



Executive
Summary

New York Says “No Insurable Interest” in SOLI/IOLI Transaction

In a General Counsel Opinion issued on behalf of the New York State Insurance Department on December 19, 2005, the NY Office of General Counsel held that a stranger-owned life insurance arrangement was not permissible under NY insurance law because no insurable interest existed.

The ruling applies to a detailed factual situation that provides results common to many arrangements. At the suggestion of investors, the insured purchases life insurance with borrowed funds, maintains coverage for a period of time, then has the option to continue coverage or to transfer it to the investors with no cost for the loan or the coverage.

The New York General Counsel held that this particular premium financing arrangement appears to facilitate the purchase of policies by the insured solely for resale to a party who is not a relative or a

person with a substantial economic benefit in the life of the insured. As such, no insurable interest exists, and an inducement of cost-free insurance to the insured may be a type of rebating.

This General Counsel Opinion applies to insurance transactions governed by the state of New York. Its holding and reasoning may well be adopted by other states, since New York is a leading state with regard to insurance and financial transactions. The applicable New York law is similar to the insurable interest laws in many states.

This Opinion is consistent with Jefferson Pilot Financial’s stated prohibition on the sale of JPF products in Stranger-Owned Life Insurance (SOLI), sometimes called Investor-Owned Life Insurance (IOLI), arrangements.

Case Details

The arrangement is best understood by describing it in the terms of these definitions.

- ▶ **Client:** High net worth individual willing to purchase a policy on his or her life using borrowed funds, with the option of selling the policy at a specified time.
- ▶ **Policy:** Life insurance policy purchased by Client with money loaned by Loan Providers.
- ▶ **Loan Provider:** Independent bank that loans money to Client to pay premiums.
- ▶ **Loan:** A Loan that is a full, recourse loan with respect to the borrower. This means that the borrower (Client) is personally responsible to pay off the Loan.
- ▶ **Put Option:** Client’s right to sell the policy at the Exercise Date.
- ▶ **Exercise Date:** A specified date at least two years from the date of the loan agreement between Client and Loan Providers.

- ▶ **Put Option Provider:** Hedge fund that agrees to purchase policy from Client at the Exercise Date.
- ▶ **Guarantee Provider:** A licensed bank that will purchase the policy from Client if Put Option Provider defaults on its promise to buy the policy on the Exercise Date. The Put Option Provider pays for this “guarantee”.

