States target 'wagering on death'

Lawmakers banning big-bucks insurance policies, which some contend prey on America's elderly

By Kirsten Scharnberg | Chicago Tribune 7/01/08

TOPEKA, Kan. — Lawmakers here recently passed legislation to outlaw a practice that critics say preys on America's elderly: an insurance transaction in which investors persuade seniors to purchase high-dollar life insurance policies and then transfer a significant portion of the death benefits to strangers.

Known as stranger-originated life insurance, or STOLI, the practice has become prevalent nationwide, particularly as Baby Boomers inch toward retirement and insurance options are aggressively marketed to an aging U.S. populace.

"It's becoming more and more of a problem," said Gary Sanders, senior counsel for the National Association of Insurance and Financial Advisors. "And it's ... being done for bigger and bigger dollar amounts."

The essence of a STOLI transaction is this: An investor entices a consumer, almost always someone elderly, to take out a large life insurance policy, often in excess of $1 million. The investor frequently sweetens the deal by paying the premiums for the consumer. In exchange, the insured person agrees to sell the policy—making the investor the beneficiary—for an upfront, fast-cash cut of what will be the policy's eventual death payout.

"The entire transaction is not what life insurance is supposed to be about," said Sandy Praeger, the insurance commissioner for Kansas, who fought to get STOLI banned in her state.

"In a traditional life insurance policy, the hope is that you will live as long as possible and that your loved ones will eventually receive the payout from your policy. STOLI is the exact opposite—the hope is that you will die soon, and the beneficiaries will be total strangers," Praeger said.

The insurance industry, one of the most powerful lobbying groups in the nation, has complained bitterly about STOLI, alleging it is blatant fraud for a consumer to buy a policy with the express goal of turning a profit by selling the policy to an outside investor.

State legislators have agreed in large numbers, saying that such "wagering on death," as the practice has become known, should be criminal.

Still legal in Illinois

Like Kansas, nearly two dozen states have either banned STOLI or are considering doing so. Iowa, Nebraska, Minnesota and Indiana began cracking down in the past year. Illinois is considering legislation that would restrict the practice.

Sanders said states with large elderly populations—Florida and Arizona, for example—have seen the majority of STOLI cases but that the practice is spreading.

Critics say STOLI not only violates the spirit of life insurance—financial protection for a consumer and his or her loved ones—but carries the potential for harm and abuse of the consumer.

CNN talk show host Larry King recently found himself in such a situation. He sued his insurance broker after selling off about $15 million in life insurance policies for cash payouts of about $1.4 million. King charged that he hadn't been informed of the tax ramifications or the fact that the move would reduce his ability to purchase more life insurance.

The selling off of life insurance policies is not new. An entire industry—known as the viatical or life-settlement industry—emerged in the late 1980s in response to the AIDS crisis, when thousands of people found themselves suddenly too sick to work and desperate for cash.

Because so many of those people were gay men without dependents, a market was born in which individuals could sell their death benefits to investors for immediate cash. For example, someone with a $200,000 life insurance policy might sell the policy to a life insurance settlement company for $150,000; the dying person got the money and the company profited $50,000 as soon as the insured died.

In contrast to STOLI, that kind of selling of policies largely has remained acceptable, and terminally ill consumers, as well as those who are in need of quick cash, keep that industry doing billions of dollars of business each year.

Even the life-settlement industry has been critical of STOLI. Doug Head, executive director of the Life Insurance Settlement Association, likened the practice to "a kid outside the 7-Eleven getting a bum to go in and buy booze for him.

Yet Head also cautioned against many of the legislative steps that some states are taking. He worries about blanket bans on selling life insurance policies for five years after they are purchased, a move he believes takes too much control away from consumers who might be selling their policies for valid reasons.

STOLI's upside

As much as the insurance industry has painted STOLI as a predatory practice, many consumers have enjoyed their windfall. Those who rake in big profits for doing next to nothing other than signing up for big insurance policies have frequently been happy with the deals they've cut, Head said.

Head questioned how prevalent STOLI has become, indicating that the insurance industry wants states to ban it because it cuts into profits by reducing the standard number of lapsed policies.

"The idea that people are jumping out of dark alleys and forcing old ladies into life insurance policies is ludicrous," he said.