

Quarter-Way Through 2009, Still No Signs Of STOLI Legislation For California

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Like most other states, California has experienced a spike in stranger-originated life insurance transactions, a relatively recent and emerging phenomenon commonly known as “STOLI.” As the name suggests, STOLI transactions are initiated by a third-party investor who does not have an insurable interest in the insured’s life. The policy’s premiums are funded by the investor, and the insured – usually a wealthy and elderly individual – receives a large cash payment up front in exchange for an agreement to transfer full ownership of the policy to the investor within a short period of time after the policy’s issuance or, in some cases, at the expiration of the policy’s two-year contestability period.

The insureds in a STOLI scheme usually are unaware that the large policy may reduce, if not eliminate, their ability to obtain other life insurance coverage for the benefit of their loved ones. And according to some, one of the problems STOLI transactions present for life insurers is that most insurers’ premium rates are based in part on statistical lapse rates – considerations that do not apply when a policy is secretly funded by an investor, as is the case with STOLI transactions.

As of now, STOLI transactions are not specifically prohibited by statute in California. Proponents of STOLI have argued that the transactions are legal since the Insurance Code allows the transfer of ownership of a life insurance policy to one who lacks an insurable interest in the insured’s life, as long as an insurable interest existed when the policy was issued.

In an attempt to curtail the negative repercussions of STOLI transactions, the California legislature proposed [Senate Bill 1543](#). Generally based on the National Conference of Insurance Legislators Model Act, the Bill sought to impose a ban on the transfer of a life insurance policy within the first two years after its issuance. It also sought to establish a statutory definition of STOLI transactions (“an act, practice, or arrangement to initiate the issuance of a life insurance policy in this state for the benefit of a third-party investor who, at the time of policy origination, has no insurable interest in the life of the insured”) and to proscribe such transactions as fraudulent.

The Bill – which received strong support from organizations such as the American Council of Life Insurers, the National Association of Insurance and Financial Advisors, the Association for Advanced Life Underwriting and the Life Insurance Settlement Association – was approved by the Senate in August 2008. It would have made California the 13th state to enact similar legislation in the wake of the STOLI boom, following the footsteps of such states as Iowa, Oklahoma and Hawaii.

But Governor Arnold Schwarzenegger vetoed the Bill in September 2008, citing a concern that its scope could unfairly exclude some companies from participating in the legitimate life settlement market, and expressing a desire to add to the Bill provisions that would ensure proper disclosure to consumers. Governor Schwarzenegger vowed to work to resolve the outstanding issues so that the Bill can be passed “quickly” in 2009. Still, as of the conclusion of the first quarter of 2009, there are no signs of any impending attempts to pass the Bill.

