to the reporting requirements of the

SEC, including those rules mandated by the Sarbanes-Oxley Act of 2002.

I strongly believe that Federal law should set a minimum standard for State regulation of life settlements. If a State does not provide at least this minimum level of regulation, I believe that the new U.S. Consumer Financial Protection Agency should supervise life settlement activity in that State, because life settlement transactions are not the business of insurance but rather a financial asset transaction, so they do not constitute the business of insurance. Thus, any Federal regulation of life settlements does not run afoul of the public policy expressed in the McCarran-Ferguson Act.

Thank you very much, and I will certainly be happy to answer any questions.

[The prepared statement of Mr. Pardo can be found on page 85 of the appendix.]

Chairman KANJORSKI. Thank you very much, Mr. Pardo.

And next, we will hear from Mr. J. Russel Dorsett, co-managing director of Veris Settlement Partners, on behalf of the Life Insurance Settlement Association.

Mr. Dorsett.

STATEMENT OF J. RUSSEL DORSETT, CO-MANAGING DIRECTOR OF VERIS SETTLEMENT PARTNERS, ON BEHALF OF THE LIFE INSURANCE SETTLEMENT ASSOCIATION

Mr. DORSETT. Good afternoon, Chairman Kanjorski, Ranking Member Garrett, and members of the subcommittee.

My name is Russel Dorsett, and I am delighted to have the opportunity to appear before you representing the Life Insurance Settlement Association, or LISA. LISA is the oldest, largest, and most inclusive body serving the life settlement industry, and it is an honor and a privilege to serve as LISA's president.

LISA's mission is to promote an orderly and transparent marketplace, sound regulation, and best practices to enable well-informed consumers to maximize the value of a financial asset, a life insurance policy which is no longer needed, wanted, or in some cases, affordable. LISA members hold nearly 75 percent of all the provider licenses which have been issued by the State regulators.

The average life settlement pays policy owners 4 to 6 times the policy's cash value. Over the past decade, the life settlement industry has delivered to policy owners approximately $6 billion above what they would have received had they simply lapsed or surrendered their policy. In doing so, we have made it possible for these policy owners to better afford retirement, medical care, or simply to enjoy the lifestyle they have earned.

Life settlements are not about Wall Street. They are about a consumer's property rights. A famous decision in 1911 authored by Justice Oliver Wendell Holmes affirmed the right of a legitimate policy owner to treat their policy as financial property and to sell to the highest bidder if they so desire.

This appearance is occasioned by the committee's concern that the growth of the secondary market and the potential for securitizations might somehow be seized upon by Wall Street's rocket scientists and grow to the point where it constitutes a systemic threat to the American economy or to the health of the life

insurance industry. We are a niche residing rather uneasily between two colossuses, the institutional capital markets and the life insurance industry. In comparison to either, the life settlement market is miniscule. In the best of times, perhaps $3 billion to $4 billion of capital was actually employed to purchase policies, which might translate to $10 billion to $12 billion in face amount purchased in any one year. While this is certainly not an inconsequential sum, it is tiny in comparison to the $20-plus-trillion mortgage market or the life insurance industry, which has some $19 trillion of face amount in force; we think about $10 trillion of that is individual policies.

Consumers attempting to utilize the life settlement option have suffered from the current financial crisis. Completed life settlement transactions during calendar year 2009 will, at best, approach 50 percent of those completed in the prior year primarily due to the dearth of investment capital available to purchase policies. In the 5 years preceding the financial crisis, however, the secondary market did experience sustained growth driven both by increased awareness on the part of consumers that such an option existed and the undeniable appeal of life settlements as an asset class.

Securitization of life settlements has been a topic of considerable interest for some time, but the number of transactions actually completed can be counted on one hand, in fact, with several fingers left over.

Demographic trends alone make it certain that more and more Americans will find themselves in a position where a life settlement becomes a valuable option. But a viable market requires both willing sellers and credible buyers. To the extent the securitizations are underwritten in a financially sound and transparent manner and, in so doing, increase the capital available to purchase unaffordable, unneeded, or unwanted life insurance policies, we cannot help but believe that both social and economic utility are indeed enhanced.

Even under the most optimistic growth scenarios, only a very small fraction of the insured population would ever qualify as a candidate for a life settlement, and the total face amount of policies purchased is unlikely to even approach $200 billion over the next decade. While this is a substantial sum, it is several orders of magnitude away from the potential for creating systemic problems comparable to those experienced in the mortgage markets.

The potential impact of life settlements on insurers is also negligible, and the settled policies are unlikely to approach even a fraction of 1 percent of the insurance enforced over the foreseeable future.

We believe that life insurance contributes greatly to society at large. It is a well recognized engine for wealth creation, and it helps to foster a culture of self-reliance and planning for the future. A secondary market for those policies which become at some point unneeded or unwanted enhances the already tremendous value proposition that life insurance represents. It will result in more people buying more policies and keeping them for longer. Should their health decline or they reach an age where they need the money now rather than later, the life settlement option can provide funds to meet their needs at a time when other assets may have

been depleted or declined in value due to adverse market conditions.

Thank you again for the opportunity to appear before you today, and I will happy to answer any questions that anyone might have. Thank you.

[The prepared statement of Mr. Dorsett can be found on page 43 of the appendix.]

Chairman KANJORSKI. Thank you very much, Mr. Dorsett.

Next, we will hear from Mr. Jack Kelly, director of government relations at the Institutional Life Markets Association.

Mr. Kelly.

STATEMENT OF JACK KELLY, DIRECTOR OF GOVERNMENT AFFAIRS, THE INSTITUTIONAL LIFE MARKETS ASSOCIATION

Ms. KELLY. Thank you, Mr. Chairman.

Thank you, Mr. Garrett.

My name is Jack Kelly. I serve as director of government affairs for the Institutional Life Markets Association, ILMA, a trade association comprised of a number of the world's leading institutional investors and intermediaries in the longevity markets. Our members include Credit Suisse, EFG Bank, Goldman Sachs, JP Morgan Chase, Mizuho International, and WestLB.

ILMA was formed 2 years ago to create best practices and to encourage transparency and standardization of documentation, and to encourage and educate consumers and investors and policymakers about the benefits of longevity-related marketplace. ILMA members, through lending or by direct purchase, have provided consumers in excess of $2.9 billion through purchases of life insurance policies no longer needed by the owners.

ILMA's first action was the creation of the Life Settlement Transaction Disclosure Statement that clearly discloses the amount of money consumers receive when they sell their life insurance policy, and how much money their broker will receive in the transactions. ILMA has advocated in every State that has considered life settlement legislation to adopt this form. It has also created a set of uniform HIPAA-compliant release forms to ensure the participants in the market use forms that protect the identity and the personal privacy records of individuals.

It is difficult to determine the actual size of the life settlement market. An upcoming report by Conning Research concludes the value of policies settled in 2008 to be $12 billion, and at the end of 2008, approximately $31 billion of policies will be in force. They conclude, by 2011 and 2012, the market will reach a saturation point with an annual growth after that of 2 percent to 3 percent. Compare this to the almost $20 trillion to $25 trillion in force today of life insurance. The size of the life settlement market is less than miniscule.

Recent news reports have advanced the story that the capital markets have initiated an effort to issue rated securitization of life settlements. I think it is important to distinguish between facts and speculation in this reporting.

As for life settlement securitizations, there have only been two rated life settlement securitizations reported: In April 2009, an internal company transaction by AIG that was valued at $2 billion

and rated by A.M. Best. This capital relief transaction was done in part to reduce some of AIG's ongoing borrowing from the Federal Reserve by $1.2 billion.

In 2004, Legacy Benefits Corporation concluded a Moody's rated securitization that included both life settlements and annuity assets. Since these are the only known transactions, it brings to question why suddenly there is such increased attention to the securitization of life settlements.

As the use of securitization by the insurance industry is widespread, it is only reasonable that such a tool would be explored for life settlements. In fact, Frank Keating, the president of ACLI, recently stated: "Securitization of life insurance policies transferred to third parties is not necessarily a bad thing."

The analogy presented by some that life settlement securitization is the next subprime crisis is completely inaccurate. The most significant participants in mortgage transactions are the homeowner and the investor. Securities that were linked to subprime mortgages relied on a continued stream of payments by the homeowners. When homeowners failed to make payments, the securitizations failed, resulting in two losers, the homeowner and the investor.

In a life settlement securitization, an investor buys a security backed by a pool of insurance policies that have been settled. It is critical to note that the original owners of the insurance policies are paid in full for the policy at the time their ownership is transferred. They have no further financial participation in the process and cannot be adversely impacted as a result of the securitization. If the life settlement securitization fails, the only loser would be the investor, which is the case in all investments, and there would be no financial impact on the insured or any original policy owner. Accordingly, such investments would only be suitable for institutional investors who can analyze and understand the risks.

ILMA's position is that life settlement transactions should be regulated to ensure that the consumer is protected and informed about the impact of such transaction, and we have argued for these protections in every State. As life settlements are regulated by State insurance regulators, there is a lack of uniformity in the laws governing these transactions. ILMA seeks the adoption of uniform laws and including all requirements of that uniformity.

We look forward to working with you, Mr. Chairman, and the members of the committee, and thank you for your time today.

[The prepared statement of Mr. Kelly can be found on page 73 of the appendix.]

Chairman KANJORSKI. Thank you, Mr. Kelly.

And next, we will hear from Mr. Kurt Gearhart, global head of regulatory and execution risk, Life Finance Group, Credit Suisse.

Mr. Gearhart.

STATEMENT OF KURT GEARHART, GLOBAL HEAD OF REGULATORY AND EXECUTION RISK, LIFE FINANCE GROUP, CREDIT SUISSE

Mr. GEARHART. Thank you.

Good afternoon. My name is Kurt Gearhart, and I am Credit Suisse's global head of regulatory and execution risk in the firm's

Life Finance Group. The Life Finance Group employs approximately 90 professionals, and the group's mandate is to intermediate mortality and longevity risk.

Credit Suisse has been an active participant in securitization markets, with considerable experience with insurance securitizations. Based on this experience, we would like to make three points today:

First, insurance securitizations are nothing new. And, as described in our written testimony, there are various types of securitization structures that have been used by the life insurance industry, with none of the experiences of the mortgage markets. Securitizing life settlements would be similar to other traditional insurance securitizations. Credit Suisse has never in fact done a life settlement securitization, so we have no direct experience to offer in that area.

Second, Credit Suisse conducts its life settlement business in complete conformity to industry best practices. We have been a leader in creating industry best practices, and we believe that they protect consumers as well as institutional investors.

Finally, Credit Suisse welcomes greater Federal regulation of life settlements. We would be pleased if a strong Federal regulator, such as the SEC, were given jurisdiction over life settlements.

We appreciate the committee's invitation to be here today, and our discussion will be divided in three parts: life settlements; life insurance securitizations and Credit Suisse's activity in life settlements; and the regulation of life settlements and life settlement securitizations.

Life insurance securitizations. I think that it is important to understand that securitization of longevity and mortality risk is not a new concept. Over the last decade, insurance companies have securitized these risks in closed block; redundant reserve; embedded value; and extreme mortality securitizations, as described in our written testimony.

Although Credit Suisse has never done a life settlement securitization, they would be similar to other life insurance securitizations. The only difference is that a life settlement provides income to consumers rather than to the life insurance companies themselves.

The reality is that there have been very few life settlement securitization deals. And although we expect the securitization market to be relatively small, we believe that a potential securitization market can be good for consumers and institutional investors.

For consumers, securitization will bring two primary benefits. First, increased liquidity to the life settlement market will result in higher cash offers for policy. Second, securitizations would ensure the protection of the insured's privacy as institutional investors will not have access to any information that would allow them to identify the insureds.

For institutional investors, life settlement securitizations provide a tool for portfolio diversification and satisfy demands for investments that are not dependent on capital markets.

The next topic I will discuss is Credit Suisse's activity in life settlements. Credit Suisse began participating in life settlement mar-

ket in 2006, initially by purchasing policies through third-party life settlement providers. In 2007, we formed our own licensed life settlement provider to purchase policies. We opted to form our own platform to ensure the quality of the policies we acquired and to provide adequate protection to policy sellers. We employ numerous best practices in our business, including requiring policy sellers to be represented by an adviser, providing comprehensive disclosures to policy sellers and insurers that identify all the risks and alternatives to life settlements, and disclose all the transaction fees paid to third parties so the consumer knows exactly how much we are paying for their policy. And, we conduct closing interviews with both the policy sellers and the insureds to ensure that they understand the substance and economics of the transaction.

Credit Suisse has paid approximately $500 million more to seniors than they would have otherwise received by surrendering their policies to the insurance companies. On average, we pay policy sellers approximately 10 times more than the cash surrender value offered by the insurance companies.

Seniors typically sell their policies to Credit Suisse because premiums become unaffordable, or because they need funds for health care, retirement, or other purposes. We manage and distribute the mortality and longevity risk with sophisticated institutional investors, including insurance companies, reinsurance companies, fund managers, and pension funds. We employ rigorous risk management practices to limit the amount of exposure we have in the life settlement business.

Finally, I would like to discuss the regulation of life settlements and life settlement securitizations. Life settlements securitizations would be securities subject to SEC regulation. They would also be subject to any general securitization reforms currently being considered by Congress. The acquisition of life insurance policies from policy sellers is currently regulated at the State by State insurance departments. We have worked with the NAIC, NCOIL, and States on life settlement regulation.

Today, 35 States regulate life settlements. Notwithstanding the efforts of the NAIC, NCOIL, and State regulators, consumers in 15 States still have no regulatory protection. The State regulatory model has led to a patchwork of inconsistent regulation, and this is confusing to consumers and impacts the effectiveness of regulation.

We have implemented a variety of best practices in our life settlement business to protect consumers regardless of whether required by State law. We do this because we value our reputation and because it protects our institutional investors who do not want to own assets that were acquired with abusive practices. Credit Suisse would support Federal regulation and oversight of this business by the SEC or another Federal regulator as a means to provide greater protection to policy sellers, insureds, and investors.

To close my testimony, I would like to restate our three primary points: First, life insurance securitizations are nothing new, and while Credit Suisse does not have direct experience, any application of securitization practices to life settlements should be the same as traditional life insurance securitizations; second, we believe strongly in the implementation of industry best practices; and

third, we would welcome strong Federal regulation from the SEC or another appropriate Federal agency.

Thank you for the opportunity to appear today. And I will be happy to answer any questions that you may have.

[The prepared statement of Mr. Gearhart can be found on page 63 of the appendix.]

Chairman KANJORSKI. Thank you very much, Mr. Gearhart.

Next, we will hear from Mr. Steven H. Strongin, managing director and head of Global Investment Research, Goldman, Sachs & Company.

Mr. Strongin.

STATEMENT OF STEVEN H. STRONGIN, MANAGING DIRECTOR AND HEAD OF GLOBAL INVESTMENT RESEARCH, GOLDMAN, SACHS & CO.

Mr. STRONGIN. Chairman Kanjorski, Ranking Member Garrett, and members of the subcommittee, we thank you for inviting us to present our thoughts on recent innovations in the securitization market and their impact on the financial crisis. We hope our thoughts prove helpful.

Mr. GREEN. Sir, would you pull your microphone a little closer, please?

Mr. STRONGIN. Is that better? Okay.

I am head of Global Investment Research at Goldman Sachs. I have been involved either directly or indirectly with the securitization markets since starting at the firm 15 years ago, as well as during my tenure at the Federal Reserve in the 12 years prior to that. I am pleased to answer your questions on behalf of the firm regarding the securitization market and, more specifically, the life settlement and life settlement securitization markets.

Before delving into detail on these topics, I would note that Goldman Sachs has never executed a life settlement securitization. We currently have no client mandates or plans to execute one.

In addition, the life settlement business is very small. We estimate that our total investment in this space represents a small fraction of the total capital in the market and is very small relative to what several of our large institutional competitors have invested. The business is also very small as a percentage of the firm's total business at considerably less than one-tenth of 1 percent.

As Goldman Sachs has not executed any life settlement securitizations, we cannot offer any experience-based view of the life settlement securitization market, but we do not believe it poses systemic risks. It is small, unlikely to grow rapidly, and it is also unlikely to impact things like lending standards, which can have far-reaching economic consequences.

We believe that the life settlement market offers significant positive benefits to the insured facing changing circumstances. That said, it could also have the potential for consumer abuse. Hence, we would emphasize the need to address consumer-protection-related issues in this market rather than systemic ones.

We do have significant experience in other securitization markets. Based on that experience, we see a few key areas where securitizations, particularly mortgage securitizations, increased systemic risk and contributed to the financial crisis. We believe

that the rules and regulations related to securitization need to be changed to address these problems.

Specifically, some financial firms used the relatively favorable rules around securitization to reduce the capital held against poor quality loans. They also made their balance sheets appear healthier than they were by reporting they were holding "good" public securities rather than the high-risk loans underlying these securities. This was true even for securities that had never actually been sold in a market, but were instead simply repackaged and relabeled with the help of ratings agencies. In some cases, these rules even allowed firms to make risks disappear entirely from their balance sheets.

These abuses led to wholesale concerns about the balance sheet integrity of all financial firms, regardless of whether they had engaged in such practices or not, and greatly contributed to the panic at the peak of the crisis. They also drove the need for widespread massive governmental assistance for even the most healthy of financial firms.

To address these issues and to make the financial system more robust to financial shocks, as well as to reduce the future need for government assistance in times of stress, we think that securitizations should only qualify for favorable regulatory treatment after significant parts of all risk tranches have been sold to a true third party. To prevent misreporting of risk exposures, large financial holding companies should consolidate all assets and liabilities onto their balance sheets and mark those assets to market.

Further, to prevent the regulatory and accounting arbitrage that allowed massive under- and unreported risks to build and inflated profits to be reported, the rules around affiliate transactions should be strengthened. Specifically, assets should not be permitted to be held off balance sheet, and firms should not be allowed to cross-subsidize business across regulatory or accounting boundaries. We believe these changes in rules would go a long way toward reducing systemic risk.

Thank you. And I look forward to answering any questions you may have.

[The prepared statement of Mr. Strongin can be found on page 92 of the appendix.]

Chairman KANJORSKI. Thank you very much, Mr. Strongin.

Finally, we will hear from Mr. Daniel Curry, president of DBRS, Incorporated.

Mr. Curry.

STATEMENT OF DANIEL CURRY, PRESIDENT, DBRS, INC.

Mr. CURRY. Thank you, Chairman Kanjorski, Ranking Member Garrett, and members of the subcommittee. My name is Dan Curry, and I am president of the U.S. subsidiary of DBRS, one of the registered credit rating agencies.

Securitizations in the mortgage and credit markets contributed significantly to the recent global financial crisis. As the markets continue to recover, policymakers, regulators, and market participants must understand what went wrong and take appropriate action to ensure that past mistakes are not repeated.

However, because our financial markets thrive on innovation, we must also recognize that a regulatory environment that prohibits new investment products will ultimately impede rather than enhance the health of our economy. Fostering innovation while limiting unnecessary risk is a delicate task. DBRS commends the subcommittee for tackling this challenge in the area of securitization of life settlements.

My testimony today will focus on three areas: An overview of the life settlement securitizations; the role of rating agencies in this market; and suggestions for prudent regulation.

To the best of our knowledge, the volume of life settlement securitizations has been relatively low and sporadic. However, there are several factors which may stimulate growth in the coming years. These include longer life spans, the decrease in defined benefit retirement plans, and other factors that may force older Americans to seek alternative sources of cash. Growth may also be spurred by increased interest in such products by institutional investors.

The role of a credit rating agency in a life settlement securitization is to issue an opinion about the ability of a transaction to repay principal and interest on bonds sold to investors. These agencies do not purchase or arrange for the purchase of life insurance policies nor do they structure, underwrite, or sell life settlement transactions.

Because responding to market proposals is a core part of part of the service we provide, last year, DBRS published the methodology for rating U.S. life settlement transactions. This methodology, which is publicly available on our Web site, calls for both quantitative and qualitative approaches to review in a life settlement securitization. It does not, however, involve the creation of mortality indexes; instead, we rely on publicly available third-party mortality tables.

Although DBRS has reviewed 14 proposals for life settlement transactions, so far we have not rated any of these deals, and our market share remains at zero percent. Only two of these transactions are currently under active review.

Now, I would like to offer some ideas on prudent regulation. The turmoil in the securitization markets arose from a number of factors involving mortgage brokers, appraisers, homebuyers, underwriters, issuers, arrangers, and investors. Of course, rating agencies also were to blame since their methodologies and models failed to keep pace with the products rated, and the rating process at times lacked transparency.

DBRS believes that the lessons learned from the recent past can form the basis for a prudent regulatory basis for life settlement securitizations. First, there must be a focus on consumer protection, including mandatory licensing of parties who buy policies and robust disclosure of information about those transactions. On the securitization front, those who structure life settlement transactions should be required to retain a portion of the risk arising from such details. This would align their interests with those of investors and promote safety and soundness in the life settlement market.

DBRS also believes that investors should be given the information they need to make informed decisions about purchasing life settlement securities.

We are pleased that the SEC has established a life settlement task force and we look forward to working with them in this area.

Finally, we believe that the regulatory regime established and still being refined under the Credit Rating Agency Reform Act of 2006 is well suited to ensure the quality, integrity, and transparency of the credit ratings on life settlement products.

Thank you. I look forward to answering your questions.

[The prepared statement of Mr. Curry can be found on page 36 of the appendix.]

Chairman KANJORSKI. I think we will take my questions, and then we will move on.

Ms. Dubberly, the task force the SEC is putting together and taking on, has there been a full examination made of what authorities under the law you have to regulate these entities, and do you need any further action by the Congress?

Ms. DUBBERLY. Thank you, Congressman.

That is one of the issues we will be looking at. The chairman has directed us to take a broad look at this entire area and to see if we think there are some types of regulatory gaps between, say, State regulation or Federal securities law regulation. We certainly haven't completed that task yet, but that is one of the mandates of the task force.

Chairman KANJORSKI. There is no question, you feel you are considering this as a security as opposed to insurance; is that correct?

Ms. DUBBERLY. When you take life settlements and you pool them and you securitize it, there is absolutely no question that is a security.

The issue of life settlement, a participation in life settlement, the Commission has also taken the position that that is a security as an investment contract. A separate, just standalone life settlement would be a different question.

Chairman KANJORSKI. Very good.

How many people think we are being premature in even holding this hearing, and that we should put in any time or effort into this question? Or is it a question that should be before the Congress at this time?

Could you show your hands? Those who think we should be pursuing this, could you raise your hands?

Okay. Those who think we should not be pursuing it?

There is a recent article in Der Spiegel magazine indicating that there is some disappointment among German investors that Americans are not dying fast enough.

Do you think we should alleviate that risk and take some action to discourage that bad feeling? That could cause international implications.

