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Charities Look to Benefit From a New Twist on Life Insurance

By STEPHANIE STROM

Caroline Rose Hunt, the 81-year-old oil heiress who built a second fortune in hotels and resorts, has long supported the United Way, lavishing millions on it and persuading her wealthy friends to do the same.

Now, she has joined groups of other elderly, wealthy donors who have allowed insurance companies, hedge funds and other investors to insure their lives in exchange for a promise that part the death benefits will flow to the donors' favorite charities.

Ms. Hunt is taking part in four such pools, allowing unknown investors to insure her life for a total of \$70 million. "I was insurable, somebody else put up the money, and on my death, charity gets the money," she said. "That makes me feel good, makes me feel I'm worth something."

Life insurance has long helped line the coffers of nonprofit organizations. Major donors have bought policies naming charities as beneficiaries, and charities have taken out policies on significant donors to protect against the sudden loss of support.

The policies purchased on Ms. Hunt's life are an example of a newer approach, offering charities the prospect of a small benefit at little or no cost to them or their donors because investors, who hope to profit substantially, buy the insurance and pay the premiums.

But the approach unites the nonprofit and commercial worlds in a way that troubles some experts. "Charities are selling their exclusive right to insure their donors to help investors build wealth, and it is remarkably unclear what charities actually get when it all settles out," said Vaughn Henry, an estate planner who holds insurance licenses in several states.

Laws in most states still prohibit such plans, although those laws are changing. The Senate Finance Committee, expressing concern about potential abuse of tax exemptions, has been reviewing some programs and questioning the various participants.

"In entering any transaction, charities need to be very careful that their tax-exempt status is not providing inappropriate benefits to a corporation," said Senator Charles E. Grassley, the Iowa Republican who is chairman of the committee. "A penny of benefit to charities doesn't excuse a pound of profit to the corporations."

Even proponents of such products concede that many of them do not pass muster. "There are a few people who are really selling the concept well and responsibly, and there are lots of others who are selling it in a way that makes it clear they don't care whether the individuals and charities really understand it because they're only interested in making a profit," said Paul Ditlevson, director of legacy estate programs at Ashland University in Ohio.

Ashland has borrowed \$8 million to buy a life insurance policy on an 85-year-old donor, which is expected to produce a \$2.5 million profit. The money will help build a new science center for the university if interest rates on the loan do not change sharply and reduce or eliminate the profit.

Far more complex is a plan developed by Edward H. Netherland, a life insurance broker based in Nashville. Mr. Netherland has joined UBS Warburg, a major financial services company, to market products known as Life Insurance and Life Annuities Based Certificates, or Lilacs.

Here is how Lilacs are intended to work: Investors put money into a trust that buys annuities and life insurance policies on participating donors. The income from the annuities is used to pay premiums on the insurance and provide a return to investors.

When a donor dies, the insurance proceeds first go to repay the investors, and any extra benefits go to the charity.

In the year since the first Lilacs were completed, no participating donor has died, so the concept has not been tested. But a secondary market has already developed, allowing the original investors to sell their stakes, making it hard to track ownership and for the insured to know the beneficiaries of the policy.

Joseph M. Belth, a professor emeritus of insurance at Indiana University and editor of *The Insurance Forum*, an industry publication, said he believed that the only way the concept would work was if the policies were underpriced, "and insurance companies aren't in the business of underpricing their policies."

"I suspect that somebody is going to suffer a substantial loss," Mr. Belth said.

Mr. Netherland said such fears were a result of a lack of knowledge about Lilacs. He said it was impossible for investors in his deals to gain from the death of insured donors. "In fact, it's quite the opposite," Mr. Netherland said, adding that investors received returns only as long as donors lived.

Most states require the beneficiaries of life insurance policies to have a proven interest in the insured's life. Such rules are devised to prevent gambling on human life and are the basis for pricing life insurance.

The theory is that family members, unlike unrelated third parties, stand to gain more from the income, health insurance and other benefits provided by the living breadwinner than from the insurance proceeds after the person's death. Courts have deemed that charities have a similar "insurable interest" in their major donors.

The Lilacs had until recently been legal only in Texas and Virginia. But after vigorous lobbying, the legislatures in Louisiana and New York are considering amending state laws governing who can own life insurance.

A bill to do that was narrowly defeated recently in Florida, where two former United States senators, Alfonse M. D'Amato and Phil Gramm, enlisted Gov. Jeb Bush to help them lobby Kevin J. McCarthy, director of the state's office of insurance regulation. Mr. Gramm is the vice chairman of UBS, and Mr. D'Amato is a lobbyist promoting the changes.

Regulators in California and New York have been less enthusiastic, as have the American Council of Life Insurers and some insurance agents themselves. Last month, two trade associations for agents, the

Association for Advanced Life Underwriting (of which Mr. Netherland is a member) and the National Association of Insurance and Financial Advisors, voiced their opposition to modifying state laws.

"Allowing unrelated third parties to purchase life insurance products on the lives of consenting strangers is akin to a form of gambling, and we believe it cheapens life insurance products and subjects them to criticism," the two organizations warned in a joint statement.

Steve Leimberg, a well-known estate planner who has led the charge against such plans on his Web site, said this caution was unprecedented. "I've been practicing since 1964, and I've never seen the insurance community come out against an idea that sells insurance," he said.

Recently, though, Gov. Phil Bredesen of Tennessee signed into law a bill relaxing rules about who could own life policies in his state. The Nebraska legislature has passed a similar measure.

Nonprofit organizations have been preparing for the change. Donelson Christian Academy, a private school in Nashville, has been lining up donors to participate in a life insurance program. "We have 21 people who have allowed insurance to be written on their lives," Dr. Danny Kellum, the school's headmaster, said. "Our goal is for 150 this year, and we're having good success."

Five Lilac deals involving a total of \$1 billion of insurance were completed last year, and a sixth is planned for this month.

The Ex-Students Association of the University of Texas, known as Texas Exes, is participating in one of Mr. Netherland's deals. The association hopes to line up 1,000 alumni, ages 72 to 90, who will allow a group of insurance companies, money managers, hedge funds and other institutional investors to insure their lives at \$1 million apiece. Texas Exes says it expects to raise as much as \$80 million over the life of the contracts, almost double its current endowment. "Donors see it as an opportunity to give something back to our association and the university without it costing them or us anything out of pocket," said Jim Boon, the association's executive director.

The University of Texas Foundation has already enlisted three donors in two Lilac transactions. Paul J. Youngdale Jr., general manager of the foundation, said their participation would generate roughly \$1.8 million for the university.

"Some people have a problem with this and say, 'Look at the huge premiums and interest being paid to outside investors, and all you're doing is getting a million dollars or so out of \$24 million worth of life insurance,' " Mr. Youngdale said. "But I say hell no, I'm getting \$1.8 million I wouldn't otherwise get."