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TWENTY-FOURTH LEGISLATURE
Regular Session of 2008

Tuesday, March 11, 2008
9:00 a.m.

TESTIMONY ON HOUSE BILL NO. 94, H.D. 1 – RELATING TO INSURANCE.

TO THE HONORABLE RUSSELL KOKUBUN, CHAIR, AND MEMBERS OF THE COMMITTEE:

My name is J. P. Schmidt, State Insurance Commissioner ("Commissioner"), testifying on behalf of the Department of Commerce and Consumer Affairs ("Department"). The Department appreciates the intent of this bill, but prefers the Administration's version in House Bill No. 3099 which adopts the National Association of Insurance Commissioner's ("NAIC") Viatical Settlements Model Act.

The purpose of this bill is to regulate the life settlement industry by adopting the National Conference of Insurance Legislators' ("NCOIL") Life Settlements Model Act. Specifically, this bill allows the Commissioner to license: (1) brokers who negotiate life settlement contracts on behalf of the life insurance policy's owner; and (2) providers who effectuate life settlement contracts with the owner. It also allows the Commissioner to conduct investigations and examinations of brokers and providers.

There are differences between the NCOIL model in this bill and NAIC model in House Bill No. 3099. For example, section 3 of this bill does not require brokers and providers to obtain a bond or show any evidence of financial responsibility, whereas House Bill No. 3099 requires evidence of financial responsibility in the amount of

$250,000. Evidence of financial responsibility is necessary to ensure that brokers and providers are able to compensate victims for their wrongful acts.

House Bill No. 3099 allows for licensing of business entities as a broker or producer similar to the process used in Hawaii Revised Statutes § 431:9A-106(b), which ensures that the designated broker or producer is responsible for compliance with insurance laws.

Subsection (m) in section 33 on page 47 of this bill prohibits anyone from entering into a life settlement at any time prior to issuance of a policy or for a two-year period following policy issuance, whereas House Bill No. 3099 imposes a five-year ban.

At any time prior to or during the first five years after policy issuance, House Bill No. 3099 requires the broker or provider to fully disclose to the insurer the plan or transactions to which the broker or provider is a party. There is no similar requirement in this bill.

Where any policy is settled within five years of policy issuance, section 6 of this bill requires the provider to file an annual statement containing information prescribed by the Commissioner by rule, whereas House Bill No. 3099 requires the provider to report information as prescribed by form.

House Bill No. 3099 also ensures that the jurisdiction of the Department's Securities Enforcement Branch ("SEB") is not affected by this legislation. This bill is silent and is unclear as to whether it infringes upon SEB's jurisdiction.

For the foregoing reasons, the Department prefers House Bill No. 3099, rather than this bill.

We thank this Committee for the opportunity to present testimony on this matter and respectfully request that the contents of House Bill No. 3099 be substituted into this bill.

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March 10, 2008

TO: Senator Russell Kokubun
Chair, Committee on Commerce, Consumer Protection,
and Affordable Housing
Hawaii State Capitol, Room 407

Via Email: testimony@capitol.hawaii.gov

FROM: Gary M. Slovin

RE: **H.B. 94, HD1 – Relating to Insurance**
Hearing Date: Tuesday, March 11, 2008, Room 229

Dear Chair Kokubun and Members of the Committee on Commerce, Consumer Protection, and Affordable Housing:

We are presenting testimony on behalf of the Life Settlements Institute (LSI). H.B. 94 is patterned after the Life Settlements Model Act (Model Act) that was recently adopted by NCOIL at its Annual Meeting on November 20, 2007. LSI participated in the NCOIL proceedings.

The Model Act is intended to bring order to Life Settlement contracts but LSI feels that some of the present provisions would, as a practical matter, inhibit life settlement contracts from being entered into, to the detriment of Hawaii residents.

Life Settlements Adds Another Option For Owners Of Life Insurance Who No Longer Have A Need For Their Life Insurance Policies

Life settlements contracts, when done properly, provide a means for consumers to make use of the value in their life insurance contracts when their life circumstances put them in a situation where they need funds. Simply put, a life settlement is the sale to a third party of a previously issued and in-force existing life insurance policy for more than its cash surrender value but less than its net death benefit. A consumer whose policy no longer meets his or her needs has options—a life settlement, as described, is one. Letting

the policy lapse is another; surrendering the policy for its cash value is also an option. However, cash surrender values offered by insurers are generally significantly less than the cash amount that a consumer can receive in a life settlement.