But seriously, I am interested—if we go to securitizing death settlements, what would be the outer limits of what we will securitize?

Does anybody want to take that question?

Mr. KELLY. What would the value be? Are you trying to say the value?

Chairman KANJORSKI. No. What areas should we not securitize?

I mean, I humorously in my opening statement mentioned the fact that we could probably structure a policy to involve divorce. But would it be wise and good public policy to do that? Or if there is an enterprising individual who at every wedding day wants to issue the odds that the marriage will last to 50 percent in 5 years, and lesser percentages thereafter, and then we could bet on whether it will last a lifetime.

Is that good policy, or are we causing some innate destruction to some reasonably good values in our society?

I just throw it out to you. My compass is twirling; I want to get it set.

Mr. KELLY. One of the things, Mr. Chairman, I think that you are saying, is the fundamental question about insuring risk; is that correct?

Chairman KANJORSKI. If you look at it as only insurance of risk in the product, the result.

Mr. KELLY. But ultimately that is what the insurance markets do.

Chairman KANJORSKI. But everything can be reduced to risk, can it not?

What is the risk that I will get 21 at a blackjack table?

Mr. KELLY. Actually, on the top of the table it says the insurance line when you make your bet.

Chairman KANJORSKI. Should we securitize that bet?

Mr. KELLY. I think the insurance industry has used models with securitization on a regular basis, and where it is appropriate, they have found a need for it. We have seen that in the many examples that were provided here today with closed block, with CAT bonds, with mortality CAT bonds.

So there are any number of insurance options that are securitized now, and they are securitized at the juncture that they have a value to the underlying risk that they are securitizing.

Chairman KANJORSKI. I want to throw this out:

Just before I came here, I was making a speech downtown to a group of regulators; and as we were leaving, I posed the question to my staff—they have not given me a full answer yet—but has anybody securitized or made life settlements on key man insurance on corporations where the key man has already left the corporation and is no longer there? And if you securitize that, how close is that to not having an insurable risk?

I understand corporations can keep the insurance policy even if the person the policy is on has left the corporate interest, which shakes me up a little bit.

Mr. KELLY. It goes back to the fundamental fact that there have only been two known securitizations of life settlements and neither has included a key man life.

Chairman KANJORSKI. But you think it could?

Mr. KELLY. I didn't say I think it could. I said it has never occurred at this juncture.

Mr. PARDO. I think the multitude of transactions that we see, in general, whether they are securitized or not, once the policy has been sold by the insurance company to the initial insured, the insured—since 1911—then has the right to do what he wants to with

that. If you take away the insured's right to sell that policy through some mechanism, then you are depriving him of his private property, his right over private property.

Chairman KANJORSKI. But that is all dependent upon if he has an insurable interest on whomever he has bought the policy for.

Mr. PARDO. The insurable interest goes to the original purchase of the policy. I can't take out one on your life and you can't take one on mine.

Chairman KANJORSKI. You could at one time in the United States.

Mr. PARDO. That was before 1881.

Chairman KANJORSKI. Right. We may be able to get you to—is it Antigua? They are selling policies on other people's lives. We can find a jurisdiction in the world that is going to do incredible things, and you will find that they will write a policy on somebody's life where you have no insurable interest.

Now assuming that they did that, the question is, should that be able to be securitized and is that good public policy?

Mr. PARDO. I don't think anybody involved in the industry or anybody sitting at this table would even consider looking at buying a policy like that, because obviously you would have problems down the road. So it would solve itself; it is just not an issue that is going to arise.

The primary issue that I think we should be concerned with is this patchwork of regulation between the States that is inhibiting access to the market by seniors. Senior citizens are in desperate need of liquidity right now because of the market meltdown. And the one in 2001, don't forget also, that helped lead in to their problems. So suddenly they find out, gee, I can sell this policy and I can get back maybe 60 or 70 percent of what I have paid in—considerable amounts of money.

Keep in mind that in our case, we buy for our clients, the average face value is $3.8 million. So these are not insignificant policies; these are large policies. They can get significant amounts of money, millions of dollars, and it means a lot to them.

So we have to be careful that we don't take that right away from them, but we also have to have some clarity in the regulatory structure.

Chairman KANJORSKI. So I take it you are making a pitch for, if there is a Federal option for insurance, that we include life settlement insurance in the Federal charter?

Mr. PARDO. I think there has to be some clarity in the law, and this patchwork of regulations has to be standardized in some form so that there is more access to the market. Because we are talking—this is a very strange set of situations when it comes to consumer law.

What we have here is, the regulated party is the buyer. I am buying your insurance policy. Normally, in consumer law, you would be regulated; you are selling it. But actually in this case, we are being regulated. But we are the buyers. All of us sitting at this table are the buyers, so why are we being regulated?

And in a large-scale transaction like this, where everybody is sophisticated—say the policy is over $500,000—nobody, I don't think, would disagree with me, here at this table or anywhere, that if we

had more clarity in terms of the regulations—and I think only Federal, some Federal guidelines are going to straighten this out as to what the basic rules are so that we know that every State has a certain set of standard rules that are the same and not this patchwork of slight nuances and differences.

And they may argue that we have the right to do what we want, and we have only made this minor little change over here, but this minor little change over here requires a fleet of lawyers to make sure that everybody is in compliance.

So what we would like to see, as a company, and I am sure for securitization to get started, which is a good thing, I think, as long as they don't get carried away, is access to the market.

Chairman KANJORSKI. So what I gather is, if we move towards an optional Federal charter, you want us to make sure we include life insurance policies that are dealt with; and then also we want to discourage the use of lawyers in our system.

Mr. Garrett?

Mr. GARRETT. Thank you.

So basically we are talking about two different issues here. We are talking about the securitization issue and life settlement products in general.

On the securitization issue, you can reiterate for me with regards to the SEC's position, as far as when you have securitization, the SEC's responsibility in that area is—

Ms. DUBBERLY. The SEC has authority over the securities. A pool of life settlements is a security, so the offer and sale would come under their jurisdiction.

To date, all of them have been offered privately, not in registered transactions. So we have less authority over the disclosure and private transactions than we do in registered transactions.

Mr. GARRETT. You do have some.

Ms. DUBBERLY. We do have antifraud authority.

Mr. GARRETT. So the sale disclosure, marketing, fraud aspects of those, and if it is registered, then it is a complete line of authority that the SEC would have?

Ms. DUBBERLY. They would have to comply with all of our disclosure rules.

Mr. GARRETT. So I was looking at the life settlement products issued, then, moving over to the next set of issues, since it sounds as though on the security side, when it is securitized and registered, we already have the SEC out there responsible. And we also found the SEC has set up the task force to look further, so looks like we are going in that direction. We will see what the end results are, and Congress can respond if they don't like the results.

So the next step is the life settlement products aspect. The question there comes to a couple of them. And I will open this up to a couple of you to answer at the same time, with Ms. Voss being on the defensive end on one end of it and saying that things are confusing and inefficient when the State is involved on the one hand.

But I always guess, on the other side, in light of all the morass that we have gone through and the problems we have gone through in the last 12 months, and you consider that, unfortunately, with all due respect, it was Federal regulators who were involved with

things at the SEC and the other banking regulators where there are some problems there, I guess hope springs eternal that this time the Feds will actually get it all right when you defer to us to actually to get the regulations in this area.

So, Ms. Voss, I know you wanted to—it looked like you wanted to make a point with regard to Mr. Pardo's comment.

Ms. VOSS. Thank you. I just want to clarify.

Actually, 45 States have some specific regulation of life settlements; and I think we would readily admit that a life settlement transaction, in most cases, is an appropriate transaction, and nobody that is regulating at the State level wants to deny somebody their property rights.

But we also want to make sure that consumers understand what they are doing with their insurance, that there is disclosure, and they know all of the information about how that transaction happens.

Mr. GARRETT. Mr. Kelly raised the point with regard to something out of the organization, the life settlement disclosure statement, which you have.

And how many clients are members of the organization?

Mr. KELLY. We have six institutional members of ILMA. And then we have five allied members.

Mr. GARRETT. And how much else out there?

Mr. KELLY. On the institutional side, we represent probably, I would say, 70 percent of the institutional side that is active in this marketplace.

Mr. GARRETT. So you folks came up with the life settlement exposure document. That lays it all out there. That is something, as far as I understand from the NSC, you don't quite—haven't adopted that as complete disclosure; is that correct?

Ms. VOSS. We have some disclosures in the model log that States are looking at, and also—the National Conference of Insurance Legislatures also has a model. So States are looking at disclosure very carefully.

Mr. GARRETT. Is there something that Congress can do in this area—I don't like us to be the heavy hand on this thing—but to encourage the States that take the proactive role on this, to go back and take a look at the—not to say that Mr. Kelly's organization has the 100 percent answer on these things, but to open the book up again, as this area begins to expand, to make sure that we are having as much transparency, particularly in the area as far as agents' compensation and all of that information?

As you said, the consumers are really what you are trying to protect.

Ms. VOSS. You make a good point; and any time you want to, write us a letter and encourage those States who may not have not adopted the model.

I am also very encouraged with the SEC. I just met with them this morning on a variety of issues, and I think by us getting together and talking about our concerns, as investors, we may come out with a joint agreement on how to, overall, protect consumers and regulate these products.

Mr. GARRETT. I will give Mr. Pardo 10 seconds.

Mr. PARDO. I just wanted to say, Mr. Garrett, if you wrote that letter, you would be writing it to every single State because, to my knowledge, no State has adopted that act. They have adopted parts of the model act, but not all of the model act.

We agree that disclosure is a good thing, but when we are talking about sophisticated investors, these are investors who are exempt by the SEC as accredited investors. People who own multimillion dollar policies, who have lawyers, who have access to professional help, don't want to be told by regulators, quite frankly, what to do with their assets.

And so the ones below, say, $500,000, they do need a level of protection. But there is a group of people who do not—not only do not need it, but don't want it.

Mr. GARRETT. I see my time is up. I am going to ask one last question and that is on this line.

Were the Congress to get involved in this area and try to set up some minimum levels in order to provide the consistency that—the argument always is, we need consistency across the 50 States. The flip side of that, we often hear from—particularly, depending on the issue—from one side of the aisle, is that going to be the floor or the max?

So if you do it on the floor on this side and, for consistency, you may end up and you still allow the States, in due deference to the States, to say they can still put on X, Y, and Z as consumer protections, do you end up with the exactly what you want? Or do you end up with the worst of both worlds, the floor and also, still, 50 State regulators?

Nothing against State regulators, but that is the argument on the other side of that, always.

Mr. PARDO. My feeling from 19 years in the industry is that we have—the States have a pretty good regulatory system going. There is not a lot of tweaking that needs to be done here, to be honest. I think it is just getting a standardization of this patchwork so that everybody at this table that is on the buy side of these transactions understands what it is they are dealing with and for that matter, the sellers understand it as well.

Mr. GARRETT. Maybe that is how we can—if we are not revisiting in an official capacity or some other capacity, maybe that is something we should look at to see how we can encourage to get to that level of standardization, so you do have that consistency.

Again, I thank the panel for their testimony.

Chairman KANJORSKI. Now we will hear from Mr. Green.

Mr. GREEN. Mr. Chairman, while they are not witnesses, I do have two State representatives who are here today with Mr. Pardo. They are Representative Jim Dunham and Representative Garnet Coleman, and I wanted to acknowledge their presence.

Let us for just a moment continue with what the chairman started, which was building a record. I am always concerned about whether or not there is systemic risk, but my suspicion is that all of the members of this panel will agree that there is not systemic risk at this time.

If there is someone of the opinion that there is systemic risk at this time, will you kindly extend a hand into the air?

There is.

Ms. VOSS. I think you really have to be careful about the effects of the securities market on what is happening in life insurance. And I think when we have these discussions with the SEC about expanding on the securitization of life settlement, what does that do in the back end to life insurance companies, their assumptions on the pricing of these products, that you could have something that would affect the insurance markets.

So I am giving you a half-hand.

Mr. GREEN. I take it.

What you are saying is, using the example of AIDS, which, of course, many persons bought policies assuming that there would be a life expectancy of a certain number of years; and then with the drug treatments that became available, the life expectancy increased and that caused some persons to lose some of their investment.

Is that the type of example that you are talking about?

Ms. VOSS. No. I am talking about, if the securitization of life settlement becomes a growing product, there is going to be a greater demand for the settlement of more policies, which could have an effect on how companies look at their assumptions when they price these products. And it could have some kind of an adverse impact; we just don't know at this point.

Mr. GREEN. I concur with you. But at this moment, would you see that as a problem today, is my question.

Ms. VOSS. Not today.

Mr. GREEN. Let the record reflect that as of today, we don't have the systemic risk, but do you agree or disagree?

Perhaps I should say, would you agree that we do need some consumer protection in the marketplace? And if there is someone who differs, if you think we don't need consumer protection, that the market is fine as is, would you kindly raise your hand?

I would like for the record to reflect that all of the witnesses are of the opinion that we do need some consumer protection.

If you think that sophisticated investors should be a part of this process—and you mentioned sophisticated investors, Mr. Pardo. Of course, to be a sophisticated investor, one does not have to have a certain level of intelligence always, but it also has to do with the amount of capital that one has available to invest. And you have spoken of sophisticated investors.

So let me ask Ms. Dubberly and Ms. Voss, if you would, is there a means by which sophisticated investors—persons who are not sophisticated investors may become involved in this to the extent that they can be harmed?

Ms. VOSS. If you are talking about the securitization and then purchase, if in fact you get to a market where the individual investor may be interested, yes, I think there could be harm.

Mr. GREEN. Do you think that this patchwork that has been alluded to is something that should be addressed because of the inconsistencies and perhaps the lack of transparency in one State versus another State? Is this something that we should address, the patchwork?

If you think that the patchwork is something we need to address, kindly extend a hand into the air.

All right. Maybe it is easier to do it another way.

If you think that we shouldn't address the patchwork and leave it as it is, would you extend your hand into the air?

Ms. DUBBERLY. I have to say that part of the purpose of the chairman's task force that she has formed on life settlements at the Securities Exchange Commission is to look at all of the questions you are asking and do a holistic analysis of the whole situation.

I don't know that we would have answers to any of those particular questions at this moment.

Mr. GREEN. I am in complete agreement with you. But I am trying to find out from the other experts, are they in agreement that this should be looked into? I think you are doing the right thing, but I do want to find out if our other experts agree.

Is there anyone who is in disagreement? Anyone?

As my time is about to expire, let me ask Mr. Pardo one additional question.

You were involved with some litigation that has somewhat helped to define this area. Do you want to have just a comment on that at this time, Mr. Pardo?

Mr. PARDO. Are you talking about the SEC *v.* Life Partners?

Mr. GREEN. Yes, sir.

Mr. PARDO. In 1994, the Securities Administration brought suit against Life Partners claiming that the purchase of life settlements for sophisticated investors constituted the sale of securities. We took the position that it did not.

The ultimate resolution of that case here in Washington, D.C., at the U.S. Court of Appeals, was that it was not a security in any rendition or iteration, as they put it in a U.S. Court of Appeals ruling in July of 1996 and reaffirmed by the court in December of 1996.

So the U.S. Court of Appeals all the way back in 1996—this was, however, fact-specific to Life Partners' business model with it: It was not a security.

But this patchwork I am talking about is that since that time, some States have chosen to ignore that Federal litigation and say, oh, well, we don't agree. And it is like me disagreeing with a cop, I wasn't speeding; I am still going to get the ticket.

Mr. GREEN. I will have to yield back because my time has expired.

Chairman KANJORSKI. Mr. Manzullo of Illinois.

Mr. MANZULLO. Thank you, Mr. Chairman.

Would anybody here like to see the securitization of these mortgages governed under the new or the proposed Consumer Financial Protection Agency? Do you guys know what that is?

Do you know what that is, Mr. Pardo?

Mr. PARDO. I am sorry. I am a little hard of hearing.

Mr. MANZULLO. Have you heard of the proposed Consumer Financial Protection Agency?

Mr. PARDO. Yes, of course, I have.

Mr. MANZULLO. Would you like to be regulated by them?

Mr. PARDO. I think they should have a regulatory role, some oversight of life settlement, yes, I do.

Mr. MANZULLO. Do you know what they would do?

Mr. PARDO. I hope they would do what Congress asked them to do.

Mr. MANZULLO. That is not what an agency does. The first thing that they would do is, they would tell you the minimum amount that you can buy a policy for.

Mr. PARDO. I do not believe that you can price fix, either the government or privately. Are you talking about putting a minimum?

Mr. MANZULLO. You bet. They will come in with life ratings and take a look at the product and take a look at the premium and the amount.

Mr. PARDO. What is going to happen there, Congressman, if that happens, you are going to then be denying the market to the owner of the policy because if that doesn't agree with our numbers—and I am talking collectively at this table—the policy is not going to get bought.

Mr. MANZULLO. I am just saying, I am against this organization, but that is exactly what they will do because they want to make sure that the consumer gets a fair price for the product. They will find some way to do that.

I don't think you want that, do you?

Mr. PARDO. Not that, no.

Mr. MANZULLO. Be careful what you ask for when you want the Federal Government involved in this stuff.

Ms. Voss, when you were saying that you know of no State that has adopted the model disclosure, you were shaking your head. Ms. Voss; is that correct?

Ms. VOSS. The model act has been introduced and passed in many States, including Iowa, and there are two different versions of regulation of life settlement that are out there.

We have 45 States that have some version of the different models that have been enacted. So, yes, there is regulation out there.

Mr. MANZULLO. But you disagree, Mr. Pardo?

Mr. PARDO. Yes, I would disagree. There are variations of regulations, and most States do regulate. But my statement was that no State has adopted the total model act, which they started working on in about the early 1990's.

Mr. MANZULLO. They have adopted the disclosure.

Ms. VOSS. We are happy to get you all of the different details of all of the different States and what they passed. And we updated that model in 2007, and many States have adopted it and even made it better, working with the life settlement industry to make sure it was appropriate.

Mr. MANZULLO. So you guys disagree with each other, correct?

I want to get some life into this boring hearing.

Mr. PARDO. The parts that have been adopted have been fine. But I am saying if you got the impression from the Commissioner from Iowa that all of the recommendations have been taken up by every single State, I don't think that is true.

Mr. MANZULLO. But you want the Federal Government to preempt that and come in with something?

Mr. PARDO. No. I didn't say that.

Mr. MANZULLO. What exactly do you want this town to do for you? What is it that you want or don't want?

Mr. PARDO. What we want is some minimum regulation from the Federal Government, minimum regulation from the Federal Gov-

ernment that standardizes the regulations between the States. Because these so-called nuances are—it is easy to say "nuance."

Mr. MANZULLO. What you want is preemption then?

Mr. PARDO. No.

Mr. MANZULLO. Nuance is called federalism. States have a right to pass their own laws with regard to the jurisdiction that exists there.

Mr. PARDO. In the case of insurance, but this isn't the business of insurance.

Mr. MANZULLO. Are you saying this is a gray area?

Mr. PARDO. I don't think it is gray.

Mr. MANZULLO. I am just trying to figure out, you know, what it is that you want from us because you never ask Washington for something and then be surprised at the product.

Mr. PARDO. I think I told you what we wanted. But maybe I didn't make myself clear.

Mr. MANZULLO. Could you take a minute or so and tell me what that minimum regulation is that you want?

Mr. GREEN. [presiding] The Chair will allow the gentleman to answer, and the time has expired afterwards.

Mr. PARDO. I am not prepared to sit here and go through the entirety of it, but I will be happy to have one of my attorneys here behind me—

Mr. MANZULLO. No. Just an idea of what it is you want.

Mr. PARDO. We would like to see—Life Partners, a 19-year participant in this industry, would like to see a standardization between the States of a minimum set of regulations such that instead of having to have two compliance lawyers and a staff looking at every single State and the differences between every single State, we can be dealing with standardized regulation.

For instance, one thing would be reciprocity. We are licensed in the State of Texas. If we are licensed in the State of Texas and we are complying with Texas law—which I will say, for the most part adopts the NAIC model, but not entirely, and we comply with it and we are in good standing, then why should we have to go through the same regulatory process as a buyer now?

Remember, we are not selling anything. Why should we have to go through that same process in Florida or New York or Iowa or any other State? Why can't there be reciprocity or some other mechanism that could be put into place that would allow—

Mr. GREEN. We will ask that additional questions be placed in writing. Mr. Pardo can respond in writing.

We will now recognize Mr. Grayson from Florida for 5 minutes.

Mr. GRAYSON. Thank you, Mr. Chairman.

Looking down the table here, I want to know, are any of you looking for a bailout?

Come on, be honest. Nobody? Well, that is refreshing, I must say.

I just want to know because a lot of hearings that we have been having lately are focused on the question of taxpayer money going to private industry. I don't think that question has been raised today.

Harm to the financial system, I don't see that question being raised today either.

So I want to make sure, are any of you too-big-to-fail? I don't mean you personally. I mean your organizations. Are any of your organizations too-big-to-fail?

No? Good. I am glad to hear that.

Are any of you going to cause the destruction of the world financial system? Come on. Be honest. If you are going to cause the destruction of the world financial system, I want to know about it. Anybody? This is your last chance.

No? None of you?

Are any of you actually regulated already by any of the laws that we have passed on this committee?

No?

Oh, hey. We have somebody here. Okay, I am starting to see why we might be here today. But I think that, as I understand it, a big part of the reason we are here today is because of an article in the New York Times.

So let me hear from Mr. Dorsett, your view of that article, since that is why we are all here.

Mr. DORSETT. I would have to say we found that article to be rather poorly researched and quite misleading in its implications. We were told by the reporter that they did extensive research in the area, including trolling the LISA Web site, but somehow they couldn't find a phone number for Doug or myself to actually talk with anyone in the industry.

I don't want to slam the New York Times, and certainly I will have to say we got a lot of calls because of that, both our individual members and LISA, by people saying, I didn't know you could sell a policy; how do I go about that? So it wasn't all bad.

Mr. GRAYSON. Tell me exactly what it was you thought was wrong about the article. You said it was misleading.

Mr. DORSETT. The numbers were vastly inflated, as you have heard from a number of testimonies today, as far as how big the industry is and what is going on. The implication that there was some relationship between the potential securitization of life settlement, which actually has not happened, and the subprime market was somewhere completely out of left field.

So, as we said, we didn't see a whole lot of accuracy to the article. But it did point attention to the industry, and I suppose that is a good thing.

Mr. GRAYSON. What were the scary things that the article mentioned that you feel aren't valid?

Mr. DORSETT. The primary one was that life securitization was a train out of control, that the numbers were large, that it was not a regulated industry, and that somehow this was out of control and a train heading our way, which I think the testimony would indicate is not the case from pretty much anyone here.

Mr. GRAYSON. What percentage of life insurance policies have been secured this way?

