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## Why is STOLI a Problem?

### SITUATION

STOLI is a contrived transaction designed to evade state insurable interest and other laws and allow investors to use life insurance to profit from the deaths of people they don't know. In STOLI schemes, investors entice seniors to take out policies with the intent to transfer most of the benefit to those investors who then profit when they die. The sooner the policyholder dies, the greater the investor's profit. In effect, STOLI promotes wagering on human life. Also, STOLI threatens to expose consumers to unexpected taxes, loss of privacy, and inability to obtain needed life insurance in the future.

### **How does STOLI work?**

- Investors, such as hedge funds, induce senior citizens to purchase life insurance. The seniors purchase the policies in their own names but agree to an arrangement where the investors, after a period of time (usually the expiration of a two-year contestability period), get beneficial ownership of the policy.
- The seniors receive some financial inducement for this: be it an upfront payment, a portion of the profit when policies are sold or a small continuing interest in the death benefit.
- Investors often agree to finance the premiums with a loan that does not require re-payment, but rather, transfer of the policy.
- The investors typically profit by collecting the death benefits after the seniors die. The sooner the seniors die, the higher the profit.

### Issues to Consider

#### **Risks to Consumers:**

- Seniors participating in these arrangements may not be aware that the income, including the cost of insurance coverage during the "free period," is generally taxable and they may receive substantially less compensation than expected.
- The seniors may not be aware that the life insurance policies may be far more valuable to them as estate protection rather than as a scheme for making a quick buck.
- The prevalence of STOLI may even increase costs of legitimate policies since companies have to devote significant resources to detect these schemes, which increase both the cost and time that it takes to issue policies to legitimate purchasers.



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- Seniors participating in STOLI may use up their insurance capacity and be unable to purchase life insurance in the future for estate planning and other legitimate needs.
- Through these transactions, seniors will be giving permission for someone to “check periodically” if they are still alive.
- Seniors need to be aware that any misstatements or lies on the application, including those questions completed by an agent that they acknowledge with their signature, could have adverse consequences. This includes the voiding of the insurance contract. Indeed, there are also many legal issues associated with STOLI. For example, STOLI applicants who mislead insurance companies on the policy applications could face legal liability or the risks of litigation.

### **Wagering on human life**

- Life insurance is designed to help families and businesses cope financially following the unexpected death of a loved one, a business owner, or a key employee. Beneficiaries should have an interest in the insured’s continued lives, not their early demise. With STOLI schemes, investors are betting that the early demise of an insured will lead to a profitable payday.
- Our nation decided long ago to prohibit wagering on human life, which is exactly what STOLI represents.

### **What is wrong with STOLI?**

STOLI violates the essential social purpose of life insurance, which is protection. Life insurance protects families from the unexpected death of a breadwinner; or businesses from the financial consequences of the death of an owner or key employee. Life insurance is not meant to be used as a vehicle for financial speculation on human life. The essential social purpose of life insurance is enshrined in state insurable interest laws and numerous rulings by the United States Supreme Court. STOLI undermines the integrity of life insurance and flouts the public policy concerns voiced by state legislatures and the Supreme Court.

### **What is the difference between life settlements and STOLI?**

The crucial factor is whether all the rules were followed from the start, including the existence of an insurable interest at the time the policy is issued. In a life settlement, the policy was purchased for its intended use—to protect family members or a small business from the risk of a premature death. But after the policy is purchased, something changes in the life of the policy owner which leads him or her to decide that the policy is no longer needed. This could be the death of the intended beneficiary, divorce, or the need for immediate cash due to illness or other loss. In such cases, the policy owner may decide to sell the policy to a third party.



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The life insurance industry does not support the enactment of laws that prevent transactions where the policy was acquired in good faith. But in STOLI transactions, the life insurance policies are not acquired in good faith. The parties intend at the outset that the investors, who have no insurable interest in the insured, receive the death benefit, directly or indirectly, depending on how the deal is structured. These transactions violate public policy interests and can be summed up in concerns expressed by the United States Supreme Court as far back as 1876 that life insurance should not be used as a vehicle for wagering on human life. "Any person has a right to procure insurance on his own life and assign it to another, provided it is not done by way of cover for a wager policy." Connecticut Mutual Life v. Schaefer, 94 U.S. 457 (1876).

### **How is the insurance industry harmed by STOLI?**

Life insurance and annuity products, by their nature, establish a long-term relationship between insurance companies and their policyholders. We have already seen though, that when a STOLI scandal erupts, it is the life insurance industry's reputation that unfairly takes the hit. And so it is the established life insurance industry that suffers the potential loss of reputation while being stuck cleaning up the STOLI mess. The life insurance industry wants to be proactive and enact laws to address STOLI before consumers are harmed and our reputations sullied. Companies also have to devote significant resources to detect these schemes, which increase both the cost and time that it takes to issue policies to legitimate purchasers.

### **Action Steps**

AALU, NAIFA, and ACLI strongly support enactment of legislation to address the abuses occurring in the marketplace today from stranger-originated life insurance ("STOLI"). We believe the best legislation can be achieved by combining provisions from the NAIC Viatical Settlements Model Act with provisions from the NCOIL Life Settlements Model Act. The best way to accomplish this is to use the provisions and format of the NAIC Model Act as the basis for the legislation.

In the meantime, please caution your clients if they are approached by individuals promoting STOLI.

Should you have any questions, please do not hesitate to call us at 440-740-0130.

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