Prepared Testimony of
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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.