Mr. DORSETT. There have been, to my knowledge, two private securitizations. One of them, the Coventry securitization; the AIG book was relatively large and involved 3,400 policies, and it was like $8 billion worth of life settlement. That, however, was a transaction done purely internally within AIG to move money from one place to another.

Outside of that, legacy benefits today are a fairly small securitization. There are certainly a number of people who would like to securitize life insurance settlements and a lot of transactions are being looked at. But there are a number of hurdles to doing that, not the least of which is getting through the rating methodology.

I have seen a lot of deals pitched here recently where, by the time you go through the process of creating the pool, adding capital support, future premium payments, overcapitalizing, the sorts of yields they were talking about weren't going to get anybody too terribly excited.

Whether it is going to work in the market is an open question.

Mr. GRAYSON. I do believe, Mr. Chairman, that we should not close the barn door after the horses have escaped from the barn. But here I see a situation where there is no barn, there is no barn door, and there are no horses, as far as I can see.

But just to be absolutely clear about that. I don't want you coming back 6 months from now and saying you want a bailout. Are we clear about this? You are not asking for any Federal money, correct?

All right.

And you are not asking us to regulate something that is not regulated now by the Federal Government, are you?

Mr. DORSETT. We are not.

Mr. GRAYSON. Thank you very much, Mr. Chairman. I yield my time.

Mr. GREEN. I thank all of the persons who are here testifying today, and I do so on behalf of our chairman who had to step away.

Before we adjourn, we will have to make a part of the record the statement of Mr. Joseph M. Belth on life settlements. Without objection, it is so ordered.

And the record will remain open so that persons who desire to submit additional questions may do so. The record will remain open for 30 days, such that we may receive the questions and responses.

This panel is dismissed, and the hearing is adjourned.

[Whereupon, at 4:20 p.m., the hearing was adjourned.]

A P P E N D I X

September 24, 2009

OPENING STATEMENT OF CHAIRMAN PAUL E. KANJORSKI

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

HEARING ON RECENT INNOVATIONS IN SECURITIZATION

SEPTEMBER 24, 2009

We meet this afternoon to examine recent innovations in our securities markets, especially those related to life insurance settlements. While the life settlement industry is now well established and quickly growing, the securitization of life settlements remains in its infancy. Investors, however, have already gained access to other securities products like life settlement funds, mortality indexes, and derivatives linked to life settlements.

Today's hearing offers us an incredible opportunity to employ the lessons that I hope we all have now learned – even though we paid too dear a price to learn them – about issuing toxic securities. By asking some fundamental questions about this industry, we can prevent trouble using foresight rather than later undoing disaster in hindsight.

Specifically, we should ask how one would securitize life settlements, what is needed to properly securitize these products, and whether or not we should securitize them. We should also explore how we can protect those who invest in these products and better safeguard those who sell their life insurance policies. Perhaps most importantly, we must examine whether or not securities products based on life settlements actually contribute to economic growth or merely prolong the casino culture on Wall Street that got us into our current economic mess.

Generally, I see enormous value in securitization. Pooling assets together to create new products can effectively allocate limited economic resources. Securitization has mobilized trillions of dollars of capital from around the world to enable Americans to purchase cars and homes, obtain a college education, and start new businesses. Through securitization, we have also created new sources of liquidity and helped investors to diversify their portfolios.

In short, the securitization of home mortgages and other assets still has the potential to produce enormous societal benefits. That said, we must remember that securitization is only an engine and not an end in itself. Like other engines, for it to run as intended, securitization needs strong, reliable inputs, responsible operators, and clear rules of the road.

In the case of the subprime crisis, we failed on all three fronts. Wall Street's insatiable demand for subprime mortgages fueled a Frankenstein-like engine that allowed originators to hit full throttle and bundle tens of thousands of toxic mortgages without regard to the consequences. At the same time, regulators ineptly monitored these activities, underwriters dangerously relaxed standards, and far too many investors failed to fully understand the purchases they made.

Perhaps most troubling, the gatekeepers to our markets – credit rating agencies – negligently, if not recklessly, stamped nearly everything with a triple "A." Their wildly inappropriate investment grades nearly drove our economy off of a cliff.

Before life settlements have the chance to give securitization another black eye, we ought to consider the need for additional safeguards. Today's hearing will therefore focus on whether or not life settlements are an appropriate input for the securitization engine, and whether or not its operators can appropriately drive this vehicle.

Life settlements can provide retirees with a source of liquidity to fund unexpected expenses or to sell an asset that they no longer need at a better price. But this industry also has the potential for substantial abuse. Presently, states inconsistently regulate life settlements. Many states have also failed to require the registration of life settlement brokers.

Moreover, because of the opaqueness of life expectancy estimates, some investors in life settlement funds have already lost money on inaccurate predictions. The financial gains made by a select few middlemen from the transaction costs related to life settlements are also estimated to be four times that associated with the sale of masterpiece paintings.

In sum, we face many problems with this budding industry. The improper securitization of life settlements could ultimately leave countless seniors penniless and innumerable investors broke. The idea of institutional investors profiting from a person's death also seems, to say the least, unsettling and immoral. It leads us down a slippery slope that might eventually result in indexes based on divorce rates and swaps tied to gambling losses.

We are hopefully now emerging from the worst recession of our time. This committee is also working diligently to strengthen the regulation of our financial system to withstand future crises. It is in this spirit of reform that we should examine the life settlement industry and its connection to our securities markets. By doing so today and before we face another crisis, we may also decide that the best policy is to keep this Pandora's box shut.

Testimony of
Daniel Curry, President
DBRS Inc.
to the
Subcommittee on Capital Markets, Insurance,
and Government Sponsored Enterprises
Committee on Financial Services
United States House of Representatives

September 24, 2009
Recent Innovations in Securitization

Introduction

Problems with securitizations in the mortgage and credit markets contributed significantly to the recent global financial crisis. As the financial markets continue to recover, it is critical that policy makers, regulators and market participants understand what went wrong and take appropriate action to ensure that past mistakes are not repeated. At the same time, however, it is important to recognize that our financial markets thrive on innovation. A regulatory environment that prohibits the development of new investment products will ultimately impede rather than enhance the economy's return to good health.

Fostering innovation while limiting unnecessary risk is a delicate task. DBRS commends the Subcommittee for tackling this challenge, and we are pleased to have the opportunity to answer your questions about the securitization of life insurance settlements. My testimony this afternoon will focus on three broad areas: (1) an overview of life settlement securitizations; (2) the role of rating agencies in this market, including DBRS's preliminary activities in this area; and (3) our suggestions for prudent regulation of life settlement transactions. Before I get to those issues, however, I would like to begin with a brief description of our company.

Overview of DBRS

DBRS is a Toronto-based credit rating agency established in 1976 and still privately owned by its founders. With a U.S. affiliate located in New York and Chicago, DBRS analyzes and rates a wide variety of issuers and instruments, including financial institutions, insurance companies, corporate issuers, issuers of government and municipal securities and various structured transactions. The firm currently maintains ratings on more than 43,000 securities in approximately 35 countries around the globe. DBRS was first designated as a Nationally Recognized Statistical Rating Organization (NRSRO) in 2003, and has been registered in that capacity since 2007.

DBRS is committed to ensuring the objectivity and integrity of its ratings and the transparency of its operations. To this end, the firm has adopted a wide range of internal controls designed to eliminate conflicts of interest wherever possible, and to disclose and manage those conflicts that cannot be eliminated. In addition to displaying all of its current public credit ratings and selected ratings history, DBRS's public Web site also discloses the firm's ratings policies and methodologies as well as extensive information about how its ratings have performed over time.

With that background, I would like to turn my attention to life settlement securitizations.

Overview of the Life Settlements Market

The sale of life insurance policies by insured parties is not a new phenomenon. Indeed, an insured's right to sell or otherwise assign the rights to his policy was confirmed by the U.S. Supreme Court almost one hundred years ago. The structured life settlement industry is a result of the evolution of the mid-1990s' viatical settlements market, which bought and sold life insurance policies of the terminally ill. In a structured life settlement transaction, an issuer buys and pools hundreds of insurance policies and securitizes the

resulting cash flows. In acquiring insurance policies for a structured product, the issuer pays the insured party an amount greater than the policy cash surrender value, but less than the death benefit. In order to receive the ultimate death benefit, the issuer/trustee must pay the associated premiums on the pooled policies until the deaths of the insured, as well as transaction expenses.

Most life settlement securitizations are private placements, so definitive data on the number of deals is hard to tally. To the best of our knowledge, the volume of these deals has been relatively low and the deal flow, sporadic. However, there are several factors which may stimulate growth in the sales of life insurance policies in the coming years. These factors include longer life spans, the decrease in defined-benefit retirement plans and other factors that may force older Americans to seek alternative sources of cash. Growth of the structured life settlement market may also be spurred by increased awareness among policy holders that they can realize value from policies they otherwise would allow to lapse, as well as by increased interest in such products by institutional investors.

From a regulatory standpoint, control of the life settlement industry is primarily a creature of state law. Over the past several years, most states have enacted legislation in this area. The primary aim of these laws is to protect consumers by mandating disclosure standards, providing the means to ensure that consumers receive fair prices, and imposing licensing requirements on companies who seek to buy life settlements from policy holders. Although the state statutes are not identical, many are based on one of two model laws crafted by associations of regulators and industry participants. Life settlement securitizations are also subject to the applicable provisions of the Securities Act of 1933 and related rules, particularly those pertaining to private placements.

Until now, DBRS has not had any interactions with federal or state regulators regarding life insurance settlements or the securitizations thereof. That, of course, may change as a result of today's hearings.

The Role of Credit Rating Agencies in the Life Settlements Market

The role of a credit rating agency in a life settlement securitization is to issue an opinion about the ability of an issuer to repay, in a timely manner, principal and interest on bonds backed by pools of life settlements. Rating agencies do not purchase or arrange for the purchase of life insurance policies; nor do they structure, underwrite or sell life settlement securitization transactions.

Because responding to transaction proposals is a core part of the services we provide, in 2008, DBRS published a methodology for rating U.S. life settlement securitizations. This methodology, which is publicly available on DBRS's website (www.dbrs.com), calls for both qualitative and quantitative approaches to reviewing a life settlement securitization transaction. From a qualitative standpoint, DBRS's ratings methodology focuses on the operational risk associated with the sourcing, origination and underwriting of the life insurance policies serving as collateral for the rated debt. The rating process also includes an assessment of the financial strength of the insurers, a review of the representations and warranties made in the transaction and a review of the legal structure and opinions. As for the quantitative component, DBRS has developed a proprietary model to evaluate each major dimension of the life insurance policy assets, as well as to review stresses of a transaction's priority of payments, based on a set of cash flow assumptions. The cash flow stresses address the issuer's ability to meet its obligations.

DBRS's rating methodology does not include the creation of any mortality indices. Instead, the company relies on publicly available mortality tables, such as those

promulgated by the Society of Actuaries. The use of such independent, public information contributes to the integrity and transparency of the DBRS ratings process.

Although DBRS has reviewed approximately 14 proposals for life settlement transactions, we have not rated any of these deals and our market share remains at zero percent. Two of these transactions are still under review, while the others failed to meet our rating criteria or did not go forward for other reasons.

Establishing a Framework for Prudent Regulation

The financial turmoil in the structured finance market over the past 12 - 18 months arose from a confluence of factors, including fraudulent behavior on the part of mortgage brokers, appraisers and home buyers; loose underwriting standards fostered by the complete transfer of risk away from the lending institutions; and the decline in home prices. For their part, issuers and arrangers failed to make sufficient information about their deals available so that investors could make informed decisions. This, in turn, led investors to over-rely on credit ratings. Rating agencies, too, bear some of the blame, as ratings methodologies and models failed to keep pace with changes in the products being rated, and the ratings process, at times, lacked transparency.

DBRS believes that the lessons learned from the past year and a half can form the basis for a prudent regulatory framework applicable to life settlement securitizations. First and foremost, there must be a focus on consumer protection to ensure that parties who buy life insurance policies do not take advantage of the elderly and infirm, who are the most likely sources of such policies. In this regard, DBRS supports states' efforts to license those who acquire life settlements from policy holders and to mandate the disclosure of fair and reliable information to consumers about the disposition of their life insurance policies. In order to avoid a balkanized system of regulation, DBRS

encourages the state insurance regulators to work together to develop a uniform system of requirements in this area.

On the securitization front, DBRS believes that steps should be taken to ensure that those who structure life settlement transactions retain a portion of the risk arising from such deals. Requiring issuers/trustees to have "skin in the game" aligns their interests with the interests of investors, and enhances the safety and soundness of the structured finance markets.

DBRS also believes that it is critical to provide investors with the information they need to make informed investment decisions. Thus, issuers should be required to supply potential investors with sufficient information about the structure, risk and collateral of all the deals they sponsor. We encourage the SEC to amend its existing regulations as necessary to make this happen, or to seek additional Congressional authority if it sees the need to do so.

Finally, with regard to credit rating agencies that are registered as NRSROs, we believe that the regulatory regime established and still being refined under the Credit Rating Agency Reform Act of 2006 is well suited to ensure the quality, integrity and transparency of ratings on life settlement products. For example, NRSROs are prohibited from rating deals they helped structure; are required to separate the analysis and business development sides of their operations; and must disclose and manage other types of conflicts of interest related to their ratings activities. They also are obliged to publish their ratings methodologies and to maintain records for SEC inspection of the rationale for certain deviations from those methodologies.

In order to permit investors to compare the quality of ratings issued by various rating agencies, NRSROs must make ratings history information publicly available in a

machine-readable format, and they also must publish default and transition studies on an annual basis to reveal how their ratings perform over time.

DBRS believes that establishing a regulatory framework along the lines I just described will permit healthy innovation of the securitization markets to continue without sowing the seeds of another financial crisis.

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I appreciate having the opportunity to present DBRS's views on life settlement securitizations and I look forward to answering any questions you may have.

Testimony Before the
United States House of Representatives Committee on Financial Services
Subcommittee on Capital Markets, Insurance and Government-Sponsored Enterprises

"Recent Innovations in Securitization"
Thursday, September 24, 2009
by
Russel Dorsett
President
Life Insurance Settlement Association

Chairman Kanjorski, Ranking Member Garrett, and members of the Subcommittee:

Summary:

Good afternoon. My name is Russel Dorsett, and I am delighted to have the opportunity to appear before you representing the Life Insurance Settlement Association (LISA). LISA is the oldest, largest, and most inclusive body serving the Life Settlement industry; it is an honor and privilege to serve as LISA's current President. Membership in LISA is available to any interested party actively involved in the industry and who can demonstrate good character and reputation, and includes institutional investors and financing entities, service providers (life expectancy underwriters, lawyers, servicing agents, consultants, and escrow agents) and the brokers and providers who, as licensed and regulated intermediaries, assist policy owners in finding buyers, negotiating terms, and completing transactions.

The latter category (brokers and providers) make up the bulk of our membership, and the major mission for LISA is promoting an orderly and transparent marketplace, sound regulation, and best practices to enable consumers (policy owners) to maximize the value of a financial asset—a life insurance policy which is no longer, needed, wanted, or some cases, affordable. We are very appreciative of the opportunity to appear before you today, as one of our primary missions is to educate consumers, regulatory bodies, and policymakers about the potential benefits to both individual consumers and the economy as a whole afforded by a robust secondary market for life insurance policies.

LISA's members are part of the negotiated process whereby individual policy owners sell their policy through Brokers to Providers who are licensed and regulated in regulated states. In this context we have delivered nearly $10 billion to those policy owners, making it possible for them to afford retirement, medical care, or simply to enjoy the lifestyle they have earned. The average settlement pays policy owners 4 to 6 times the policy's cash value. Over the past decade the life settlement industry has delivered to policy owners approximately $6 billion above what they would have received had they simply lapsed or surrendered the policy.

Life settlements also generate additional revenue for the US Treasury. When a policy is "transferred for value", what would otherwise be tax-free income to the beneficiary becomes taxable in the hands

of the policy's new owner. Revenue Ruling 2009-13 and 2009-14 were issued earlier this year to help clarify the proper treatment of these transactions. It has always been recognized that the gain received by the seller (policy owner) was taxable; these rulings provide some guidance as to how that gain should be calculated. Unfortunately, these rulings are not entirely clear or consistent, and we look forward working with Treasury as well as Congress to fully and properly address the issues surrounding the taxation of life settlement transactions.

This appearance is occasioned by the Committee's concern that growth of the secondary market and the potential for securitizations based upon the asset class (settled policies) might somehow be seized upon by Wall Street's rocket scientists and grow to the point where it constitute a systemic threat. Life settlements represent a niche marketplace residing (rather uneasily) between two colossuses; the institutional capital markets and the life insurance industry. In comparison to either the life settlement market is miniscule. In the best of times perhaps $ 3-$4 billion of capital was actually employed to purchase policies, which might translate to face amounts of $12 to $15 billion purchased in any one year. While this is certainly not an inconsequential sum, it is tiny in comparison to the mortgage markets ($14.6 trillion of outstanding debt and $8.9 trillion of outstanding mortgage related securities, not including credit default swaps or other exotic counter party instruments[1]) or the life insurance market ($19 trillion of face amount in force, $10 trillion of which is individual policies[2]).

It is somewhat ironic that we might be perceived to be a threat, in that this particular industry has suffered mightily due to the current financial crisis. At best the number of completed life settlement transactions during calendar 2009 might approach 50% of those completed in the prior year; there are some indications that the volume of competed transaction declined by as much as 75% during the first half of 2009 compared to the prior period, primarily due to dearth of investment capital available to purchase policies. While many attribute the ongoing financial crisis to rampant and poorly supervised innovation on the part of Wall Street, in our case the effect has been to greatly reduce the opportunity for senior Americans to realize the full market value of their financial property via the life settlement option. In the five years preceding the financial crisis, however, the secondary market did experience growth, driven both by increased awareness on the part of consumers that such an option existed and the undeniable appeal of life settlements as an alternative asset class.

Although securitization of life settlements has been a topic of considerable interest for some time, the number of transactions actually completed can be counted on one hand—with several fingers left over. A number of hurdles exist, including but not limited to the relatively small number of policies available to create "pools", the lack of sufficient credible experience to validate actual to expected results in terms of life expectancy, and the evolution of an accepted methodology and criteria for obtaining ratings.

Life settlements are seen as a growth opportunity over the longer term. Demographic trends alone make it certain that more and more policy owners will, due to age and health status, find themselves in a position where a life settlement becomes a viable option, and even the most skeptical of

[1] The Bond Market Association

[2] ACLI Insurance Fact Book 2008

observers have concluded that life settlements can greatly benefit consumers in the circumstances where they are appropriate. To the extent that securitization can be accomplished in a financially sound and transparent manner, and in so doing increases the capital available to purchase unneeded or unwanted life insurance policies, we cannot help but believe that both social and economic utility are enhanced.

It is worth noting that even under the most optimistic growth scenarios only a very small fraction of the insured population would ever qualify as candidates for life settlement, and the total face amount of policies purchased is unlikely to approach even $200 billion over the next decade. While this is a substantial sum, it is several orders of magnitude away from the potential for creating systemic problems comparable to those experienced in the mortgage markets.

Life insurance, after all, is generally accepted to be a tremendous engine for wealth creation. It provides unmatched entrepreneurial opportunities for those with the energy and enthusiasm required to prosper as life insurance agents, and it creates jobs for clerical, administrative, and professionals within life insurance companies. The premiums collected are productively employed to generate investments in stocks, bonds, real estate and private placements, and in that context the life insurance industry is one of the bedrocks of the global financial system. It promotes planning and self-reliance on the part of individuals and via the cash values created and the benefits paid upon the death of the insured, it protects families from financial ruin upon the death of a breadwinner and puts capital in private hands to finance businesses small and large.

In our view the existence of a secondary market only enhances an already tremendous value proposition for both individuals and society at large, and results in more people buying policies and keeping them for longer. Should their health decline or they reach an age where they need the money now rather than later, the life settlement option can provide funds to meet their needs at a time when other assets have been depleted or declined in value due to adverse market conditions.

History and Purpose:

The secondary market for life insurance, more commonly known as "life settlements" is a relatively new addition to the financial services landscape. The legal right of a policy owner to sell to an unrelated third party has been recognized for over 100 years and affirmed by the Supreme Court in 1911 in Grigsby v. Russell. A loosely organized secondary market first appeared in the 1980's when "viatical" settlements arose, largely as outgrowth of the AIDS epidemic. Today's secondary market evolved from those foundations: pricing methodologies, contractual provisions for conveying ownership, and a nascent regulatory structure under state insurance regulators.

The evolution of a robust and transparent secondary market has not been smooth or seamless. In the early stages of the market's evolution, potential sellers (often AIDS victims) were paired with "Angel Investors" who were willing to provide funds for the compassionate purpose of allowing a terminally ill individual to afford housing, medical care, or to simply live out their final months or years with a measure of dignity. Because the market was "private", new, and outside the boundaries of existing experience or regulatory structures, returns promised to early investors were high.

As policymakers and regulators became aware of this market there were two obvious areas of concern. The seller (policy owner) was presumed to be terminally or catastrophically ill and thus an obvious candidate to fall into a class needing special consideration and protection. Investors participating in the market were doing so with little regulatory guidance, and were thus also potentially in need of protection against fraud and misrepresentation. Despite these quite legitimate concerns, complaints from either buyers or sellers were relatively infrequent.

Since the underlying asset involved in these transactions was a life insurance policy, state based insurance regulators stepped into the breach and in 1992 the NAIC began work on a model law for the regulation of Viatical Settlements. Model laws focused on creating and regulating the activities of two new classes of insurance intermediary:

- The Broker, who is charged with representing the interest of the seller (policy owner) and owes a fiduciary duty to his client
- The Provider, who acts as a principal in the transaction and acquires the policy, either on their own behalf or for an investor (or investors)

When anti-viral treatments began to emerge, AIDS became a chronic but treatable condition rather than a certain death sentence. As a result, many of the "viators" (policy sellers with terminal illnesses defined in the NAIC Models) who had been deemed terminally ill proved to be anything but, and the returns promised to angel investors failed to materialize. In 1996, the SEC, concerned with the welfare of these investors, filed suit (unsuccessfully) against Life Partners for their practices in the solicitation of private angel investors. This suit failed and others saw this as a green light to solicit private investors for the purchase of policies. [3]

The secondary market of today is almost entirely focused on life settlements,[4] and most investors are institutional investors working with professional asset managers. A life settlement involves the negotiated purchase of an in-force life insurance policy for an amount in excess of the cash surrender value but less than the face amount (death benefit) of the policy. Candidates for life settlement

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[3] During this same period insurance regulators made an attempt (still contained in Model legislation of the NAIC), to regulate the investment in these products. Meanwhile, the SEC renewed its efforts, bringing several successful cases to stop inappropriate investments by unwary individuals. The North American Securities Administrators Association (NASAA) noted in 2006 that nearly every state had taken a firm position concerning such investments by average investors that they were securities. These positions were based on investment contract analysis or specific state law in all but three states. LISA supported this effort and encouraged NASAA to make this position clear for the National Conference of Insurance Legislators as they developed new model laws governing settlements in 2008. The general consensus was that no entity without considerable financial sophistication and analysis was equipped to make such investments and that only qualified institutional investors should participate in this arena.