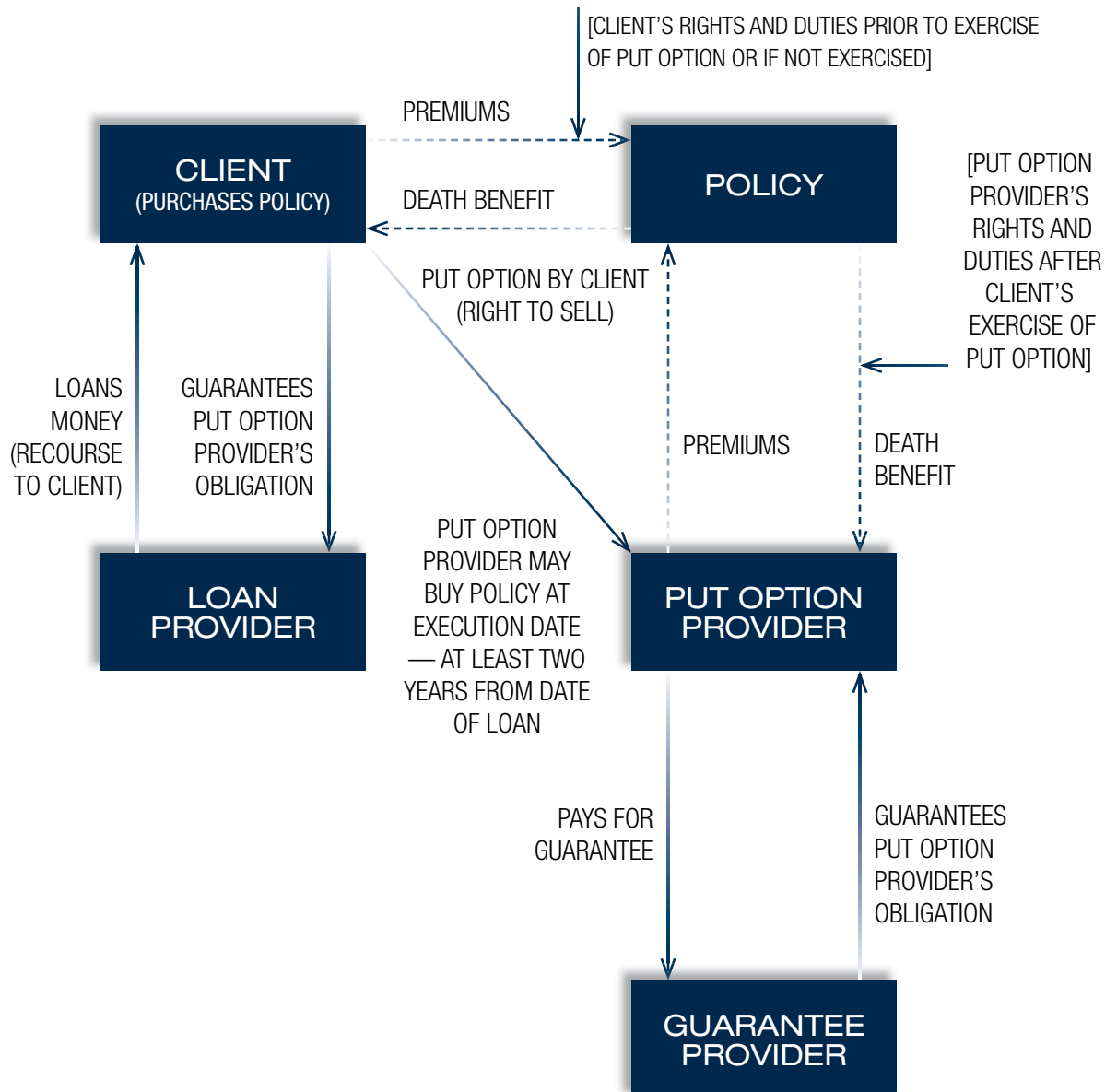
An independent bank known as *Loan Provider* loans money to *Client* who uses the money to purchase a life insurance *Policy* and keep the *Policy* in force. By executing a *Put Option*, *Client* agrees to sell the *Policy* to a third party, called the *Put Option Provider*, at a future date called the *Exercise Date*. The *Exercise Date* will be at least two years from the date of the loan agreement. The *Loan* matures on a specified date on or after the *Exercise Date* and is secured by the *Policy* and by *Client’s* right to sell under the *Put Option*. In the event that *Client* dies before the maturity or repayment of the *Loan*, the *Loan* would be repaid out of the *Policy’s* death benefit, with the remainder paid to the designated beneficiary under the *Policy* or *Client’s* estate.

Under the *Put Option*, the *Put Option Provider*, a hedge fund, commits to purchase the *Policy* from *Client* on the *Exercise Date*, provided *Client* exercises his or her option to sell. The exercise price of the *Put Option* is derived from a pre-determined formula, the sum of which covers the repayment of the *Loan* by the *Client*, plus *Loan* interest. However, if *Client* elects not to exercise the *Put Option*, he or she is fully liable for repayment of the *Loan*, plus interest, and continues to own the *Policy* and have responsibility for paying future premiums. If *Client* does not exercise the *Put Option* and keeps the *Policy*, the *Put Option* lapses and the *Put Option*

Provider's right to buy the *Policy* terminates. The *Policy* is assigned to the *Put Option Provider* only if *Client* exercises the *Put Option*. No payments under the *Loan* would be due prior to the *Exercise Date*.

In addition, a licensed bank, called the *Guarantee Provider*, provides a guarantee to *Client* that it will purchase the *Policy* from *Client* should the *Put Option Provider* not be able to meet its obligations under the *Put Option* agreement. The *Put Option Provider* pays for this guarantee, and the *Guarantee Provider* and *Put Option Provider* regulate their interests regarding this guarantee under a separate agreement.