LSI Affirms That An Insurable Interest Must Be Present at the Inception of the Policy

The reputable parties engaged in the various aspects of life settlements agree that persons should not be permitted to purchase life policies where, at the time of policy issuance, the policy owner has in place an agreement to sell his or her policy to a third party that does not have a lawful insurable interest in the insured under the policy. For a policy to be lawfully issued, a valid insurable interest in the insured must exist at the time when the life policy is issued. The Model Act, in addition to requiring extensive disclosures, is intended to address these situations, known as STOLIs, or stranger owned life insurance policies. LSI agrees that STOLIs are a bad practice and should be stopped.

STOLI Definition in HB 94 HD1 May Deny Hawaii Consumers the Benefit of Life Settlement Contracts

The problem, however, is that the present definition of STOLI in H.B. 94, vigorously supported by ACLI, is overly broad, such that it gives authority to insurance carriers to challenge legitimate life settlements. This will deny Hawaii consumers the benefits of these contracts. This would provide an unfair benefit to insurers while denying a needed financial aid to Hawaii consumers. This is fundamentally unfair and we understand that, in fact, some ACLI members are moving away from the definition of STOLI that is in H.B. 94 because they recognize this fact.

A couple of facts should be noted. According to a study published by the Life Insurance Marketing and Research Association and the Society of Actuaries, about 25 to 30% of universal life policies lapse in the first five years after issuance for people aged 60 and above. When life settlement contracts are entered into lapsing does not occur. Therefore, there may be a benefit for companies to challenge life settlements so that significant lapsing of policies may still occur. But that is certainly not a benefit for consumers. The present STOLI definition makes such challenges easier. To the extent such challenges are easier, it is less likely credible investors will offer life settlements. The definition we are offering, a variation of which has been offered in other states as well, will make frivolous challenges less likely by insurers and create a fair balance between the interests of insurers and insureds.

STOLI Definition Not "carved in stone"

A number of states are considering changes to the definition of STOLI. Kentucky, Indiana, Ohio and Arizona are all considering alternative definitions for STOLI. The legislator in Kentucky who is pushing for a change to the STOLI definition from the Model Act is Representative Robert R. Damron, who was one of the key authors of the Model Act.

Legislators should be aware, that, while most of the Model Act was given extensive analysis, the STOLI definition that is in the bill came in at the last minute. Its impact upon the rights of consumers is too great not to give its impact very full consideration.

Amendment To Clarify STOLI Definition

HB 94, HD1 contains a definition of Stranger Originated Life Insurance ("STOLI") that reflects the definition used in the NCOIL Model Act. It should be noted that this definition was presented to the NCOIL Executive Committee at the very last minute—just 10 minutes before the final vote on approval of the Act.

A primary mover on the NCOIL Executive Committee for the inclusion of a STOLI definition in the Act was Representative Robert R. Damron of Kentucky, who, upon reflection, has decided that the definition in the Act should be revised. LSI strongly supports the revised definition of STOLI that Rep. Damron has introduced in Kentucky and has passed the Kentucky House as HB 348/HCS, Kentucky Regular Session of 2008 (see attached). Kentucky's proposed definition is below and LSI suggests that it replace the STOLI definition in HB 94, HD 1 on page 13, line 16 through page 14, line 10:

Proposed Amendment: "Damron Amendment"-HB 348/Kentucky	**NCOIL Model Act-HB 94 HD1: Page 13, line 16 through page 14, line 10**
"Stranger-oriented life insurance" or "STOLI" means the procurement of **new life insurance** by **persons** or entities **that lack insurable interest** on the insured and, at policy inception, such **person** or entity **owns or controls the policy** or the **majority of the death benefit** in the policy and **the insured or insured's beneficiaries receive little** or none of the proceeds **of the death benefits** of the policy.	"Stranger-originated life insurance" or "STOLI" means a practice or ***plan*** to initiate a policy for the benefit of a third party investor who, at the time of policy ***origination***, has no insurable interest in the insured, and includes: (1) Arrangements in which life insurance is purchased with resources or guarantees from or through a person or entity who at the time of policy inception, could not lawfully initiate the

	policy himself or itself, and where, at the time of inception, there is an arrangement or agreement, whether verbal or written, to directly or indirectly transfer the ownership of the policy, the policy benefits, or both, to a third party; and
Trusts that are created to give the appearance of insurable interest and are used to initiate policies for investors violate insurable interest laws and the prohibition against wagering on life.	(2) Trusts created to give the appearance of insurable interest and used to initiate policies for investors.
STOLI arrangements do not include those practices set forth in subsection (b) of the definition of "Life Settlement Contract."	"STOLI" does not include those practices set forth in subsection (b) of the definition of "life settlement contract".