LISA has supported that approach by supporting specific language in all models which recognize the role of such investors in the markets. LISA has steadfastly joined with the NASAA effort to establish that the regulation of investments in this arena must occur under state and federal securities laws, while recognizing that the sale of an individual policy to a licensed Provider should properly be the domain of insurance regulators equipped to protect the seller in such a transaction. Over thirty-five states[3] now regulate these consumer transactions through insurance law. LISA has participated in the development of all of these laws through our direct activity or through the activity of our members. We maintain a comprehensive data base of these laws for our members and are delighted to share that information with the committee members or staff.

[4] Viatical settlements still occur, but are a very small part of the market

would generally include policy owners where the insured is age 70 and up and where the insured's health status has undergone a change since the policy was first issued.

The reasons for considering a life settlement are many and varied. Insurance is often purchased for specific purposes: income replacement in the event of the untimely demise of a breadwinner, debt, estate liquidity, etc. All of these needs are forward looking, and over time circumstances change, particularly as insureds achieve senior status. They may, for example, have out-lived their beneficiaries and paid off the mortgage and all their other debts. The estate may not have grown as anticipated, or the need for liquidity may have been reduced by the repositioning of assets. Last but hardly least, insured may simply decide that they are no longer willing or able to continue paying premiums, and that receiving a lesser sum while they are still alive to enjoy it outweighs the potential of a larger sum paid to their beneficiaries or their estate.

It is worth noting that seniors who have participated in the life settlement market as "sellers" have generally been very satisfied with both the process and the outcome. Even as the number of regulated jurisdictions has grown substantially, the number of complaints about the activities of life settlement brokers and providers has been negligible. Thus far in 2009, no complaints have been registered regarding life settlements with the NIAC's complaint database, and only 9 have been registered during the preceding four years.

Size and Recent Growth:

Over the past decade, the market for Life Settlements has grown substantially as measured by a steady increase in the face amount of policies presented for sale. Various authorities estimated the total face value of life settlement transactions completed during 2006 was at $5 billion in face amount. In 2005, Sanford C. Bernstein & Co., LLC, a research unit of Alliance Bernstein, L.P., estimated that approximately $13 billion in face value of policies had been purchased from 1998 through 2005. Since establishment of those benchmarks, industry insiders have spent considerable time trying to measure the size and direction of the growth. A 2002 Wharton School study estimated $100 billion in face value as potentially available, while a Bernstein Research study last year suggested that approximately $160 billion in face amount would become available for purchase over a ten year period.

In the early years of this decade, institutional investors become big players in the life-settlement business, with substantial investment capital coming from German institutional funds. Current estimates are that life-settlement purchases have increased from $2.5 billion of face amounts in 2003 to $10 billion to $15 billion during 2008.

It is worth noting that for the volume estimated, the capital actually employed to purchase policies may amount to, at most $3 to $4 Billion in any one year. That number has not changed significantly in recent years. This figure is, however, substantially smaller than the number recently cited in the New York Times. But we see little sign that the market for policies could possibly exceed the $100 Billion of purchased policy fact mentioned in the studies of 2004. In the current year, with stress on all investment classes and a reluctance to invest, we believe that the total market has declined from

2008 and that investment may have fallen to as little as $1.5 Billion. At this level, it would represent .01 Percent of the total market for life insurance and be an insignificant factor in life policy pricing, far lower than executive compensation and much, much lower than a rounding error in the investment results of the insurers.

Regulatory Structure:

Life settlements are currently regulated by the insurance departments in 35 states, and legislation covering life settlement transactions has currently either been passed or is pending in major jurisdictions such as Illinois, California and New York. LISA has worked diligently to support responsible regulation in all jurisdictions, and it is expected that be the end of 2010 more than 90% of the US population will reside in states where settlement transaction are regulated.

State based regulation of life settlement transaction has generally evolved from the models developed for the regulation of viatical settlements, and the primary focus is on the licensing and supervision of life settlement brokers and life settlement providers. Both the National Conference of Insurance Legislators (NCOIL) and the National Association of Insurance Regulators (NAIC) have developed model legislation for life settlements[5]; in most states that have recently passed legislation have used the NCOIL model as a starting point.

We believe that the States system of regulation has worked for our industry. We have our concerns in some jurisdictions, but expect them to be addressed and resolved. The nature of the process in fifty states is that we expect to see slight differences of opinion. For example some states have embraced the concept that consumers be aware of this option when lapsing or surrendering their life insurance policy and mandated such notice. Others have established enough obstacles to participation that no policies come to the market at all from the citizens of those states. We believe that the former pattern will prevail in the near future and that hurdles will diminish with greater familiarity with our market. That is happening rapidly, as evidenced by the extensive piece in the most recent issue of the AARP journal which explains the utility of the market with good cautionary notes to those who would avail themselves of its benefits.

LISA's Role:

LISA is an industry trade group of 144 members which are licensed in many states:

- 40 Brokers
- 34 Providers
- 15 Financing Entities
- 51 Industry Services
- 4 Producers

[5] The NAIC Model continues to use the archaic language of "Viatical Settlements" rather than "Life Settlements" supported by NCOIL.

We are proud that LISA members now hold over 1000 licenses in the regulated states. With a total of 888 licenses issued to the licensed Providers who are the policy buyers in all states, LISA members have obtained 624. Additionally, LISA Members represent nearly all of the nationally recognized brokerages who service residents of more than five regulated states.

We continually develop best practices for our members and refine them with a view to addressing emerging issues. We have developed extensive data bases for our members to allow for full compliance with and understanding of the laws of the states. Our efforts are extensive in seeking good regulation and we have been actively involved in dialogue with all industry regulators wherever permitted.

Securitization:

Much of the current concern seems to have arisen from a recent article published by the New York Times. We found this article to be poorly researched and somewhat misleading. Nevertheless, its publication caused a flood of calls from seniors to both LISA and our members, wanting to know how they could take advantage of the life settlement option for the policies they own. LISA did send out a response to this article, which is attached.

The life settlement marketplace isn't actually about Wall Street at all. It is, rather, about providing older Americans with the opportunity to profit from an asset for which they have bought and paid. Nor is it about "profiting from death"; it is about allowing seniors to benefit from a life insurance policy while they are still around to enjoy it. Owners of life insurance have long been able to treat these policies like any other "ordinary property", so said Justice Oliver Wendell Holmes in 1911 (Grigsby v. Russel). Indeed, as far back as 1855 New York's highest court held that policy owners enjoy the property rights in life insurance and, as such can "go to the best market the can find, either to sell it or borrow money on it."

While virtually every residential and commercial property in the US is mortgaged at some point, not everyone owns (or keeps) a life insurance policy. Of those that do, only a small percentage would qualify for the life settlement option, either now or in the future. For an in-force life insurance policy to have a value in the secondary market, the present value of the death benefit must exceed the present value of future premiums at an acceptable rate of return.

As an example, a 45 year old female non-smoker has a life expectancy of approximately 35 years.[6] (This number represents the probability that 50% out of 1000 individuals at this age will have died 35 years into the future.) Accordingly, an investor purchasing this policy would have a 50% chance of paying premiums on an insurance policy for the next 35 years— and they would also have a 50% chance of paying premiums for more than 35 years in order to receive any return on their investment. Sophisticated mathematics are not required to know that this is not a good investment opportunity.

For the most part the life settlement option is only available to individuals age 70 and up. It is worth noting that a female age 70 with no major health issues has a life expectancy (on the same basis) of

[6] 2008 VBT mortality table, female non-smoke age last birthday

nearly 17 years—still not a good investment, unless her health has changed substantially since the policy was issued. The numbers simply don't work and the policy has no value as a life settlement.

Efficient capital has entered the market in recent years and it is likely that some form of formal regulated securitization is indeed on the horizon. Done responsibly, and with proper oversight, this further development of the secondary market will bring more capital into the marketplace and thus provide more insureds with more value. This is good news for American consumers. Nor is there anything morbid or ghoulish about investing in settled policies as an asset class. Investments in mortality/morbidity are a multi-trillion dollar global industry which has been around for at least 200 years—it is indeed one of the foundations of the modern global economy, including annuities, cat bonds, and many other varieties of insurance linked securities.

In conclusion, we believe that life settlements provide a tremendous service for consumers. We believe the Committee should know that Life Settlements are a legitimate and well regulated market providing a true benefit to seniors in need. We believe that life settlements clearly provide social and economic utility, and make a positive contribution to society at large.

I want to thank you for your strong support for the American Economy. We believe that your work is invaluable and hope that we can be of further assistance in strengthening and enhancing good markets and confidence in those markets for the American consumer.

I would be happy to answer any questions you may have.

Testimony Concerning "Recent Innovations in Securitization"
by Paula Dubberly

Associate Director, Division of Corporation Finance
U.S. Securities and Exchange Commission

Before the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises of the United States House of Representatives Committee on Financial Services

September 24, 2009

Good afternoon Chairman Kanjorski, Ranking Member Garrett, and Members of the Subcommittee. I am pleased to testify on behalf of the Commission today on the topic of life settlements and new developments in securitization. I appreciate the opportunity to discuss with you the Commission's work in this area.

Background

Securitization is a financing technique in which financial assets, in many cases themselves relatively illiquid, are pooled and converted into instruments that may be offered and sold in the capital markets. In a typical securitization, a sponsor initiates a securitization transaction by selling or pledging to a specially created issuing entity, such as a trust, a group of financial assets that the sponsor either has originated itself or has purchased. The trust or other issuing entity sells securities. The money from the sale of the securities is used to purchase the financial assets from the sponsor. The financial assets are pooled and the pool typically is designed to cover a wide range of obligors on the underlying assets. The securities pay a return based on the assets in the trust.

Although we recognize that securitization plays an important role in the financial markets, the recent experience with securitization in the mortgage markets argues for the

careful review and analysis of all developing securities activities. In this regard, the Commission is taking steps to address issues with securitization. The staff currently is engaged in a broad review of the Commission's regulation of asset-backed securities including disclosure, offering process, and reporting of asset-backed issuers.

The securitization market continues to develop, and we recognize that securitization of life settlements appears to be a growing practice. A life settlement is the sale of an existing life insurance policy to a third party for more than its cash surrender value but less than its net death benefit. For a policy owner, a life settlement offers an alternative source of liquidity to those that historically have been available from the issuing life insurance company.[1] A life settlement becomes possible when the policy's market value exceeds its cash surrender value. We understand that the key factors determining market value are the amount of the death benefit, cost of expected premiums, and life expectancy of the insured.

Traditionally, an owner of a life insurance policy could access the value in the policy either through taking a loan against the cash value of the policy or by surrendering the policy for its cash value less any applicable surrender charges. The cash value or cash surrender value are frequently significantly less than the policy's death benefit. For a policy owner who may no longer need the policy, who may be unable to afford the policy's premiums, or who may have an immediate need for cash, a life settlement can

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[1] The so-called "viatical settlement" industry emerged in the 1980s in response to the AIDS epidemic. During that time, the industry developed as a means for AIDS patients to obtain needed cash by selling their life insurance policies. Generally, a viatical settlement involves a policyholder with a life expectancy of less than two years, while a life settlement generally involves a policyholder with a life expectancy of more than two years. The life settlement market developed as an offshoot from the viatical settlement market as seniors began to access the life settlement market as an option to exit life insurance policies. The market has grown rapidly in recent years.

offer a means for obtaining greater value than is available from the insurance company itself.

We understand that this additional liquidity may make life settlements attractive to some policy owners. At the same time, a life settlement may have certain drawbacks for the policy owner. Some of these drawbacks may include sacrificing the right to a death benefit substantially greater than the amount of the life settlement, potential loss of insurability, adverse tax consequences, and the difficulty of determining whether a life settlement provides a fair price for the policy. In addition, the sale of a life settlement potentially could result in dissemination of sensitive health or other personal information about the insured.

A life settlement offers the third party purchaser of the policy the opportunity to profit by receiving a death benefit that exceeds (in some cases substantially) the amount paid to the policy owner for the policy. The third party purchaser pays the premiums due on the policy during the insured's life. Upon the insured's death, the third party purchaser receives the death benefit from the insurer. Profitability depends on the value of the death benefit relative to the amount paid to purchase the policy from the insured and to maintain the policy through premium payments.

An industry source states that the life insurance settlement industry has grown from a $2 billon industry in 2001 to $16 billion in 2008.[2] Life settlements generally are considered securities when a third party purchaser sells a fractional interest in a single

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[2] Life Insurance Settlement Association, "The Basics of Life Settlements," *available at* http://www.thevoiceoftheindustry.com/files/content/docs/Brochures/ConsumerEducationweb.pdf (last visited September 21, 2009).

policy[3] or pools the life settlements and sells interests in the pool. To date, we are not aware of any securitized life settlements pool being registered with the SEC and publicly sold to investors, but we will continue to monitor this developing practice involving life settlements.

SEC Life Settlements Task Force

In light of the potentially far-reaching consequences of the recent movement toward securitization of life settlements, Chairman Schapiro has established a Life Settlements Task Force to examine emerging issues in the life settlements market and to advise the Commission whether market practices and regulatory oversight can be improved. The Task Force will consider, among other things, the application of the federal securities laws to life settlements, the emerging role of securitization, the life settlements marketplace (including trading platforms), and market intermediaries. In particular, in light of reported recent efforts to collect and securitize life settlements by some large investment banks, the Task Force will focus on investors, sales practices and intermediaries. This assessment will require a multi-disciplinary approach; our Life Settlements Task Force is comprised of senior SEC officials from throughout the agency. Participants include representatives from the Divisions of Corporation Finance; Trading and Markets; Investment Management; Enforcement; and Risk, Strategy, and Financial Innovation, as well as the Offices of General Counsel; Chief Accountant; Compliance Inspections and Examinations; and Investor Education and Advocacy. The Task Force has started researching the issues and has initiated discussions with state regulators and other market participants. As discussed below, the Task Force is reaching out to fellow regulators to obtain a greater overview of the life settlements marketplace and assess any

[3] See Footnotes 9-18 and accompanying text.

regulatory gaps. In addition, we will be reaching out to other interested parties, such as investor representatives and counsel who practice in the area. In light of the recent market turmoil, some investors may be looking for additional investment opportunities, while some holders of life insurance policies may be looking for additional liquidity. However, these individuals may be more vulnerable due to the current environment. The Task Force will consider ways to better inform and protect these individuals.

Disclosure

Various groups of investors are affected by life settlement securitizations, including investors in the companies that sponsor securitizations, investors in insurance companies, and investors that purchase securities backed by life settlements. Not only will the staff be looking at issues raised with respect to these groups, but we also will be looking at the disclosure provided to these groups of investors.

With respect to investors in public companies that are sponsors of securitizations of life settlements and investors in insurance companies, we will assess whether the companies have clear disclosure about their businesses and the risks involved in their business model. With respect to the securities backed by life settlements (or life settlement securitizations), investors need clear disclosure. Many securitizations in general, and life settlement securitizations in particular, are complex financial instruments. Investors need the information necessary to understand these products, including the structure of the transaction and issues related to that such as provisions for payment of policy premiums. Investors need clear disclosure regarding risks, among other things, such as the risk of changes in expected returns if assumptions and estimates used to structure the transaction prove inaccurate and risks related to all parties in the

chain of ownership of the life settlement, including the provider, seller and issuer of the securities. We realize there are some evolving issues. For instance, how do we resolve the tension between full disclosure to investors (a hallmark of SEC regulation) versus the legitimate privacy rights of the insured?

We also will be considering possible issues raised by the business model of creating securitized pools of life settlements, how that model relates to the interest of investors, and what kinds of fees are generated for securitizers. But foremost, we will work to assure that investors receive the information necessary to understand these products. The Task Force will consider the adequacy of disclosure investors receive, and whether securities offerings that purport to rely on exemptions from registration under the federal securities laws are doing so properly.

Sales Practices

In addition to issues related directly to investors, the Life Settlement Task Force will consider sales practices regarding both the sale of existing life insurance policies by contract holders and the sale of interests in life settlement pools to investors. Both transactions raise important investor protection concerns.

As to the sale of an existing life insurance policy, the Task Force will consider what information market participants are receiving regarding the terms of the sale. There have been reports of extremely high commission rates paid to life settlement brokers, and we will consider the effect such compensation has on the sales process. The Commission is especially concerned that life settlement brokers may be targeting policyholders who are particularly vulnerable to abusive sales practices, including seniors and the seriously ill.

We understand that some contract holders may consider selling their policy based on a need for cash. The Task Force will consider whether contract holders are being told of other alternatives to the sale of their insurance policy. For instance, are contract holders being informed that there may be alternatives to a settlement, such as borrowing against the policy or invoking other contract features, such as the right to an accelerated death benefit? To the extent regulation of these disclosure practices is beyond our jurisdiction, we will share our findings with the appropriate regulators.

Regarding the sale of interests in life settlement pools, the Task Force will assess whether intermediaries soliciting potential sellers of existing contracts or purchasers of life settlement pools are adequately licensed and trained given the nature of their activities.

Working with Fellow Regulators

In executing its responsibility for maintaining fair, orderly, and efficient markets, the Commission oversees self-regulatory organizations, including the Financial Industry Regulatory Authority (FINRA).[4] FINRA, the self-regulatory organization for most U.S. securities firms, has for a number of years been addressing the obligations of member firms in the life settlement area. Most recently, in July of this year FINRA issued a regulatory notice reminding firms that variable life insurance settlements are securities transactions subject to the federal securities laws and FINRA rules, and focusing on

[4] In July 2007, the member regulation functions of the National Association of Securities Dealers, Inc. (NASD) were merged with those of the New York Stock Exchange (NYSE), creating the Financial Industry Regulatory Authority (FINRA). Since that time, FINRA has been engaged in the consolidation of NASD and NYSE rules into a single rulebook. For ease of reference, this testimony will refer to FINRA throughout.

suitability, disclosure and commission rates.[5] In the past, FINRA has reminded firms that recommendations to sell an existing variable insurance policy must be suitable, and that firms must adequately train and supervise associated persons involved in such transactions. FINRA also has reminded firms of their best execution obligations regarding the sale of the policy, including the need to obtain a favorable price.[6]

The Task Force will work closely with FINRA in its efforts to reach out to its members regarding their obligations in the area of life settlements. In addition, because FINRA only has jurisdiction over its member firms and their associated persons, the Task Force will consider whether investors would benefit from similar protections being applicable to other participants in the life settlement industry.

In that regard, life settlement issues draw on the expertise of regulators throughout the Unites States. For instance, a number of states have adopted laws regarding life settlements.[7] Thus, Chairman Schapiro has asked the Task Force to reach out to regulators and other interested parties, including the National Association of Insurance Commissioners, the North American Securities Administrators Association and

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5 *See* FINRA Regulatory Notice 09-42, *available at* http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p119546.pdf (last visited September 21, 2009). With variable insurance products, the policyholder's premium payments are allocated to a segregated or "separate" account investing in securities, typically mutual funds, not to the company's general account (which receives premiums for non-variable life insurance and annuity policies). Under variable contracts, certain benefits (such as cash surrender values, annuity payments, and death benefits) reflect the investment performance of the portfolio of the applicable separate account.

6 In August 2006, among other things, FINRA reminded firms and their associated persons that life settlements involving variable insurance policies are securities transactions subject to applicable FINRA rules. *See* Notice to Members 06-38, *available at* http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p017131.pdf (last visited September 21, 2009).

7 *See, e.g.*, OHIO REV. CODE ANN. § 3916 (2009).

FINRA, to coordinate regulatory efforts and analyze whether gaps in oversight exist that should be filled through legislation or other action.

Enforcement

The SEC has the ability to use its civil enforcement authority to combat fraud and other unlawful securities-related activity in the life settlements market and has brought a number of cases in this area since the 1990s.[8] Initially, life settlements involved the sale of interests in individual policies. As a threshold matter, the SEC has taken the position that life settlements are securities, and, therefore, are subject to the requirements of the federal securities laws, including the antifraud rules. The courts have not reached a uniform answer on this question, which has raised some obstacles to the SEC's ability to protect investors in this growing market. Selling interests in a pool of life settlements, which is a securitization, does not raise the same issue present in the prior enforcement cases.

The first major case, *SEC v. Life Partners, Inc.*,[9] focused on the issue of whether a participation in a viatical settlement investment is an investment contract and therefore a "security" under the Supreme Court's decision in *SEC v. W.J. Howey Co.*[10] The *Life Partners* opinion held that the defendants' offerings satisfied the first two elements under *Howey*, specifically, they involved (1) an investment of money (2) in a common enterprise but did not satisfy the "efforts of others" third element in *Howey*, because the

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8 *See, e.g., Sec. & Exch. Comm'n v. Mutual Benefits Corp.*, 408 F.3d 737 (11th Cir. 2005).

9 87 F.3d 536 (D.C. Cir. 1996).

10 328 U.S. 293, 298-99 (1946). *Life Partners* involved investors buying parts of a policy as opposed to a life settlement securitization where investors buy a piece of a pool of life settlements. As noted above, a life settlement securitization does not raise the security question addressed in *Life Partners*.

promoters' "post-purchase" efforts – holding the policy, designating the beneficiaries, monitoring the insured's health and paying the premiums – were mostly "ministerial" in nature.[11]

Life Partners has been widely criticized and most courts have not followed it, either factually distinguishing their cases or rejecting *Life Partners'* distinction between pre- and post-purchase efforts – a distinction that was not part of the Supreme Court's *Howey* test – and its conclusion that the success of the investment depends principally on the death of the viator.[12] In 2004, the SEC obtained emergency relief to stop an ongoing fraudulent securities offering by Mutual Benefits Corporation, then the largest viatical settlement investment company in the country, which had raised over $1 billion from 30,000 investors.[13] The district court declined to follow *Life Partners* and held that the Mutual Benefits' investments were securities.[14]

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11 *Life Partners*, 87 F.3d 536, 545-546. Although the D.C. Circuit subsequently clarified its decision by stating that they were not adopting an "artificial bright-line rule," the court went on to discount the pre-purchase efforts in that case, noting that the dispositive factor relative to the success of the investment was the death of the viator, which was not in the promoter's control. *Life Partners*, 102 F.3d 587-89 (D.C. Cir. 1996). By the time the D.C. Circuit considered *Life Partners*, the company had significantly re-vamped its procedures to eliminate nearly all of its post-closing work.