Diagram of the Concept and Operation



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Issues

1. Does a valid “insurable interest” exist in the described transactions under New York insurance law?
2. Would the transactions as described, especially the put option, be permissible under the New York Insurance Law, especially N.Y. Ins. Law §3205(b)(1)?

Conclusions

1. No, a valid “insurable interest” does not exist in the transactions described.
2. No, the described transactions are not permissible under the New York Insurance Law.

Reasoning

The pertinent law that governs the issues in this fact situation is N.Y. Ins. Law §3205(b), which says:

(b) (1) Any person of lawful age may on his own initiative procure or effect a contract of insurance upon his own person for the benefit of any person, firm, association or corporation. Nothing herein shall be deemed to prohibit the immediate transfer or assignment of a contract so procured or effectuated.

(2) No person shall procure or cause to be procured, directly or by assignment or otherwise any contract of insurance upon the person of another unless the benefits under such contract are payable to the person insured or his personal representatives, or to a person having, at the time when such contract is made, an insurable interest in the person insured.

N.Y. Ins. Law §3205(a)(1) further defines “insurable interest” as follows:

(1) The term, “insurable interest” means:

(A) in the case of persons closely related by blood or by law, a substantial interest engendered by love and affection;

(B) in the case of other persons, a lawful and substantial economic interest in the continued life, health or bodily safety of the person insured, as distinguished from an interest which would arise only by, or would be enhanced in value by, the death, disablement or injury of the insured.

The New York General Counsel Opinion says,

“Although it is not expressly stated in the inquirer’s description, based on our review of the transaction it appears that the arrangement is intended to facilitate the procurement of policies solely for resale. It is our view that a plan of this nature does not conform to the requirements of the New York Insurance Law. First, the policies obtained by the Clients herein are arguably not obtained “on [their] own initiative” as required by N.Y. Ins. Law § 3205(b)(1). Secondly, the potential transferees do not appear to have a legitimate “insurable interest” in the lives of the Clients.”

The Opinion recognizes that New York Insurance law “expressly allows an individual to procure and immediately transfer or assign to another a policy on his own life, irrespective of the existence of an insurable interest in the assignee.” However, the Opinion further states that the Insurance Department views the type of transaction described in the Opinion as “the procurement of insurance solely as a speculative investment” and “is contrary to the long established public policy against ‘gaming’ through life insurance purposes.”

The Opinion further states that the transaction may also be a form of illegal rebating. If the Client were to exercise the put option and sell the policy, it is likely that the sale proceeds would be enough to pay back all borrowed fund plus interest, thereby providing the Client with free insurance coverage for at least two years. This cost-free coverage could be considered an inducement to enter into the transaction.



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Although this General Counsel Opinion applies only to insurance transactions governed by the state of New York, its holding and reasoning may well be adopted by other states, since New York is a leading state with regard to insurance and financial transactions. This General Counsel Opinion is not necessarily the final word on this matter in New York because the courts may have a different view if this issue is litigated.

An interesting feature of this fact situation is that the transaction was held to be impermissible under New York Law even though the loan was recourse to the borrower; although it appears that the outcome would have been the same if the loan had been non-recourse. This New York General Counsel

Opinion is consistent with Jefferson Pilot Financial's stated prohibition on the sale of JPF products in Stranger-Owned Life Insurance (SOLI), sometimes called Investor-Owned Life Insurance (IOLI), arrangements. See Warren May's memos, JPF's Position on SOLI and IOLI Business dated March 15, 2005 and SOLI - IOLI Update dated December 6, 2005, for a more detailed discussion of Jefferson Pilot Financial's position on SOLI/IOLI. These memos are on MyJPF.com under Compliance>> JPF Life and Annuities.

Jefferson Pilot Financial's Advanced Sales team will keep you up to date on any further developments in this area. If you have questions, contact Richard Baier at 1-800-4JPFMKT (457-3658), ext. 3370 or richard.baier@jpfmkt.com.

For more information, feel free to contact Jefferson Pilot Financial Advanced Sales – Case Design consultants at 866-457-3658, Option 2, or by email at advancedsales@jpfmkt.com. Check for updates to this document at www.myjpf.com >> Marketing >> JP Life & Annuity >> Advanced Sales. Do not use this document after January 2007.

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