12 *See Wuliger v. Christie*, 310 F. Supp. 2d 897, 904 (N.D. Ohio 2004) (declining to follow *Life Partners* and observing that the decision has been "not been embraced by other circuits"); *see also Sec. & Exch. Comm'n v. Tyler*, 2002 U.S. Dist. LEXIS 2952 (N.D. Tex. Feb 22, 2002) (entering preliminary injunction in SEC action, distinguishing *Life Partners* based upon defendants' post-purchase efforts to create a secondary market for viatical settlements); *Sec. & Exch. Comm'n v. Viatical Capital, Inc.*, Case No. 8:03-CV-1895-T-23TGW (January 22, 2004, Merryday, J.) (adopting Report and Recommendation distinguishing case from Life Partners due to certain post-purchase activities).

13 We argued that the district court should decline to follow *Life Partners* because: (1) the D.C. Circuit's distinction between pre- and post-purchase efforts was novel and not supported by *Howey* and its progeny, and (2) information developed about the viatical settlement industry since *Life Partners* was decided established that the "profit" earned by investors is far more dependent upon the expertise of the promoter than "the death of the viator" as the D.C. Circuit observed.

14 *Sec. & Exch. Comm'n v. Mutual Benefits Corp.*, 323 F. Supp. 2d 1337, 1343 (S.D. Fla. 2004). The court stated that the "bright-line rule enunciated by the D.C. Circuit . . . is inconsistent with

In affirming the district court's decision, the Eleventh Circuit observed that under *Howey* and the more recent decision of the Supreme Court in *SEC v. Edwards*,[15] a court must construe what constitutes an "investment contract" broadly, to "'encompass virtually any instrument that might be sold as an investment.'"[16] The Eleventh Circuit disagreed with the pre- and post-purchase bright line approach adopted by the D.C. Circuit in *Life Partners*, stating that neither *Howey* nor *Edwards* requires such a distinction.[17] Importantly, the court noted that investors "relied heavily" on Mutual Benefits' pre- and post-purchase activities, concluding that Mutual Benefits "offered what amounts to a classic investment contract."[18]

The SEC also has brought a number of other cases related to life settlements. For instance, we have brought cases against viatical settlement providers that have made misrepresentations to investors about the underlying policies and quality or reliability of the medical assessments of life expectancies.[19] Similarly, the SEC has brought cases

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the policies underlying the federal securities laws and misconceives the nature of investments in viatical settlements."

15 540 U.S. 389 (2004).

16 *Sec. & Exch. Comm'n v. Mutual Benefits Corp.*, 408 F.3d 737, 742 (11th Cir. 2005).

17 The court stated: "While it may be true that the 'solely on the efforts of the promoter or a third party' prong of the *Howey* test is more easily satisfied by post-purchase activities, there is no basis for excluding pre-purchase managerial activities from the analysis." *Id.* at 743.

18 *Id.* at 744.

19 *See Sec. & Exch. Comm'n v. Viatical Capital, Inc., et al.*, SEC Litigation Release No. 19598 (March 8, 2006). *See also Sec. & Exch. Comm'n v. Mutual Benefits Corp.*, 323 F. Supp. 2d 1337, 1343 (S.D. Fla. 2004), *aff'd by* 408 F.3d 737 (11th Cir. 2005); and *Sec. & Exch. Comm'n v. Viatical Capital, Inc.*, Case No. 8:03-CV-1895-T-23TGW (M.D. Fla. 2003) (VCI's portfolio contained policies that were fraudulently obtained, thus subject to cancellation, and many terminated and canceled policies).

alleging that ponzi schemes promised safe and profitable investments in life insurance policies.[20]

The enforcement cases to date have focused on sales of life settlements as investment opportunities. In the event that possible securities law violations are present in sales of securities through life settlement securitizations, we stand ready to pursue those cases vigorously.

Conclusion

Life settlements, and the growing trend toward securitization, create issues relating to disclosure and sales practices that could significantly impact investors. Chairman Schapiro has established the Life Settlement Task Force to address the emerging issues raised by the life settlement market. By incorporating a multi-disciplinary approach and working with fellow regulators and other interested parties, we will make a fresh, in-depth analysis of the issues raised in the securitization and life settlements market, so that we can make sure investors are informed and protected.

Thank you again for inviting me to appear before you today and for the Subcommittee's support of the agency at this critical time for the nation's investors. I would be happy to answer any questions you may have.

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[20] *See Sec. & Exch. Comm'n v. Secure Investment Services, Inc., American Financial Services, Inc., Lyndon Group, Inc., Donald F. Neuhaus, and Kimberly A. Snowden*, SEC Litigation Release No. 20362 (November 13, 2007).

Recent Innovations in Securitization

TESTIMONY OF KURT GEARHART

on behalf of Credit Suisse

Subcommittee on Capital Markets & Insurance
House Financial Services Committee
September 24, 2009

Testimony of Kurt Gearhart
Hearing on Recent Innovations in Securitization
Subcommittee on Capital Markets & Insurance
September 24, 2009

Introduction

Good afternoon. My name is Kurt Gearhart and I am Credit Suisse's Global Head of Regulatory & Execution Risk in the firm's Life Finance Group. The Life Finance Group employs approximately 90 professionals located primarily in New York and London and the group's mandate is to intermediate mortality and longevity risk. I am also the current President of the Institutional Life Markets Association which is separately providing testimony today.

Prior to joining Credit Suisse nearly three years ago to assume my current role, I was a Partner in the Insurance and Financial Services Group of Sidley Austin where I represented banks, insurance companies and other financial institutions in connection with insurance linked securities and other capital markets transactions relating to mortality and longevity risk.

Credit Suisse has been an active participant in securitization markets with considerable experience involving insurance securitizations. Based on this experience we would like to make three basic points today. First, insurance securitizations are nothing new and as we will describe there are any number of types of securitization structures that have been utilized by the life insurance industry with little risk to investors with none of the experiences found in the mortgage markets. Securitizing life settlements would be comparable to any of these types of traditional insurance

securitizations. Credit Suisse has never in fact done a securitization in the area of life settlements so we have no direct experience to offer.

Second, Credit Suisse conducts its life settlement business in complete conformity to industry best practices. We have been a leader in creating industry best practices and we believe that they protect consumers as well as institutional investors.

Finally, Credit Suisse also welcomes greater federal regulation of life settlements. We would also be pleased if a strong federal regulator such as the SEC were given jurisdiction over life settlement practices.

We appreciate the Committee's invitation to be here today and our discussion will be divided into three parts relating to life settlements. They are: (1) life insurance securitizations, (2) Credit Suisse's activity in life settlements, and (3) regulation of life settlements and life settlement securitizations.

Life Insurance Securitizations

To begin with, I think it is important to understand that securitization of longevity and mortality risk is not a new concept. For purposes of clarification, longevity risk is the risk that a person lives longer than expected, such as the risk that a pension fund has with its pensioners. Mortality risk is the risk that a person dies earlier than expected, such as the risk a life insurance carrier has when issuing a life insurance policy. Insurance companies have securitized these risks for quite some time, with at least $18 billion in publicly announced securitizations being completed in the last decade. The face amount of the underlying policies in a securitization is typically many multiples of the amount of the securities issued. Thus, it is likely that the completed securitizations represent hundreds of billions of dollars in policy face amount securitized.

Examples of common types of securitizations in the life insurance industry include the following:

1. Closed Block Securitizations. In connection with the demutualization of several large life insurance carriers, including Prudential, MetLife and Axa, large blocks of life insurance policies were securitized to facilitate the initial public offerings or acquisitions of the carriers. These were large transactions that involved the securitization of millions of life insurance policies.

2. XXX Securitizations. These securitizations are a means for insurers and reinsurers to transfer their regulatory reserve requirements that are in excess of their economic reserves, to investors. Insurers and reinsurers who have completed transactions include Banner Life, Genworth, RGA and Swiss Re. Investors in these securities are exposed to mortality risk.

3. Embedded Value Securitizations. These securitizations allow carriers to monetize the captured value of a block of business by moving the block of business off balance sheet. In this situation the carrier in essence transfers all of its risk in the block of policies to investors. In this respect, the securitizations are similar to a reinsurance arrangement but they allow the risk to be distributed to a wider group of institutions. Swiss Re is an example of one carrier that has engaged in embedded value securitizations.

4. Extreme Mortality Securitizations. This type of transaction has the carrier transfer the risk, and resulting losses, of a catastrophic event that would cause a significant reduction in length of time that people are living.

Securitizations of life insurance policies have allowed the risk of these policies to be distributed more broadly, which results in lower cost of insurance to consumers.

Turning to life settlements, a life settlement securitization transfers the same general type of risks to investors as any other life insurance securitizations. The only difference is that a life settlement securitization, in theory, provides income and liquidity benefits to consumers rather than to the life insurance carriers themselves.

The reality is that there have been very few life settlement securitization deals done in the last decade. Although we expect the securitization market to be relatively

small, we believe that a potential securitization market for life settlements can be good for consumers and institutional investors.

For consumers, securitization will bring two primary benefits. First, securitizations will provide increased liquidity to the life settlement market which results in higher cash offers for their policies. We estimate that for every $1 billion of face amount securitized, consumers would have received approximately $120 million in excess of the amount offered by the insurance carriers. We think that this is the primary advantage of securitizations for the policy sellers. Second, securitizations would ensure protection of the insureds' privacy as institutional investors will not have access to any information which would allow them to identify the insureds.

For institutional investors, including those that recently experienced significant losses across asset classes, life settlement securitizations provide a tool for portfolio diversification and satisfy investor demands for investments that are not dependent on capital markets. Insurance companies and pension funds by definition have mortality and longevity risk and life settlement securitizations could allow them to more efficiently hedge these risks.

On this basis, Credit Suisse would not rule out participating in properly structured life settlement securitizations – built on longstanding concepts of insurance securitization -- where benefits to consumers and institutional investors can be well-established.

Credit Suisse's Activity in Life Settlements

The Life Finance Group of Credit Suisse began participating in the life settlement market in 2006, initially by purchasing policies through licensed third parties, referred to

in the industry as life settlement providers. In 2007, the Life Finance Group formed Credit Suisse Life Settlements, LLC, its own licensed life settlement provider to purchase policies. We opted to form our own platform to purchase policies to ensure the quality of the policies purchased and adequate protection of policy sellers. We employ the following best practices in our purchase of life settlements:

a. Policy sellers must be represented by a financial and/or legal advisor;

b. Advisors undergo a Credit Suisse due diligence background check;

c. Policy sellers are typically higher net worth (average size policy purchased by Credit Suisse is over $2M);

d. Insureds do not have catastrophic or terminal illnesses; they generally are seniors and have life expectancies of 8 to 12 years;

e. A comprehensive anti-fraud review is completed to ensure that there are no indicia of fraud in connection with the transaction or the original issuance of the insurance policy;

f. Comprehensive disclosure statements are provided to policy sellers which

(1) identify alternatives to life settlement transactions that may be available and

(2) include full disclosure of all transaction fees including payments made to brokers and other third parties; this way the policy seller knows exactly how much Credit Suisse is paying for their policy;

g. Closing interviews are conducted with policy sellers and insureds to ensure that they understand the substance and economics of the transaction; and

h. All cases are subject to Credit Suisse's strict legal and compliance standards and each case is reviewed prior to closing.

Since commencing activity in this industry, Credit Suisse has paid approximately $500 million more to seniors than they would have received by surrendering their insurance policies to the issuing insurance carrier. On average, Credit Suisse paid policy sellers approximately 10 times the surrender value offered by the insurance

carriers. Without a robust secondary market for life settlements, U.S. seniors would not be able to realize the fair market value for their life insurance policies when there are changes in their needs for life insurance. Seniors typically sell their policies for the following reasons: (1) premiums become unaffordable, which has become even more relevant as a result of recent economic times, (2) estate planning needs have changed, (3) funds are needed for long term health care, (4) to raise funds for other investment needs, (5) beneficiaries no longer need coverage, or (6) they no longer need or want life insurance for a variety of other reasons.

Credit Suisse sells portfolios of the policies to, or otherwise manages and distributes the risk with, sophisticated institutional investors including insurance companies, fund managers and pension funds.

Apart from Credit Suisse's core Life Finance business, Credit Suisse through a private equity fund, owns a majority stake in another life settlement provider that is in the business of purchasing life settlements for institutional investors. This ownership stake was acquired as a private equity investment and Credit Suisse does not exercise management control.

Credit Suisse employs rigorous risk management practices to limit the amount of exposure, including quantitative and qualitative limits that Credit Suisse maintains in connection with its life settlement business. Moreover, Credit Suisse encourages prudent behavior through compensation practices that seek to align compensation more closely with the risk we as a firm are taking. For example, Credit Suisse has broad compensation claw backs as a condition of bonuses on all senior employees. Last year Credit Suisse paid bonuses to investment bankers largely in distressed assets.

Regulation of Life Settlements and Life Settlement Securitizations

In the event they occur, life settlement securitizations would be regulated as securities transactions subject to the Securities Act of 1933 and SEC regulation. They also would be subject to any general securitization reforms currently being considered by Congress as part of the Administration's Financial Regulatory Reform proposal.

The acquisition of life insurance policies from policy sellers is currently left to regulation by state insurance departments. Credit Suisse has worked with the other industry participants, the NAIC and the National Conference of Insurance Legislators (NCOIL) to develop model laws, and with states to enact their own regulation. Today, 35 states regulate life settlements.

Notwithstanding the efforts of the NAIC, NCOIL and state regulators, consumers in 15 states still have no regulatory protection. In addition, the separate models and various debates at the state levels have led to a patchwork of inconsistent regulation across the country. While possibly providing adequate protections at the local level, this regulatory framework unfortunately causes market participants to use different form agreements from state to state, and adopt different business and anti-fraud plans from state to state, which can be confusing to consumers and impact the effectiveness of regulation. This increases the frictional costs to consumers. Many states do not have state of the art consumer protections and the laws truly do not apply as intended. For example, the laws are intended to protect policy sellers, insureds and beneficiaries, but life settlement laws apply only in the jurisdiction where the policy sellers reside. Thus, if a policy seller resides in an unregulated jurisdiction, neither the insured nor the beneficiaries will have any regulatory protections even if their own state regulates life

settlements. In addition, the life settlement market, like most other capital market products, is dynamic and it is difficult for all of the states to ensure sufficient resources to continually update their regulations and laws as necessary to ensure effective regulation.

As I mentioned above, Credit Suisse has implemented a variety of best practices in our life settlement business to protect consumers regardless of whether required by state law. We do this because we value our reputation and because we believe it protects our institutional investors who do not want to own assets that were acquired with abusive practices. Credit Suisse would support federal regulation and oversight of this business by the Securities and Exchange Commission or another federal regulator as a means to provide greater protection to policy sellers and insureds.

Federal regulation adds to the state level protection of investor interests in life settlements as well. Investors could benefit from assurances that insurance carriers and the life settlement industry abide by best practices. Clear laws mandating insurance carriers' and the life settlement industry's obligations and responsibilities will protect investors and lead to more certainty in the market.

Accordingly, federal regulation could lead to (1) standardized origination practices, documentation, disclosures, (2) consumer protection, (3) market and operational efficiencies and (4) protection for investors, all of which could be important to the responsible growth of the life settlement industry, without which seniors will have limited options for their unneeded or unwanted insurance coverage.

Conclusion

To close my testimony, I would like to restate our three primary points -- 1. Life Insurance securitizations are nothing new and -- while Credit Suisse does not have direct experience -- any application of securitization practices to life settlements should be the same as traditional insurance securitizations; 2. We believe strongly in the implementation of industry best practices; and 3. We would welcome strong Federal regulation in the form of the SEC or other appropriate federal agency.

As discussed, life settlements provide seniors with a valuable option for disposing of their unneeded insurance policies. The life settlement industry has provided billions more dollars to seniors than they would have received if they surrendered their policies. The entrance of banks and institutional investors such as pension funds and insurance companies into this market has enhanced standards and industry best practices. Life settlements investments are independent of returns in the capital markets and can be a valuable option.

Thank you for the opportunity to appear today and I will be happy to answer any questions that you may have.

September 24, 2009

Statement

Of

The Institutional Life Markets Association (ILMA)

Presented by

Jack Kelly

Director of Government Affairs

Before

Subcommittee on Capital Markets, Insurance,
and Government Sponsored Enterprises

Committee on Financial Services
United States House of Representatives

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Mr. Chairman, my name is Jack Kelly. I serve as the Director of Government Affairs for the Institutional Life Markets Association (ILMA).

ILMA is a trade association comprised of a number of the world's leading institutional investors and intermediaries in the longevity marketplace. We welcome the subcommittee's interest in exploring the emerging secondary market for life insurance, known as life settlements. ILMA's members include Credit Suisse, EFG Bank, Goldman Sachs, JP Morgan Chase, Mizuho International and WestLB. ILMA's members are highly regulated entities that are subject to the rules and regulations of federal and state regulators including the U. S. Securities and Exchange Commission, Federal Reserve Board, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency or by substantially similar regulations of other appropriate authorities. As such, we are committed to appropriate regulation and oversight of the life settlement industry.

ILMA was formed two years ago to promulgate best practices, encourage transparency and standardization of documentation, and to educate consumers, investors, and policy makers about the benefits of the longevity related marketplace. ILMA has been and continues to be an advocate for appropriate regulation of the evolving life settlements marketplace. Life settlements provide seniors with choices designed to enable them to maximize the economic values of their life insurance policies. ILMA members, through lending or by direct purchase, have provided consumers in excess of $ 2.9 billion through the purchase of life insurance policies no longer needed by the owners.

The cornerstone of ILMA's Guiding Principles (which I have attached to my testimony) is the promotion of transactional transparency, best practices, protecting the identity of insureds, supporting longstanding insurable interest principles and advancing public understanding of the life markets. To that end, the first action by ILMA was the creation of the Life Settlement Transaction Disclosure Statement.

This document was the first uniform document created that clearly and concisely discloses the amount of money consumers will receive when they sell their interest in a life insurance policy; unlike the lack of disclosure for fees and commissions associated with the original purchase of a life insurance policy from an insurance carrier. Included in the disclosure statement is a policy's face value amount, estimated cash surrender value (CSV), gross sales price, the amount of the broker's compensation and the net amount a consumer will receive for the sale. The form allows consumers to know exactly how much money they will receive for their policy and exactly how much their broker will receive in compensation for the transaction.

ILMA has advocated in every state that has considered legislation or regulation governing life settlements to incorporate the contents of the ILMA disclosure statement in their respective laws and regulations. ILMA has appeared before the National Association of Insurance Commissioners (NAIC) and the National Conference of Insurance Legislators (NCOIL) for inclusion of the ILMA disclosure statement in their model life settlements acts.

Shortly after the adoption of the ILMA disclosure form, we created the first set of uniform HIPAA-compliant release forms to ensure that participants in the markets have access to the sample forms designed to adequately protect the privacy of the records of individuals

who are participating in a life settlement transaction. The transaction disclosure form and HIPAA forms are available free of charge on ILMA's website at www.lifemarketsassociation.org.

In its invitation to appear today, the committee has asked us to discuss the history, purpose, size and recent growth of the life insurance settlement markets. As stated by the committee, this market has been the topic of discussion by commentators and journalists, specifically the New York Times article of September 6, 2009, entitled "Wall Street Pursues Profit in Bundles of Life Insurance."

The History of Life Settlements

Life settlements are not a new phenomenon. The notion of transferring ones life insurance policy for value was the topic of a 1911 decision by the U.S. Supreme Court in the case of Grigsby v. Russell. This case established a legal basis that the owners of life insurance policies have the right to transfer an insurance policy like any other asset they own.

The practice of selling one's interest in a life insurance policy expanded in the 1980's, when individuals diagnosed with acquired immune deficiency syndrome (AIDS) needed access to funds to pay for their medical treatments and healthcare. Many of these individuals were denied medical coverage by their insurance carriers or the coverage they had was so limited that it failed to provide for their treatment or their healthcare. Subsequently, an option developed called viatical settlements which allowed individuals to sell their interest in their life insurance in order to receive money to assist in paying for their healthcare. The business of viatical settlements was loosely regulated resulting in certain abuses. In response, the NAIC developed a model viatical settlements act which numerous states adopted. As medical solutions developed to combat AIDS and effectively prolong the lives of those infected, the demand for viatical settlements dissipated.

In the 1990's, seniors, who were faced with paying premiums for unwanted or unneeded life insurance policies, sought an alternative to surrendering the policies for the cash surrender value. The result was the development of a life insurance settlement where owners' receive a sum greater than the CSV for their interest in the insurance policy and the purchaser continues paying the premium. When a third party purchases the rights to the benefits of a policy it is referred to as a life settlement.

The reasons for selling one's interest in a life insurance policy vary from not needing the policy because the beneficiary pre-deceased the insured, the children have grown and are now self-supporting, wanting cash to fund retirement or to fund a policy that more appropriately meets the current needs of the policy holder. With the option for a life settlement, the owner could achieve a greater financial benefit than simply allowing their policy to lapse or receiving the CSV upon the surrender of the policy.

The Size of the Industry

It is difficult to determine the actual size of the life settlements markets as there has been limited validated data as to the number of transactions that have been completed. According the Conning Research & Consulting, Inc., Life Settlements: New Challenges

to Growth, 2008, the annual face value of life insurance policies settled in the secondary market is expected to average $21 billion over the next ten years, reaching $31 billion by 2017. Conning predicted a growth at 11.5 % annually in the next five years slowing to 8.2% in the following years.

In the next few weeks, Conning will issue its 2009 report on the life settlement markets. It is their conclusion that the annual face value of life insurance policies settled in the secondary market in 2008 was $12 billion. At the end of 2008, there were approximately $31 billion annual face value policies in force in the life settlement market. They conclude that growth in the life settlement market was flat from 2007 to 2008. They further report that prospective growth will remain strong due to increased consumer awareness, but by 2011 and 2012 the market will reach a saturation point with an annual growth of two to three percent.

It must be noted that the recent developments in the capital markets that created the so called "credit crunch" have had a significant impact on this marketplace. During the past year, many participants in the secondary market have been unable to renew their credit lines and overall interest for policies in the secondary market has dramatically declined. However, even against this backdrop, there is continued interest in this market because of its low-correlated returns, risk diversification and the ability to understand and measure the risks associated with life settlements.

According to the Insurance Studies Institute, "the secondary market of life insurance provides a great social and economic value to seniors." The 2008 publication by the National Underwriter Company, Tools and Techniques for Life Settlements, provides an example that a policy with the face value of $1,000,000 sold as a life settlement was over three times greater than the cash surrender value. In addition, the present value of premiums saved (by the consumer) from not continuing to make premium payments was over two and a half times the cash surrender value at the settlement. ILMA members believe that actual purchase prices paid to consumers represent multiple times greater than the values used in the National Underwriter example. Thus, when suitable to a consumer, a life settlement can afford a significant financial benefit for their financial planning.

ILMA and other participants in this marketplace think that the development of consistent and verified data on transactions should and needs to be developed.

ILMA'S Role in Regulatory and Legislative Developments

ILMA has from its inception promoted the development of law and regulation surrounding life settlements. We have been an active participant and supported the adoption of model acts created by both the NAIC and NCOIL. Throughout the development of those model acts, ILMA submitted both oral and written testimony and has worked with regulators and legislators throughout the United States to adopt appropriate and comprehensive laws and regulations. We have been the single strongest advocate for the adoption of requirements that life settlement transaction documents include complete disclosure of all fees and commissions associated with the transactions so that consumers can know exactly how much they will receive when they participate in life settlements and how much is being paid to those associated with the transaction.

Since the adoption of the NAIC and NCOIL Life Settlements Model Acts, ILMA has worked towards the adoption of life settlement laws and regulations in over 16 states. To date, laws governing the conduct of life settlements have been adopted in 35 states and Puerto Rico. Presently, ILMA is an active advocate in supporting legislation drafted by the New York Department of Insurance to regulate this marketplace and legislation in California that is pending the signature of the Governor.

At the federal level, ILMA worked with the Senate Aging Committee in its review of the life settlement markets and publicly commended the committee for its work in this area to ensure that senior's rights are protected when they choose to consider a life settlement. In furthering its efforts, ILMA is working with the Congress' Government Accountability Office in the examination of the life settlements market.

Securitization

Recent news reports have advanced the story that the capital markets have initiated an effort to issue rated securitization of life settlements. I think it is important to distinguish between facts and speculation in this reporting.

First, the securitization of insurance products is not a new concept. On September 1, 2009, A.M. Best Company, the rating agency that since 1899 has reported on the financial conditions of insurance companies, issued a Best Review on the insurance marketplace. Included on its report were different categories of insurance linked securities and transactions that they have rated.

Second, securitization plays an important role in bridging insurance markets with capital markets. The College of Insurance defines Insurance Securitization as the transferring of underwriting risks to the capital markets through the creation and issuance of financial securities. In particular, the insurance securitization process involves two elements:

- The transformation of underwriting cash flows into tradable financial securities
- The transfer of underwriting risks to the capital markets through the trading of those securities

In general, securitization can have a number of economic benefits. These include i) lowering the cost of borrowing; ii) giving consumers choices and creating liquidity; iii) providing risk transfer from entities that no longer want a risk to investors who are prepared to bear the risk; iv) separating credit quality from the owner of an asset and the asset itself; and, v) professionalizing the asset management and servicing of the asset.

The insurance linked securities rated by A.M. Best include[1]:

1. Natural Catastrophe Bonds: An alternative to reinsurance, these securities are used by insurers to protect themselves from natural catastrophic events. Typically, they pay high yields because investors could lose their entire stake in the event of a disaster.

[1] A.M. Best – Best Reviews; September 1, 2009

2. Securitization of Surplus Notes and Insurance: Securitization of surplus notes provides another funding source for small and midsized insurance companies that find it very costly to issue capital on their own due to Financial Strength Ratings (FSR's). The securities in these pools are issued by a stand alone special purpose vehicle (SPV) and sold to investors. The proceeds of these notes are used to purchase the transaction's collateral, which consist of surplus notes.

3. Embedded Value (Closed Block) Securitizations: An insurer can close a block of policies to new business, and receive immediate cash from investors in exchange for some or all of the future earnings on that block of business. The pledged assets remain with the insurer and are potentially available in the event of insolvency.

4. Regulation XXX Securitizations: In 1999, the NAIC stated a change to the Valuation of Life Insurance Policies Model Regulation, commonly referred to as "XXX". This change, which increased statutory reserve requirements for newly issued level term policies, created a strain on surpluses for insurers. In addition, the closely related Guideline AXXX mandated additional reserve requirements for universal life policies with secondary "no lapse" guarantees, adding to that strain. As a result, many life insurers employed securitizations and surplus notes to fund a portion of the reserve requirements.

5. Mortality Catastrophe Bonds: A derivative of natural cat bonds, investors in these bonds lose money only if the level of deaths linked to a catastrophic event exceeds the threshold. The event that can bring about the trigger is extreme, such as a pandemic.

6. Securitization of Structured Settlements: This is a popular method of settling personal injury, product liability, medical malpractice and wrongful death cases. The defendant (typically an insurance carrier) discharges the obligation by purchasing an annuity from a highly rated life insurance company. Securitization of annuity cash flow is achieved through the use of a bankruptcy-remote SPV. The issuer of the securities, the SPV, raise funds from investors that are used to purchase annuity cash flows from the insurance companies or annuitants. The most important risks associated with these transactions are the credit risks ascribed to insurance companies involved in the transaction and mortality risks.

7. Sidecars: Separate, limited purpose companies, generally formed and funded by investors, usually hedge funds, which work in tandem with insurance companies. The reinsurance sidecar purchases certain insurance policies from an insurer and shares in the profits and risks. It is a way for an insurer to share risks, and if the policies have low claim rates while in possession of the sidecar, the investor will make higher returns.

8. Securitization of Reinsurance Recoverables: Insurance and reinsurance companies have been finding alternative ways to reduce their exposure to uncollectible recoverables and reduce the concentration risks associated with ceded exposures. One approach is the securitization of reinsurance

recoverables, which involves a structured debt instrument that transfers risk associated with the uncollectible reinsurance to the capital markets.

9. Life Settlement Securitization: A life settlement contract is a way for a policy holder to liquidate a life insurance policy. A portfolio of the contracts may be securitized to provide a source of capital. However, certain variables, such as the uncertainties associated with life expectancies, and regulatory issues can create obstacles that may slow their path to the marketplace.

There have only been two rated life settlement securitizations reported. Each of these is somewhat unique, as the market is in its early stages, particularly when compared with other insurance linked securities. The most recent securitization, reported in April 2009, was an internal company transaction for AIG (that involved no outside investors) and resulted in the largest securitization of life settlements to date—well over $2 billion. This capital relief transaction was a securitization of a substantial portion of AIG's life settlements portfolio. In 2008, AIG valued its life settlements portfolio, which included the death benefits on 4,000 life insurance policies, at $2.58 billion.

This securitization was done, in part, to reduce some of AIG's ongoing borrowing from the Federal Reserve by $1.2 billion. The securitization notes, which were privately rated by AM Best, are being held by AIG's commercial insurance group. Following the transaction, AIG told Business Week that the "securitization notes are an attractive asset class (for AIG) because their performance is not correlated to credit or real estate markets and the notes pay an attractive coupon."[2]

The only other known securitization of a portfolio that included both life settlements and annuity policies occurred in March of 2004, when Legacy Benefits Corporation became the first life settlement company to successfully conclude a rated securitization of life insurance settlement and annuity assets. This transaction was underwritten by Merrill Lynch and was rated by Moody's. The notes were sold in two tranches: the Class A notes were rated A1 and pay a coupon of 5.35% and the Class B notes were rated Baa2 and pay a coupon of 6.05%.[3]

Since these are the only known transactions, it brings to question why suddenly there is such increased attention to the "securitization of life settlements." As I have stated, the use of securitization by the life insurance industry is widespread. In fact, immediately following the New York Times article on this subject, Frank Keating, President of the American Council on Life Insurance stated, "securitization of life insurance policies transferred to third-parties is not necessarily a bad thing."[4] In light of the long and well established history of securitization in the life insurance industry, it is only reasonable that such a tool would be explored for life settlements.

Insurance carriers have utilized securitization to access increased capital in order to provide products to their customers. Increased access to capital funding sources will result in more competition which will benefit consumers in obtaining the maximum price

[2] Business Week , April 7, 2009
[3] Press Release, Legacy Benefits, March 16, 2004
[4] Letter to the Editor, NY Times, September 9, 2009

for life insurance policies they wish to sell. Life settlement securitization also has the potential to create additional choices and liquidity for life insurance owners.

It is also worth pointing out that there are a number of reasons why only such a limited number of life settlement securitizations have been completed. The life settlement industry is a relatively new. It typically takes a number of years for an asset class to mature to make securitization possible. In addition, life settlements do not have scheduled payments (creating challenges for those developing a model of cash flows), do not have uniform documentation, and each life insurance policy in a portfolio is unique from the others.

Some commentators argue that if the market for life settlement securitization were to grow, it could force insurance companies to increase life insurance premium costs. The argument rests on the assumption that life settlements will reduce the number of policies lapsing and the decrease in profits to the insurance company will be transferred to and borne by other insureds. There are a number of reasons why ILMA does not agree with this argument:

1) The life settlements market is available for seniors. The elderly and those with health problems both tend to lapse their policies less frequently in any event, so there is no, or limited, adverse effect from the policy being settled in the secondary market.[5]

2) Reduced lapse rates may in fact have a positive impact on life insurance companies. The issuance of life insurance policies typically entails large underwriting and upfront origination costs (such as sales commissions). This cost structure provides insurance companies an incentive to move towards lower lapse rates.[6]

3) The limited size of the overall life settlement market compared to the amount of life insurance in-force undercuts one argument against life settlements, the concern that an active life settlement market will result in increased premium costs. According to the American Council of Life Insurers (ACLI), Life Insurers Factbook 2008, there is approximately $25 trillion of life insurance in force today and according to the Conning Report, $31 billion in life settlements. By comparison, the life settlement market is simply not large enough to have any recognizable effect on pricing, and it is not clear that it will ever grow to the point where it would have a real effect on policy premium costs. In fact, over the past decade, according to the Insurance Information Institute, life insurance premium costs have decreased despite the growth in the life settlement market.

   Furthermore, it is unclear to what extent, if any, life insurance companies assume a certain lapse rate when setting policy premiums, especially policies sold to older consumers who are less likely to let them lapse. Typically seniors, who secure life insurance policies for estate or financial planning purposes, intend and do maintain the policy in force.

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[5] "Determinants of the lapse rate in life insurance operating companies", Review of Business, Fall, 2007 by Laurence Mauer, Neil Holden.
[6] ibid

Life settlements benefit the insurance industry through additional policy issuance: concurrent with a sale of a policy many insureds will purchase a new policy more suited to their current circumstances.

Myth v. Truth: Life Settlement Securitization is the Next Subprime Mortgage Crisis

The analogy presented by commentators, journalists and bloggers that life settlement securitization is the next subprime crisis is completely inaccurate.

Mortgage securitizations involve the following participants:

- Borrower (Homeowner)
- Loan originator (Bank)
- Special Purpose Trust
- Underwriter (investment bank)
- Rating agency
- Investor (capital markets)

The most significant participants in this transaction are the Borrower and the Investor. Asset-backed securities linked to subprime mortgages relied on the continued stream of payments by the homeowner to fund the securitization. When the Borrower defaulted or failed to make payments, the asset (the mortgage) did not generate sufficient cash flow to meet the payment obligation under the security, thus resulting in a default of the security. In the case of mortgage backed securities, there were two clear "losers" when the security defaulted: the Borrower who has defaulted on his mortgage and may lose his home and the Investor who will not receive anticipated cash flows from this security.

A life settlement securitization involves the following participants:

- Issuer (bankruptcy remote SPV)
- Pool of life insurance policies (acquired through licensed Providers)
- Underwriter (investment bank)
- Rating agency
- Investor (capital markets)

It is critical to note that the original owner of the insurance policy, who has sold the policy to a state licensed life settlement provider, is paid in full for the policy at the time the ownership is transferred. They have no further financial participation in the process and cannot be adversely impacted as a result of the securitization. This greatly differs from the mortgage backed security, which relies upon continuing payments by the borrower. Rather, the major risk in a life settlement securitization is the uncertainty associated with predicting longevity. Unlike a mortgage-backed securitization that relies on continuing payments from the borrowers, investors in life settlement securitizations would be required to provide sufficient funds in advance to keep the life insurance policies in the pool in force. If the life settlement securitization fails the only loser would be the investor, which is the case in all investments, and there would be no impact on the insured or any

original policy owner. Accordingly, such investments would only be suitable for institutional investors, who can analyze and understand the risks.

Regulations Relating to Life Settlements

ILMA's position is that life settlement transactions should be regulated to ensure that the consumer is protected and informed about the impact of such a transaction. To that end, ILMA believes that the persons transacting the life settlement with the policy owner, both the life settlement broker representing the policy owner and the life settlement provider purchasing the policy, should be licensed and regulated. Life settlements may or may not be appropriate transactions for all individuals. ILMA believes that transactional transparency in the documents associated with a life settlements contract should inform the participants of exactly how much money they will receive for their policy and how much money is being paid to the brokers representing the seller from the sale of the policy. Additionally, consumers should, from the onset of the transaction, consult with their financial adviser, their tax adviser and an attorney to review the transaction to evaluate if the transaction is appropriate based upon the tax impact and their financial and future insurance needs.

Presently, due to the fact that life settlements are regulated by state insurance regulators, there is a lack of uniformity in the laws governing these transactions. ILMA seeks the adoption of uniform laws and regulations that will protect consumers that participate in these transactions. Such uniformity would include uniform disclosure requirements, licensure of participants and enforcement procedures.

ILMA believes the U.S. Securities and Exchange Commission (SEC) regulates the securitization of life settlements as it regulates all securitizations. To date, the SEC has stated that it regulates any life settlements transactions involving the sale or purchase of a variable life annuity or the offer of an investment in a fractionalized interest in a life insurance policy. The Financial Industry Regulatory Authority (FINRA) has promulgated several advisories to its members concerning the regulation of variable annuity life settlements. ILMA stands ready to work with the SEC and FINRA as they explore this issue.

In closing Mr. Chairman, I would again like to thank the subcommittee for the opportunity to present ILMA's views on life settlements. We look forward to working with the subcommittee and its staff to answer any of your questions and to work towards appropriate law to govern this emerging market.

INSTITUTIONAL LIFE MARKETS ASSOCIATION, INC.

GUIDING PRINCIPLES

The Institutional Life Markets Association, Inc. (ILMA) is a trade association comprised of a number of the world's leading institutional investors and intermediaries in the mortality and longevity marketplace, formed to encourage the prudent and competitive development of a suite of evolving mortality and longevity related financial businesses, including the businesses of life settlements and premium finance.

Life insurance is one of the most important financial assets a consumer owns, and the prudent regulation of the life settlement and premium finance industries is critically important to a consumer's ability to acquire such asset and, during the term thereof, to realize all of the economic opportunities associated therewith.

To help bring consensus among the various life insurance companies, life settlement providers, brokers, banks, premium finance lenders and other participants in the life settlement and premium finance industries, and to facilitate the promulgation of appropriate regulation and the development of industry "best practices," ILMA has formulated the following guiding principles to be considered when conducting business in this marketplace.

- Transparency. Consumers are entitled to transparency when engaging in life settlement and premium finance transactions. Accordingly, a consumer's representative should disclose all bids received and provide full disclosure of all fees and commissions payable to such representative. Industry participants should not engage in premium finance transactions designed to conceal the nature of a transaction from life insurance companies. When a consumer applies for a life settlement or premium finance program, an advisor should emphasize the consumer's obligation to complete the application truthfully and accurately.

- Suitability. Life settlements and premium finance loans are not appropriate for everyone. Industry participants should advise consumers applying for life settlements or premium finance loans to seek competent, professional advice to fully understand the risks involved and to determine whether a transaction is right for them.

- Consumer Choices. Consumers should have the ability to choose how to finance their life insurance policy and whether to hold the policy to maturity, surrender it for cash surrender value or settle it in the secondary market. Regulations that unnecessarily restrict such choices are anti-consumer and should not be supported.

- Fiduciary Duty. Life settlements and premium finance loans are complex financial transactions. Consumer representatives such as agents, brokers, and other advisors should be mindful of the fiduciary duty they owe to consumers who participate in such transactions, including helping consumers understand the value of a policy and how best to realize this value. The nature and scope of this fiduciary duty should be explained and defined at the start of the professional relationship.

- Insurable Interest Principle. Industry participants should support laws designed to deter transactions that seek to evade insurable interest laws and principles.

- Policy Origination. No person should pay, directly or indirectly, an inducement to any prospective policy owner or insured for taking out a life insurance policy. Offers of "rebates," "free insurance" and similar questionable incentives should be prohibited.

- Protection of Insured's Identity. Industry participants should develop and implement procedures designed to appropriately safeguard the identity of insureds engaging in life settlement and premium finance transactions. These participants should make every effort to prevent the inappropriate disclosure of confidential information relating to an insured or to a particular transaction.

- Competition. A well regulated and competitive marketplace best serves the interest of consumers and industry participants. Industry participants should not support or engage in practices that seek to unlawfully restrict competition.

- Marketplace Education. Industry participants should seek to educate consumers, investors and others on legislative and administrative developments affecting the life settlement and premium finance industries. These persons should also seek to provide a forum for interested parties to examine and review such developments.

With these Guiding Principles as a basis, ILMA looks forward to engaging in a dialogue with the leaders of the life settlement and premium finance businesses to promote common interests and objectives and to develop industry "best practices." ILMA also looks forward to working with legislators and regulators to help design appropriate and consumer-oriented regulation.

Prepared Testimony of
Brian D. Pardo
Chairman and Chief Executive Officer
Life Partners Holdings, Inc

Before the Subcommittee on Capital Markets, Insurance and Government-Sponsored Enterprises
Committee on Financial Services
United States House of Representatives

Hearing on "Recent Innovations in Securitization"
September 24, 2009

Mr. Chairman, Ranking Member Garrett, and members of the Subcommittee:

My name is Brian Pardo, and I am the founder and Chief Executive Officer of Life Partners Holdings, Inc. Thank you for asking me to testify before you today as this panel examines the role of life settlements as a supporting asset class for collateralized debt obligations or other securities. It is a privilege to provide you with our Company's insight on the need, especially in today's financial environment, for uniform regulation of this asset class to provide older Americans with unimpeded access to the market and to provide investors with a reliable, asset-based investment which is not correlated to the financial markets.

Life Partners is headquartered in Waco, Texas. I started the company back in 1991, and today it is both the United States' oldest life settlement provider and the only one that is publically-traded. This summer, Fortune Small Business magazine named us as the "Fastest Growing Small Public Company in America."

For those who are unfamiliar with the term, a ***"life settlement"*** is the transfer of ownership of a life insurance policy to another party in exchange for a cash discount from the policy's face value. The amount of this discount depends on the policy's estimated present value and the cost of maintaining the policy in force until maturity. Life settlements usually involve both special-purpose policies with large face values and financially-sophisticated insureds and policyowners.

The life settlement industry has its roots in the AIDS crisis of the late '80s and early '90s when terminally-ill Americans who could no longer work faced certain poverty at life's end as they saw their life savings devoured by medical costs. Life Partners stepped-in to assist in the transfer of these life-insurance policies, which gave insured access to a hefty portion of the benefits for which they paid premiums before they died. Countless individuals told me that they were more interested in how they're going to live until they die and that these transactions gave them tremendous piece of mind in their last days.

Fast forward to today and one sees that the last year or so of severe recession caused older Americans to suffer staggering losses to retirement savings and severe reduction in

home equity value at the same time. The purpose of life settlements is still the same: ***providing people with access to the cash value of their assets to meet their needs.***

Approximately 8 percent of current life insurance policies are not purchased for traditional inheritance purposes. Instead, they are purchased by older individuals for purposes such as estate planning or key person coverage.

For example, a high-wealth woman who is 63 might be advised by her tax planner to obtain a life insurance policy to ensure her estates has enough money to pay estate taxes in the event of an early death. However, as she ages and her estate becomes more liquid, she may no longer need the policy for the reason she bought it.

Another example is a general contractor building a high rise project who is required to obtain life insurance by lienholders. Since the policy was not intended as a long-term inheritance asset, he no longer needs it once the project is completed.

These special-purpose polices are usually universal life policies. Since they are not purchased for wealth accumulation, policyholders usually only pay the minimum amount of premium to keep the policies in effect. Thus when they decide they no longer want the policy, the surrender value of these types of policies is typically only 1 percent of the face value, which is significantly less than the premiums that have been paid.

When an insured no longer desires a policy, they have three options. They can let the policy lapse and surrender it, resulting in a substantial windfall for the insurance company. Second, they can continue to pay the premiums. Third, they can sell the policy in the secondary market as a life settlement. Usually an insured can obtain far more in selling their policy as a life settlement than surrendering it. And often the option of continuing to pay the premiums is beyond what the insured believes is prudent financially.

According to the American Council on Life Insurance, the lapse rate of all individual policies in force has been around 5% throughout the last 4 years (this does not include surrenders or group policies). The total amount of face value of just these individual policies in force in 2007 was over $10 trillion ($19 trillion if you count all types of life insurance). The portion of policies which are actually viable as life settlements is only a fraction of this amount. For example, estimates are that a total of $10 billion face value in life settlements was transacted in 2007, while over $500 billion in face value of individual policies simply lapsed.

The Wall Street Journal reported last fall that, "with a life settlement, policyholders can typically net more than is available by surrendering a policy to the insurer for a lump-sum payment."[1] This is the policyholder's legal right since a 1911 U.S. Supreme Court

[1] Anne Tergesen, *Source of Cash for Seniors Is Drying Up,* Wall St. J. D1 (Nov. 13, 2008).

ruling.[2] One's life insurance policy is a personal property asset, and the sale of this asset is not the business of insurance.

Currently, if regulated at all, life settlements are regulated by a patchwork of State insurance departments. Each claims jurisdiction to regulate the transaction with inconsistent and frequently conflicting statutes which vary from State to State. Some States have regulations which effectively prevent insurance consumers from any access to the secondary life insurance market while others have no regulation at all.

Life Partners is domiciled and registered in the State of Texas as a life settlement provider. We are regulated by the Texas Department of Insurance, which must pre-approve our forms and requires us to file copies of advertisements and annual reports.

The lack of uniformity in state regulation can be problematic. The participants in a life settlement transaction may involve persons and entities from throughout the United States. For example, the life settlor who is selling the policy may be a trust formed under the laws of New York with a trustee in Connecticut, while the insured lives in Arizona. Their life settlement broker may be located in Florida The insurance company which issued the policy may be located in Iowa, but issued the policy was issued in New Jersey. The life settlement provider who is facilitating the purchase may be in Texas and is buying on behalf of an investor in Illinois. Determining which State has jurisdiction over the transaction can be very confusing.

Life settlements may also involve the investor purchasing a fractional interest in the policy. This allows investors to buy smaller portions of multiple policies, thereby spreading their risk. In addition, with large policies, the ability of many investors to buy fractional interests creates a larger market for the policy, and thus a more competitive purchase price for the seller. The sale of a fractional interest in a policy, as transacted by Life Partners, does not involve securitization or a derivative. The investor actually owns a piece of the policy outright.

This bears repeating: life settlement transactions are not derivatives. And when the investor actually obtains ownership of the policy, or a fraction of the policy, a life settlement is not a security. It is merely the assignment for value of a contract right.

However, as with many types of assets, the securitization of life settlements is very possible, and recent news articles indicate Wall Street is looking at life settlements as a replacement for mortgages in investment-backed securities.[3] This is nothing new. In 2002 and 2003, Wall Street opted out of this asset class because they couldn't see how to transform it into a derivative. To the extent that life settlements are bundled and transformed into derivative securities, they would be subject to the statutes and regulations governing securities.

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[2] *Grigsby v. Russell*, 222 U.S. 149, 32 S.Ct. 58 (1911).

[3] *See, e.g.*, Jenny Anderson, *Wall Street Pursues Profit in Bundles of Life Insurance*, N.Y. Times A1 (Sept. 6, 2009).

Since the life settlement industry is still relatively new, States have struggled with how to provide adequate consumer protection. Most States have failed to recognize that, unlike other consumer transactions, the individual policyowner or insured is the seller of the asset, and have regulated only the buyers of policies. Of course, with regard to representation by brokers, a life settlor is a consumer, but some States have attempted to regulate the transaction in a manner similar to the insurance industry where agents represent the interests of the insurance companies, not the consumer. Finally, some States have passed statutes or regulations declaring life settlement transactions to be securities and further complicating issues of compliance with multi-State jurisdictional claims. The fact that life insurance companies have a tremendous amount of influence over State legislatures and want to maintain their windfalls by blocking older Americans' access to the secondary market may account for much of this confusing legislation.

In order to provide older Americans with unfettered access to the valuable secondary market for their life insurance policies, a uniform, minimum level of regulation for life settlement transactions in the United States is advisable. Life settlement providers should not shy from reasonable regulation. Life Partners actually went public, not to raise capital, but to voluntarily bring itself under meaningful oversight and regulation required of public companies. We are subject to and comply with the reporting rules set forth by the SEC, including rules mandated under the Sarbanes-Oxley Act of 2002[4]. We see a value in assuring investors that our balance sheet and financial operations are open and scrutiny.

I strongly believe that Federal law should set minimum standards for State regulation of life settlements. If a State does not provide at least this minimum level of regulation, I believe that the new U.S. Consumer Financial Protection Agency should supervise life settlement activity in that State. Because life settlement transactions are not life insurance transactions, but rather financial asset transactions, they do not constitute the business of insurance. Thus, any Federal regulation of life settlements does not run afoul of the public policy expressed in the McCarran-Ferguson Act.

At minimum, regulations should provide for:

1. **registration of brokers and providers with a State agency.** This assures those advising and/or representing both the investor and the seller have some level of expertise, oversight, and fiduciary duty. The registration process should include
    a. background checks on all officers, directors, and shareholders holding an interest in these registrant of 10 percent or more;
    b. the filing of a business plan that includes a disclosure of any material pending litigation against the registrant and a description of the registrant's anti-fraud measures for deterring fraud in transactions in connection with a life settlement;

[4] Pub. L. No. 107-204, 116 Stat. 745 (July 30, 2002) (codified at scattered sections of Titles 15, 18, and 28, United States Code).

c. the posting of a surety bond of at least $250,000 or similar evidence of financial responsibility.

2. **approval by a State agency of life settlement contract forms before the first use of the forms to assure consumer protection and full disclosure of the transaction.** Since most financial services contracts are standard form contracts with little negotiation between the parties, the requirement for form pre-approval reduces inequality of bargaining power between the parties.

3. **disclosure to life settlors of information necessary regarding the attributes, risks, and benefits of entering into a life settlement, the terms and details of the proposed life settlement, and name of the provider arranging for the life settlement.** Ideally, this would be in the form of a "nutrition box" disclosure statement that allows apples-to-apples comparisons. This protects consumers who are not considered accredited or sophisticated investors by providing meaningful information they might not think to ask about on their own.

4. **prohibiting unfair discrimination in the provision of life settlements.** There is simply no room in any business for meaningless distinctions between customers.

5. **maintenance of appropriate confidentiality of personal and medical information, to protect the interests and rights of the insured.** In this day and age, it is so easy to post the intimate details of a person's life on the Internet. The best way to prevent this from happening is by requiring upfront protections.

6. **use of an independent escrow agent to receive, hold, and pay funds under the terms of a life settlement contract, to assure funds being help for future payment of premiums is used only for that purpose and not improperly diverted for other use.** One of the things that has given the life settlement industry a black eye is unscrupulous operators using investor money earmarked for future premium payments for purposes such as buying other policies or personal use.

7. **annual filing of an audited financial Statement for a provider's most recent fiscal year, to insure financial stability and transparency of that entity.** The best tool for any investor or consumer is meaningful information regularly reported.

8. **imposing a rescission period.** If it's good enough for home equity lending, it ought to be good enough for life settlements. Any rescission requirements must include—
   a. a rescission period of not less than 15 days during which a life settlor may rescind a life settlement contract;
   b. automatic rescission of a life settlement contract if the life settlor dies during the rescission period imposed under State law; and

c. requiring all funds paid by the life settlement provider or life settlement purchaser as consideration for the life settlement contract to be returned within a reasonable period of time; and

9. **continued compliance with the State's laws or regulations relating to life settlements after a person's registration is revoked, suspended, or otherwise lapses.** You shouldn't be able to avoid these meaningful consumer protections by simply closing up shop. A continuing duty to abide by your promises made to State authorities is a benchmark protection; and finally,

10. **a clear statutory mandate that gains from a life settlement transaction, whether realized by a seller or a purchaser, are to be treated as capital gains.** Currently, a policy which lapses provides no tax revenue. Likewise, the proceeds from a policy which is held to maturity also provides no tax revenue. Clear, statutory language that designates gains from a life settlement to be treated as capital gains will offer clarity, foster a continuing market for seniors to access, level the playing field between life settlements and other investments and increase revenue to the treasury which it otherwise would not have received.

These protections protect a person's legal right to trade their life insurance policy in interstate commerce. However, to ensure that this interstate commerce is not unduly burdened by piecemeal activity by the States, Federal law should also provide that a State cannot restrict:

1. national advertising that is not specifically targeted to the residents of a particular State;
2. the amount of consideration that must be offered in a life settlement;
3. choice of law provisions that are agreed to by all participants;
4. any activity permitted by Federal law;
5. interstate commerce by inhibiting any permitted activity; and
6. the activities of a person holding a license from a State meeting the Federal standards for regulation just because that person does not have a principal place of business in the restricting State.

Finally, the current exemptions under Federal law and SEC regulations for certain securities transactions should be applied to life settlement transactions involving sophisticated participants and sophisticated transactions. That is, transactions involving a face value of $500,000 or more in which all sellers and buyers of policies who are considered "accredited investors" or "qualified institutional buyers" under SEC regulations do not require the same level of regulatory protection as transactions involving persons who are not financially sophisticated. This is practically identical to "Reg D" exemptions in securities law. However, all life settlement providers facilitating transactions under this exemption should be required to file with the new Agency quarterly and annual financial reports similar to 10-Qs and 10-Ks for publicly-traded companies.

Life settlements serve a valuable purpose. They provide reasonably predictable returns to investors, currently around 10 percent annualized, that are not dependent on economic factors or cycles. They are tied to mortality tables. Life settlements allow investors to diversify their investment portfolio while also providing insurance consumers with access to capital at a time when their retirements may have been depleted by poor performance in the financial markets.

It is possible that securitization of life settlements can be done responsibly with added value to the investor and the insurance consumer. But it is just as possible that developing derivative securities using life settlements could be catastrophic if the investment banks' focus turns away from the inherent value of the transaction and turns toward reliance on third-party rating agencies, fee generation and increasing product flow without regard to quality control of the product.

That is, the securitization of life settlements could go haywire if the banks that issue these derivatives are not properly monitored. Life settlements currently have the potential to help older Americans wiped out by the con men of the world operating Ponzi schemes and who will not cease to prey on Seniors simply because some of these con-artists have been sent to prison in the last few months.

Because of our expertise, maintaining a high level of quality control is a critical role which providers like Life Partners play in such a transaction. The SEC and Congress should assure investors that they will remain vigilant in their supervision to make certain that Wall Street's move toward the use of life settlements as the underlying assets for new investment vehicles do not take the same road that led us to the current financial crisis. Life settlement providers, brokers, life settlors and investors should all support regulation that protects both insurance consumers and investors.

Again, I thank the Committee for the chance to discuss the life settlement industry with you today.

Testimony of Steven H. Strongin
Managing Director
Goldman, Sachs & Co.

United States House of Representatives Committee on Financial Services
Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises

'Recent Innovations in Securitization'

September 24, 2009

A. Executive summary:

Chairman Kanjorski, Ranking Member Garrett, and Members of the Subcommittee, we thank you for inviting us to present our thoughts on recent innovations in the securitization market and their impact on the financial crisis. We hope our thoughts prove helpful. I am Head of Global Investment Research at Goldman Sachs (the 'Firm'). I have been involved either directly or indirectly with the securitization market since joining the Firm 15 years ago, as well as during my tenure at the Federal Reserve in the 12 years prior to that. I am pleased to answer your questions on behalf of the Firm regarding the securitization market, and more specifically, the life settlement and life settlement securitization markets.

Before delving into detail on these topics, I would note that Goldman Sachs has never executed in a life settlement securitization. We currently have no client mandates or plans to execute one. In addition, our life settlement business is very small. We estimate that our total investment in the space represents a very small percentage of the total capital investment in the market, and is a fraction of what a number of our institutional competitors have invested. In addition, it is a very small percentage of our overall business.

Given that we have never executed a life settlement securitization, we cannot offer an experience-based view of this market. But, we do not believe that it poses systemic risks and we see significant potential positive benefits from the life settlement market for those who are insured and facing changed circumstances. Yet, we also see the real potential for abuse of consumers. Hence, we would emphasize the need to address potential consumer protection related issues rather than systemic concerns in this market.

We do, however, have significant experience in other securitization markets. Based on that experience, we see a few key areas where securitizations, particularly mortgage related ones, increased systemic risk and contributed to the financial crisis.

Specifically, some financial firms used the relatively favorable rules around securitization to reduce the capital held against poor quality loans. They also made their balance sheets appear healthier than they were by reporting that they were holding 'good' public securities, rather than the high risk loans underlying these securities. This was true even for securities that had never actually been sold in a market, but were instead simply repackaged and relabeled with the help of a ratings agency. In some cases, these rules even allowed firms to make risks disappear entirely from their balance sheets. These abuses lead to wholesale concerns about the balance sheet integrity of all financial firms – regardless of whether they had engaged in such practices – and greatly contributed to the panic at the peak of the crisis. They also drove the need for widespread, massive government assistance for even the most healthy of financial firms.

To address these issues, make the financial system more robust to financial shocks and reduce the future need for government assistance in times of stress, we think that securitizations should only qualify for favorable regulatory treatment after significant parts of all risk tranches have been sold to a true third party. To prevent misreporting of risk exposures, large financial holding companies should consolidate all assets and liabilities onto their balance sheets and mark those assets to market. Further, to prevent the regulatory and accounting

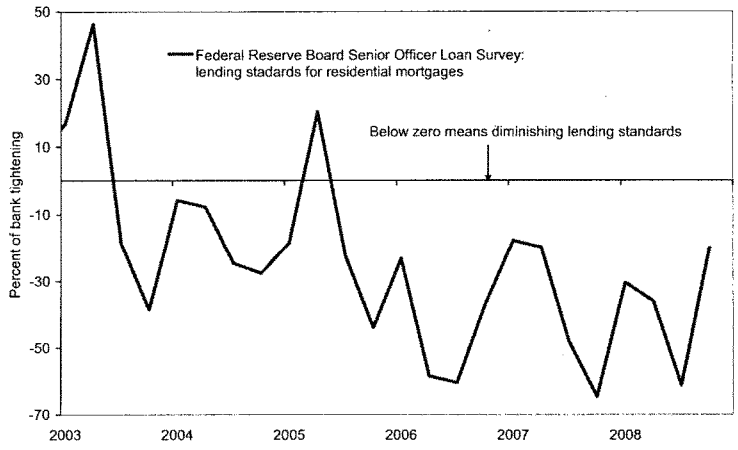
arbitrage that allowed massive under- or un-reported risks to build, and inflated profits to be reported, the rules around affiliate transactions should be strengthened. Specifically, assets should not be permitted to be held off balance sheet and firms should not be allowed to cross subsidize business across regulatory or accounting boundaries. We believe these changes in rules would go a long way towards reducing systemic risk.

B. Securitizations and their contribution to systemic risk:

The direct and dominant cause of the financial crisis was substantial lending that did not meet prudent lending standards. In our view, it is unclear whether securitizations worsened or moderated the decline in lending standards. When considered in terms of market discipline, they clearly acted as a moderating force. In fact, low quality assets reached a point where they were largely unable to be sold in the open market. Instead, they were mostly held at originating firms. However, the accounting and regulatory gaps around securitizations made some firms willing to make and hold these substandard loans even after the market had shut down entirely.

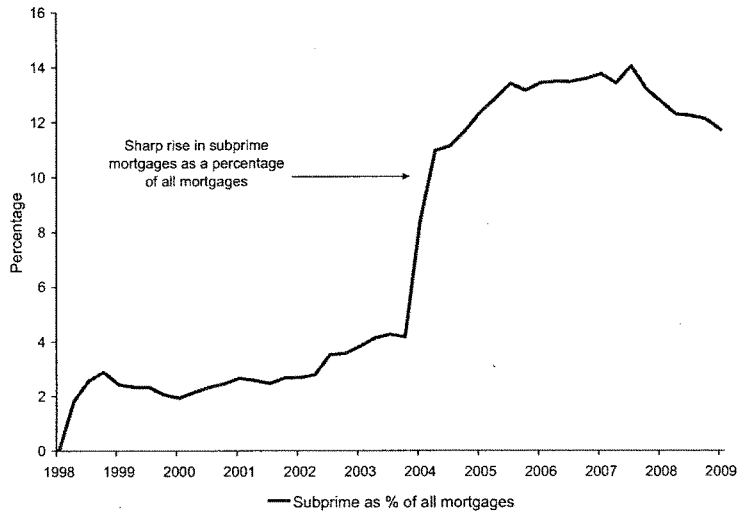
As we show in Exhibit 1, lending standards eroded sharply in the build-up to the financial crisis. When lending standards reached their lows in 2006, the securitization market began to shut down and was nearly completely closed 6 months later. What is disturbing is that subprime loans continued to be made even after the securitization market shut down (see Exhibit 2). This was possible in large part because these loans were labeled and held on the balance sheets of many financial firms not as sub-prime loans, but as highly rated public securities, even though most of these securities were still in the hands of the originating bank and had never actually been sold in a market.

Exhibit 1: Lending standards eroded sharply



Source: Federal Reserve Board, Goldman Sachs Global Investment Research.

Exhibit 2: The percentage of subprime mortgages soared to record levels, even after securitization markets shut down in 2006



Source: Mortgage Bankers Association, Goldman Sachs Global Investment Research.

Securitization benefited from lower capital standards than the underlying loans because the packaging of loans into securities that were then re-sold was supposed to reduce risk at the individual bank level by spreading it more broadly across the financial system. Yet, when banks became unable to sell low quality securitized assets, they continued to securitize and hold them anyway.

Financial firms were willing and able to continue to make these 'bad' loans for a few reasons. First, they were able to reduce their capital requirements by securitizing them. Second, some banks used hold-to-maturity accounting or aggressive marks on these assets, justified by the high ratings these securities enjoyed. As such, they felt comfortable not marking these loans to market and therefore did not report the losses that were accumulating from poor lending standards. And third, some banks moved securitized assets off balance sheet into captive Structured Investment Vehicles, using overly flexible rules around affiliate transactions. By doing so, in some cases they made risks disappear from regulatory and investor oversight entirely.

The combination of these actions taken by some financial firms left the system under-capitalized and brought the balance sheets of all financial firms into question – regardless of whether a specific firm had engaged in these questionable strategies. It is precisely this loss of faith in the balance sheets of all financial firms that moved this problem from an institution specific crisis into a general one, and caused all firms (healthy or not) to require government assistance.

The simplest demonstration of the importance of this lack of faith was the market response to the U.S. Stress Test. The Stress Test forced banks to reassess the value of their assets based on a series of consistent and challenging parameters. In the process, it made bank balance sheets considerably more transparent and gave investors greater confidence in the prices assigned to bank assets. As a result, within days of the release of the stress test results, U.S. banks raised $140bn – nearly twice as much as the Treasury required them to raise over six months. And, even the worst-positioned banks were able to raise capital.

C. Life settlement and life settlement securitization markets:

Before we discuss our view on the potential risks posed by the life settlement securitization market, we provide a brief background of the life settlement and life settlement securitization markets, as well as our role in them:

The life settlement market began in the mid 1990's. Its purpose is to provide owners of life insurance with alternatives to lapsing or surrendering their policies, for a small fraction of the premiums they pay. Policyholders whose circumstances change – who no longer want or need coverage or who cannot afford it – can choose to sell their policy for more than they would receive by surrendering it to the issuing insurer for its cash value.

In a report published in March 2005, Bernstein estimated that $13bn of insurance policy face value had been sold into the life settlement market[1]. We estimate that those purchases represented an investment of approximately $3bn of capital[2]. Current estimates of capital invested in life settlements range from $10bn - $12bn [3]. Consider, for the purpose of comparison, that the mortgage market in the U.S. reached more than $11trn at the end of 2008.

We entered the life settlement market in 2006. Our primary focus has been as a principal investor. Our business is small – both in terms of the life settlement market itself and relative to our overall revenues as a firm. As we noted earlier, our total investment in this space represents a very small percentage of the total capital invested in the market to date, and we are small relative to our competitors. In addition, it is a very small percentage of our overall business.

We buy life settlements through a wholly-owned, state licensed life settlement provider. We also have a minority stake in a second provider. We operate the business with very conservative investment standards and business practices and procedures. We also launched a longevity index called QxX in December 2007. The index has allowed market participants to observe longevity and mortality trends, and if needed, to hedge those risks in their portfolios. At present, there is no commercial activity occurring in connection with this index, and it is used as a statistical / actuarial tool. Several other longevity indices have been launched in recent years by other institutional participants in this market.

The handful of life settlement securitizations that have occurred to date, appear to have had little or no impact on the life settlement or life insurance markets. We estimate that just over $1bn of life settlements have been securitized since 2000 This remains one of the smallest and most sporadic of the securitization sectors, and while we have never been involved in a life settlement securitization, we see little investor interest in such a market given its size as well as numerous structuring challenges.

D. Life settlement securitization market not likely to pose systemic risks but should be monitored:

We do not see the life settlement securitization market as a cause for concern for the financial system as a whole. First, as we noted earlier, it is a very small market and we see limited prospects for growth. As such, it is unlikely to become large enough to pose risks that could be systemic in nature. And second, quite unlike the mortgage securitization market, it is unlikely to drive concerns around issues like lending standards, which can have more far reaching implications for the economy.

That said, we agree that there may be the potential for abuse in this market. The primary effect of securitization is that it can raise the potential amount the insured may be able to receive. This would, in our view, be a positive outcome. But, questions must be raised about how much of this incremental income will be passed down to the insured and how such transactions will be represented to the insured. Therefore, it is our view that the rules around

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[1] BernsteinResearch – Life Settlements Update, March 4, 2005.

[2] GS estimate assumes purchase price of 20-25% of policy face value.

[3] Life Insurance Settlement Association (LISA), FINRA.

direct or indirect sales of life settlements that may end up in securitization pools need to be carefully scrutinized.

E. Our suggestions for improved regulation of all securitizations:

As we have noted, life settlement securitizations do not appear to pose any special securitization related risk, and can be treated like any other securitization. However, there does appear to be special issues in terms of consumer protection in life settlement in general that may be appropriate for Congress or a regulator appointed by Congress to address.

We have several suggested changes that can be made to regulatory and accounting rules to reduce the systemic risks posed by other securitization markets. We believe that our suggestions would help to make the financial system more robust to financial shocks, improve transparency and reduce the need for future government interventions in times of stress:

First, securitizations should only qualify for favorable regulatory treatment after significant parts of all risk tranches have been sold to a true third party. Second, to prevent misreporting of risk exposures, large financial holding companies should consolidate all assets and liabilities onto their balance sheets and mark those assets to market. Third, to prevent the regulatory and accounting arbitrage that allowed massive under- or un-reported risks to build and inflated profits to be reported, the rules around affiliate transactions should be strengthened. Specifically, assets should not be permitted to be held off balance sheet and firms should not be allowed to cross subsidize business across regulatory or accounting boundaries.

Testimony of Susan E. Voss

Commissioner, Iowa Insurance Commission

Vice President, National Association of Insurance Commissioners

Before the House Financial Services Subcommittee on

Capital Markets, Insurance, and Government Sponsored Enterprises

"Recent Innovations in Securitization"

Thursday, September 24, 2009

Introduction

Chairman Kanjorski, Ranking Member Garrett, and Members of the Subcommittee, thank you for the opportunity to testify at today's hearing. My name is Susan Voss, and I am the Commissioner of the Iowa Insurance Commission, with jurisdiction over insurance and securities regulation in my state. I am also the Vice President of the National Association of Insurance Commissioners, and I am here representing that organization.

I congratulate the subcommittee for taking the time to learn more about life settlement products, as many of them are legitimate business transactions. Life settlements were first developed as "viatical settlements" during the 1980s, in response to demand from HIV/AIDS patients who wished to sell their life insurance policies in order to raise much-needed funds for personal and health care expenses.

Life settlements are currently regulated by 43 insuring jurisdictions. Such transactions are proliferating rapidly; according to the Financial Industry Regulatory Agency, this industry had grown from $5.5 billion in 2005 to $11.8 billion by last year. There are $26 billion worth of life insurance policies out there right now; the possibility for growth in this field (and related securitization) is significant.

Life settlements are growing and diversifying at a much more rapid pace than the speed at which regulators have been able to conduct oversight, yielding significant opportunities for the conduct of fraud. It is extremely important that steps are taken to

ensure transparency and consumer protection, first regarding the transactions themselves, and second regarding any related securitizations.

Update on Efforts against STOLI Policies

During this decade, a new type life settlement transaction has emerged. STOLI, or "stranger-owned life insurance," policies are owned by a person that has no interest in the insured at the time of policy issuance.

Under STOLI, investors solicit a healthy and high net-worth individual, who is typically at least 70 years of age, to obtain a life insurance policy with a certain minimum death benefit. The individual buys the life insurance with the specific intent to sell that new policy to a third party, and after a minimum period of incontestability ends, ownership of the life policy is automatically transferred to the investors in exchange for a taxable lump sum. The investors then receive the face value of the death benefit (tax free) when the insured individual dies.

The basic purpose of having life insurance is to provide financial security in the event of death for individual, family, and business needs. But STOLI transactions violate state laws, because there is no true insurable interest present at the time of policy issuance. The people who stand to benefit from the policyholder's death are in no way related to that individual.

The National Association of Insurance Commissioners has adopted a Viatical Settlements Model Act as a recommended regulatory structure for states to protect consumers from unscrupulous settlement providers. Under that model, unless the policyholder meets certain criteria (such as developing a terminal illness or divorcing one's spouse), he or she must wait a certain period of time – anywhere from two to five years – before conducting a life settlement transaction. Requiring the policyholder to retain insurable interest in the policy for a set amount of time makes the transaction less attractive to STOLI investors.

The Impact of Life Settlements on Life Insurance Policy Issuance

As states strengthen oversight of STOLI policies, bankers are turning to legitimate life settlement products as a new opportunity for securitization. Unfortunately, this market interest could have an unintended effect on the premiums that are individually assessed on all life insurance policies.

Writers of life insurance currently assume that a certain number of policyholders will eventually allow their policies to lapse. For example, a financially-stable single parent who has raised her children to adulthood may no longer see the need to maintain her life insurance policy, and will simply stop paying the premium on it. However, if the market existed for that parent (and tens of thousands like her) to sell her policy instead of just allowing it to lapse, premium rates would need to increase across the board in order for companies to prepare for the increased numbers of policyholders expecting to receive face value payouts down the line.

The Need for Greater Federal Oversight of Life Insurance Settlement Securities

As banking interests purchase more and more life insurance settlements with the intent of combining them into securities products, there is an abject need for federal securities regulators to work together. They must quickly and efficiently fill all existing gaps regarding oversight of life insurance settlement securitization, in order to ensure that policyholders and investors alike are properly protected.

Please allow me to underscore when a life insurance product morphs into an investment product, the rights of the insured must still be guaranteed. Securities regulators must be cognizant of how their enforcement actions could affect the structure and value of the underlying insurance products. They must also take the privacy rights of the policyholders into consideration, and they must work to complement the state regulatory structure that already exists to protect these policyholders.

Regardless of how federal regulators address life settlement securities, protecting the basic virtues of the life insurance policies will be of paramount importance to state insurance regulators across our country. Specifically, we must ensure that life insurance beneficiaries – those people holding that insurable interest I discussed earlier, such as relatives of the deceased – will still be able to receive their proceeds tax-free. Beneficiaries are financially and emotionally dependent on the life of the insured person, and their needs remain as great today as they were before the development of the life settlement industry.

Due attention must also be given to the privacy rights of policyholders. When seniors engage in life settlement transactions, they often must provide the investor, and any subsequent investors, with access to their confidential medical records. I'm sure you will agree with me that the implications of providing this confidential information need to be fully examined and regulated.

Finally, I am very encouraged by the establishment of an agency-wide task force regarding life settlements at the Securities and Exchange Commission, and hope that body will make the protection of securitized insurance products a priority. This is the best example of the need for securities regulators and insurance regulators to work together to make sure that the insured's rights are protected while also protecting the investor in security purchases.

Mr. Chairman, thank you again for the opportunity to testify before your panel today. I hope this hearing will shed much-needed light on both the positive and negative aspects of life settlements, and I stand ready to answer any questions you may have. Thank you.

STATEMENT OF JOSEPH M. BELTH ON LIFE SETTLEMENTS

Subcommittee on Capital Markets,
Insurance, and Government Sponsored Enterprises

Committee on Financial Services

United States House of Representatives

September 24, 2009

Chairman Kanjorski, Ranking Member Garrett, and other Members, I am Joseph M. Belth, professor emeritus of insurance in the Kelley School of Business at Indiana University, editor of *The Insurance Forum*, and author of *Life Insurance: A Consumer's Handbook*. I have written extensively about the secondary market for life insurance policies in general and life settlements in particular. A list of articles in *The Insurance Forum* is in Exhibit A.

I am not being compensated for preparing this statement, and the views expressed are mine. I respectfully request that the statement be included in the record of today's hearing. I will try to answer any questions you may have.

Background

Life insurance is important. Among its purposes are to protect the families of breadwinners, create estates, preserve estates, and fund business continuation arrangements. It is regrettable that it is being converted into a commodity and used to speculate in human lives.

In 1774, because of concern about the widespread use of life insurance to speculate in human lives, the British Parliament enacted legislation prohibiting the issuance of life insurance where the applicant did not have an insurable interest in the life of the proposed insured. In 1844,

Elizur Wright's horror at seeing life insurance policies auctioned in public to speculators prompted his crusade for life insurance reform. In 1905, the Kansas Supreme Court called the situation where the owner of a life insurance policy did not have an insurable interest in the life of the insured "contrary to good morals and a sound public policy" and cited another case that said "of all wagering contracts, those concerning the lives of human beings should receive the strongest, the most emphatic, and the most persistent condemnation." In 1951, the Missouri Supreme Court said the trend is to establish the rule that an insurable interest is not essential when the ownership of an existing life insurance policy is changed, but the court added the condition that the change must not be made "to cover up a gambling transaction."

In 1989, a newly-formed, private, for-profit corporation launched the modern speculative market for life insurance policies in the United States. The firm began buying relatively small policies from insured persons who were terminally ill; the transactions came to be known as "viatical settlements." By 1998, the market had expanded to the purchase of relatively large policies issued to insured persons whose health was impaired but who were not terminally ill; the transactions are called "life settlements." Also, the market had expanded to the bribing of wealthy, elderly persons to apply for large policies destined for purchase by speculators; the transactions are called "stranger-originated life insurance," or "STOLI." In this statement, I refer to the transactions as "speculator-initiated life insurance," or "spinlife."

Terminology

When a person buys a life insurance policy from an insurance

company, the transaction is in the primary market. When the insured person sells the policy to another party, the transaction is in the secondary market. When the policy is resold one or more times, the transactions are in the tertiary market. I view tertiary market transactions as part of the secondary market.

The terminology used in the secondary market is innocuous. Here are three examples. First, the expression "secondary market" itself diverts attention from the fact that the transactions may involve speculation in human lives, and that the transactions may involve not only a lack of insurable interest but also may create a financial interest in the early death of the insured person.

Second, consider the situation where a person is loaned all the premium money needed to buy a life insurance policy on his or her life for the benefit of speculators, and in addition is offered a cash payment or another item of value in exchange for buying the insurance. Critics of the practice sometimes call the additional payment a "rebate." That is incorrect, because a rebate is a payment to induce a person to spend money to buy something. In contrast, a payment to induce a person to allow his or her life to be insured, and where the person does not spend any of his own money to buy the policy, is a "bribe." It is an inducement to aid and abet circumvention of insurable interest laws and violation of the public policy against speculating in human lives.

Third, some observers say insurance itself is gambling. That is incorrect. Insurance textbooks draw a sharp distinction between insurance and gambling. Risk is uncertainty about occurrence of loss. In the case of life insurance and life annuities, the risk is called "longevity risk." In

other words, life insurance policies protect against the risk of dying too soon, and life annuities protect against the risk of living too long. Insurance involves four elements: (1) combining many similar exposure units, (2) transferring risk to the insurance company, (3) reducing risk through the operation of the law of large numbers, and (4) sharing of losses among the exposure units. In contrast, gambling involves creating risk that did not exist previously.

Insurable Interest

Life insurance creates a financial incentive to murder the insured. For that reason, and to prevent speculation in human lives, the concept of "insurable interest" evolved. One scholar has defined it as "an interest to preserve the life insured in spite of the insurance, rather than to destroy it because of the insurance." In the U.S. today, state statutes, case law, and common sense require a life insurance company to refuse to issue a policy where the applicant does not have an insurable interest in the life of the proposed insured person.

However, an insurable interest is *not* required when the ownership of an existing life insurance policy is changed. The reasoning behind the unrestricted right to change ownership is the notion that life insurance is property whose disposition should be within the discretion of its owner.

Nonforfeiture Laws

Ownership changes without an insurable interest propelled Elizur Wright into his reform activities. As a result of those activities, he has been called "the father of life insurance" in the U.S. He was appalled by slavery, and was an ardent abolitionist. During a trip to England in 1844, he was shocked to see life insurance policies auctioned in a public market

after speculators had examined the insured persons. He likened the practice to slave auctions.

The practice was common because the equity in a level-premium life insurance policy was forfeited when the insured person discontinued the policy. Wright said he "should not like to have a policy on my life in the hands of a man with the slightest pecuniary motive to wish me dead." When he returned to the U.S., he fought successfully for enactment of "nonforfeiture laws" prohibiting the issuance of level-premium policies where the equity was forfeited when a policy was discontinued.

The cash value now required under nonforfeiture laws generally is more than a speculator would pay for a policy, but important exceptions remain. A speculator may be willing to pay more than the cash value under any of three conditions: (1) the insured person currently is in poor health, (2) the insurance company underpriced the policy when it was issued, or (3) the speculator is given false or incomplete information about the insured person's health or other important matters.

Spinlife

In 1998, a certified public accountant wrote a letter to a 79-year-old widow. The letter, an early manifestation of spinlife, is in Exhibit B.

When I spoke to the accountant, he said the market was limited to insured persons aged 78 and older. When I asked him to identify the investors (I wanted to know what kind of individuals were speculating in human lives), he said he did not know who they were. He said he worked with four investment firms, but he declined to identify them.

In 2005, an attorney wrote a letter to a proposed insured person. The arrangement described in the letter differs from the one described by

the accountant in 1998, but there are many similarities. The attorney's letter is in Exhibit C.

Company Actions

Some life insurance companies have taken actions to prevent the use of their policies in spinlife transactions. For example, some companies now include questions in their application forms about whether the proposed insured person has been involved in the sale of a policy in the secondary market, and whether he or she has been involved in discussions about the possible sale of the policy in the secondary market.

Also, some life insurance companies have informed their field force that they oppose spinlife transactions. In some instances, the company statements refer specifically to arrangements involving so-called non-recourse premium financing, but all the statements express concern about the use of life insurance policies to speculate in human lives.

Despite these and other actions, life insurance companies are limited in their ability to prevent spinlife transactions. One reason is that promoters have devised techniques for concealing from the companies that the intent is to use the policies in spinlife transactions.

Licensing of Promoters

A person licensed to sell life insurance in the primary market should not be allowed to use the license as authority to operate in the secondary market. A person selling life insurance is in the insurance business, while a person involved in the secondary market is in the business of speculating in human lives. Stated another way, one is selling life insurance and the other is "unselling" life insurance. Those businesses differ markedly and therefore require different types of education and training.

Compensation of Promoters

The compensation paid to promoters and other intermediaries in the secondary market often dwarfs the compensation paid to those who sell in the primary market. That is ironic, because it is easier to persuade an insured person to stop paying premiums and accept money for an existing policy than to persuade an insured person to start paying the premiums on a new policy.

Winners and Losers

Promoters of secondary market transactions say all the parties are winners. That is nonsense. The only sure winners are the promoters and other intermediaries, all of whom are paid up front. All the other parties are potential losers.

The insured person is a potential loser. The insured person is told that the payment received in exchange for the policy is larger than the policy's cash value. What the insured person is not told is that the payment is smaller than the economic value of the policy, so that it might be preferable to liquidate an asset other than life insurance if the person needs money. Nor is the insured person informed of the large amounts of compensation paid up front to numerous intermediaries. Nor is the insured person told that, once the policy is transferred to the secondary market, it may be resold many times, and the insured person may never know who owns the policy and thereby has a financial interest in the insured person's early death. Nor is the insured person informed of the income tax ramifications; recent rulings by the Internal Revenue Service do not adequately clarify the tax treatment of secondary market transactions. Nor is the insured person informed that transferring a policy to the secondary

market may adversely affect the insured person's ability to obtain additional life insurance in the future. Nor is the insured person informed, in the case of a spinlife transaction, about the legal ramifications of participating in a scheme designed to circumvent insurable interest laws.

The insurance company is a potential loser. Life insurance has been granted important tax and other advantages not applicable to other financial instruments because of the social purposes it serves. To the extent that life insurance policies are traded like commodities, some or all of those advantages may eventually be taken away.

The speculators, who assume the ultimate risk in secondary market transactions, are potential losers. Speculators may be told about the yearly probabilities of death (or, more likely, the life expectancy) of insured persons without information about the qualifications of the parties making the evaluations. Speculators are told that policies are incontestable after two years, but they are not told that it may be possible for an insurance company to rescind a policy even after the contestability period where egregious fraud is involved in the issuance of the policy. Secondary market promoters, who claim to be more knowledgeable than the actuaries and underwriters of life insurance companies, have convinced speculators they will make money. I think speculators will lose money. Even where promoters succeed in identifying policies that are genuinely underpriced by insurance companies, too much money is spent in upfront compensation to intermediaries to allow profitability for speculators.

Conclusion

Over the years there have been many programs--some of them have involved charities and others have involved various other financial

arrangements--where so-called sophisticated investors have been victimized by too-good-to-be-true schemes that turned out to be precisely that. Although reliable data about the scope of the life settlement market are not available, anecdotal data suggest that the market is growing. I think the growth is driven by pure, unadulterated greed on the part of intermediaries who are heavily compensated up front. The promoters will be gone from the scene when the consequences of their activities are felt by the victims they leave behind.

A Postscript

In March 2001, *Forbes* magazine said this about the secondary market: "This is a pretty ghoulish way to make a buck, but as a cold-blooded investment it sounds good." It is indeed ghoulish, but *Forbes* fell for the promoters' sales pitch. In response, Maurice R. Greenberg, who at the time was chairman and chief executive officer of American International Group, said this about the secondary market in an internal memorandum that was made public in the course of a government investigation: "It seems to me that anybody doing anything in the field stands the risk of adverse PR. I am uneasy about this." He was not uneasy enough. He entered the secondary market, as did Warren Buffett, chairman and chief executive officer of Berkshire Hathaway, and other so-called sophisticated investors. They will learn the lesson eventually.

EXHIBIT A

DATES OF ISSUES AND TITLES OF ARTICLES IN *THE INSURANCE FORUM* ABOUT THE SECONDARY MARKET FOR LIFE INSURANCE POLICIES

Mar 89 A System for the Exploitation of the Terminally Ill
Mar 99 Viatical Transactions and the Growth of the Frightening Secondary Market for Life Insurance Policies
Jun 99 A Provocative Question about Viatical Transactions
Oct 99 Alleged Criminal Activity and Other Developments in the Viatical Industry
Dec 99 More Allegations of Wrongdoing in the Viatical Industry
Jan 00 A Bizarre Amendment to Michigan's Viatical Statute
Feb 00 Congress Should Say Who Will Regulate the Viatical Business; Comments by Northwestern Mutual on Viatical Commissions
Mar 00 Viatical Fraud and the Legislative Attack on the Venerable Incontestability Clause in Life Insurance Policies; Financial Information about Viaticus
Apr 00 More about Life Partners and the Fifth Circuit; The Uninsurables at Universal Guaranty Life--A Case Study in the Dangers of Simplified Underwriting
May 00 The Arithmetic of Viatical Senior Settlements; More Information about Viaticals
Jun 00 A Florida Grand Jury Goes After Viatical Fraud; The Huge Commissions Paid to Viatical Brokers; Purchases by Viaticus in Texas During 1998 and 1999
Jul 00 Federal Criminal Allegations in California Relating to Viatical Fraud; Justus Viatical and the Illinois Insurance Department
Aug 00 The First Viatical Fraud Convictions
Oct 00 An Update on Florida's Viatical Reports
Nov 00 Life Partners and the Nonregulation of the Viatical Industry; Viatical Senior Settlements and Contingency Insurance
Dec 00 Arson vs. Murder: The Insurable Interest Anomaly and the Frightening Secondary Market for Life Insurance Policies
Jan 01 Who Should Regulate the Viatical Industry? (by S. Roy Woodall, Jr.); Should the Federal Trade Commission Regulate the Secondary Market for Life Insurance?
Feb 01 Health Related Cash Values--Some Practical Aspects (by Albert E. Easton); Should Life Insurers Compete with Viatical Firms by Offering Cash Values Related to the Health of Insureds?
Mar 01 The LOMA Report on Viatical and Life Settlements
Apr 01 Dirtysheeting--Another Type of Viatical Fraud; More on the Arithmetic of Senior Settlements
Jul 01 ViatiCare, Senior Settlements, and the Veterans of Foreign Wars
Feb 02 The Shrinking Secondary Market for Life Insurance Policies
Jul/Aug 04 Flawed Life Insurance Programs Promoted to Charities

May/Jun 05 A Conflict of Interest for Actuaries Involved in Both Life Settlements and Universal Life with No-Lapse Guarantees
Jun 06 The Growing Speculation in Human Lives Through the Secondary Market for Life Insurance Policies
Jul 06 The Ill-Advised ACLI Proposal for an Excise Tax on Speculator-Initiated Life Insurance Transactions
Aug 06 Life Insurance Companies Should Take Over the Secondary Market for Their Policies
Jan/Feb 07 Spitzer, Coventry, and the Secondary Market for Life Insurance Policies
Mar/Apr 07 *The New York Times* Features Spinlife and the Secondary Market for Life Insurance Policies; More on Life Insurance Policy Buyout Programs
Jul 07 A Landmark Decision about the Secondary Market for Life Insurance Policies
Oct 07 The Mounting Legal Problems at Life Partners; A Novel about Viaticals
Nov 07 Observations on Reports Filed in Texas by Coventry First and Life Partners; New York Life's "Access Plus" Program
Dec 07 Recent Developments in New York and Florida Relating to Coventry and the Secondary Market for Life Insurance Policies
Jan 08 Obscene Commissions for Intermediaries in the Secondary Market for Life Insurance Policies; Larry King's Lawsuit against an Insurance Agent Relating to a Pair of 2004 Transactions in the Secondary Market; The *National Underwriter* Magazine and the Secondary Market for Life Insurance Policies; Another Proposed Alternative to the Secondary Market for Life Insurance Policies
Feb 08 Lincoln National's Lawsuit Seeking Rescission of $30 Million of Spinlife, and Other Developments Relating to Spinlife
Apr 08 Recent Developments Involving Life Partners
May 08 Correspondence about Our February 2008 Issue
Jun 08 The Use of Spinlife to Facilitate Replacement; "Free Insurance"--What I Tell My Friends (by Stephan R. Leimberg)
Aug 08 Life Insurance Company Statements on Spinlife
Oct 08 Recent Developments at Life Partners
Feb 09 A Defeat for Life Partners in a Dispute with the Colorado Securities Commissioner
Mar 09 More on Life Partners and the Colorado Securities Commissioner
Apr 09 A Lawsuit by American General Seeking Nullification of a Spinlife Policy
Jun 09 Money Laundering through Annuities; The Minnesota Department's Attack on Spinlife; Phoenix Life, Steven Lockwood, and Several Spinlife Lawsuits
Aug 09 How Insurance Companies Screen for Spinlife

EXHIBIT B

ACCOUNTANT'S 1998 LETTER

[*Note*: The proposed insured person, who was a resident of Pennsylvania, was a 79-year-old widow at the time. She knew "Steve," an attorney in Florida. The Florida certified public accountant who wrote the letter was Steve's partner.]

As you may know, I am Steve's partner. He has asked that I write to you to explain the process of obtaining an insurance policy and then selling the policy to an investor for a portion of the face value.

The concept is called a "Viatical Settlement." A person such as yourself applies for a policy with a face value of at least $1,000,000. Upon the issuance of the policy, an investor offers to buy the policy from you for approximately 5% of the face value or $50,000. There is no money out of your pocket. The investor makes all premium payments. You would receive the amount directly into your bank account from the investor.

We are then paid our fee directly from you. Our fee is 20% of the funds which you receive. As an example, if you receive $50,000 for the sale of the policy, we would be paid $10,000 from you. The net amount of $40,000 would be taxable to you.

I hope the above will answer any question which you may have. If you have any further questions, please do not hesitate to contact me.

EXHIBIT C

ATTORNEY'S 2005 LETTER

[*Note*: Underlining, italics, and boldface are in the original.]

Over the years, [our law firm] has explored many life insurance related strategies that might be beneficial to our clients. Many have been beneficial--many have not. Recently, [our law firm] completed our due diligence regarding an insurance strategy that we feel we must share with our clients.

However, before I begin explaining the insurance strategy, I would like to define a few terms you might not be familiar with:

- *life settlement company -- a large company (usually a subsidiary of a large insurance company) that is in the business of buying insurance policies on the "secondary market"*
- *premium finance company -- a company (usually a large financial institution) that provides money to finance life insurance purchases*
- *premium financing -- a strategy to allow an insured to borrow money to pay their annual life insurance premiums*
- *non-recourse loan -- a type of loan that requires no collateral and no personal guarantee*
- *insurance capacity -- the amount of life insurance available for an individual to purchase based upon that individual's financial net worth and insurability (as a rule of thumb, total net worth less existing life insurance in force)*

The "life settlement" industry has set aside large sums of money for investment in life insurance contracts. I have been working with certain bankers, life insurance professionals and actuaries who, along with me, can assist you with gaining access to these funds to provide a benefit to your family or to your favorite charity in a little more than two years at no cost to you through non-recourse "premium financing." We can accomplish this by using your excess "insurance capacity." This program is offered to individuals who are between the ages of 75 and 90 and who have a net worth in excess of $5,000,000.

Following is a simple example to demonstrate the concept: John Smith is 80 years old. He has a net worth of $10 million and has $2 million of existing insurance on his life. [Our law firm] will work with John to take advantage of his excess "insurance capacity" (approximately $8 million) to purchase a new life insurance policy on John (with an $8 million death benefit).

During the underwriting process, we arrange for a "premium finance company" to agree to pay the premiums on John's behalf for the first 24 months (on a "non-recourse" basis, so John has no financial risk). Therefore, John will own the policy but will not be obligated to pay the annual premiums (which in this example could be approximately $300,000 per year including accrued interest).

After 24 months have passed, John's health and the policy's fair market value will be re-evaluated. Offers to purchase the policy will be obtained from "life settlement" companies and the best offer will be selected. John then sells the policy to a life settlement company (usually in the range of 10-15% of the death benefit). Since the policy in this example

had a death benefit of $8 million, the sale price could range between $800,000 and $1.2 million.

The sale proceeds must first repay the "non-recourse" loan to the "premium finance company," then John (or his designated beneficiary) will receive the excess, if any. In this example, assuming a $1 million sale price and a repayment of $600,000 to the "premium finance company," John will receive $400,000 -- ***this amount will be treated as a long-term capital gain currently taxed at 15%, netting John $340,000 after taxes!***

I have enclosed the necessary forms to begin the insurance underwriting process. If you are interested in applying for this program, please complete the forms and return them in the enclosed envelope. *Please understand, there is no obligation, financial or otherwise, by completing these preliminary forms. It has been our experience that only approximately 40-50% of the individuals who submit the forms will be eligible to participate in the program. The underwriting process takes approximately six weeks to complete, at which time you will be informed whether you are eligible to participate. At that time, we will meet to discuss all the details and answer any questions you may have.*

I look forward to working with you on this amazing opportunity!

O