Rationale:

1. The word ***plan***, in the right column, could be viewed, as picking up the possible intent of a policy owner to sell his or her policy at policy inception, though a third party may be present. The term "plan" could also be construed to be an agreement, though the ambiguity is too great.

2. The definition in the Model Act does not make clear that STOLI involves the purchase or acquisition of a **new** life insurance policy.

3. The definition in the Model Act does not make clear that an agreement by the third party to acquire the policy must exist at policy issuance.

4. The term ***origination*** is not meaningful with respect to insurance, and it could be construed to cover a life settlement.

Disclosure of Common Control

Additionally, LSI believes that the prohibition of common control between a broker and a provider, as called for in Part V, § -41 subsections (6) and (7) of HB 94, HD 1 should be modified. Transparency is critical to consumer protection and we propose an amendment that would provide such transparency. A broker who is under

common control with a provider might make the best offer to an owner for the sale of the policy. Common control of an entity should not preclude an owner from obtaining the maximum amount in disposing the policy so long as full disclosure has been made. As long as a life settlement broker has established policies and procedures that require the full disclosure of its affiliation to any life settlement provider, and as long as these parties are required to disclose this relationship to the consumer, in order to prevent any conflict of interest, a life settlement broker should be able to procure a sale of a policy to the highest bidder, regardless of the relationship among parties. Prohibiting a broker from selling a policy to an entity under common control (even where the entities are separately managed) is inconsistent with a broker's fiduciary duty to his or her client where the sale is in the consumer's best interest, e.g. where the affiliate is the highest bidder. In order to ensure that the consumer obtain the maximum value for a policy, LSI proposes the following amendments:

On page 52, subsection (6) should read as follows:

"(6) With respect to any policy or life settlement contract and a broker, knowingly solicit an offer from, effectuate a life settlement contract with, or make a sale to any provider, financing entity, or related provider trust that is controlling, controlled by, or under common control with such broker, unless such relationship is disclosed to the owner."

On page 52, subsection (7) should read as follows:

"(5) With respect to any policy or life settlement contract and a provider, knowingly enter into a life settlement contract with an owner, if, in connection with such life settlement contract, anything of value will be paid to a broker that is controlling, controlled by, or under common control with such provider or the financing entity or related provider trust that is involved in such settlement contract, unless such relationship is disclosed to the owner."

LSI strongly believes that there should be no tolerance for unscrupulous players in this market who take advantage of consumers who are probably at the most vulnerable stage of their lives. We look forward to working with you and other interested parties in developing legislation that will prevent such players from doing business in Hawaii while allowing consumers the opportunity to obtain needed financial assistance free from harm.

Thank you for the opportunity to submit testimony.

AMERICAN COUNCIL OF LIFE INSURERS
TESTIMONY IN SUPPORT OF HB 94, HD 1, RELATING TO INSURANCE

March 11, 2008

Via E Mail: testimony@capitol.hawaii.gov
Senator Russell S. Kokubun, Chair
Senate Committee on Commerce, Consumer Protection and Affordable Housing
Hawaii State Capital, Conference Room 229
415 S. Beretania Street
Honolulu, HI 96813

Dear Chair Kokubun and Committee Members:

Thank you for the opportunity to testify in support of HB 94, HD 1, relating to Insurance.

Our firm represents the American Council of Life Insurers ("ACLI"), a national trade association whose three hundred fifty-three (353) member company's account for 93% of the life insurance premiums and 94% of the annuity considerations in the United States among legal reserve life insurance companies. ACLI member company assets account for 93% of legal reserve company total assets. Two hundred sixty-one (261) ACLI member companies currently do business in the State of Hawaii.

HB 94, HD 1, enacts the National Conference of Insurance Legislators ("NCOIL") Life Settlement Model Act. The NAIC Viatical Settlement Model Act, as recently amended, has been introduced this session in the House as HB 3099 and in the Senate as SB 3021. Both Model Acts require the licensing of brokers who negotiate life settlement contracts and providers who effectuate the life settlement contracts with the owner.

While the NCOIL Life Settlement Act and the NAIC Viatical Settlement Model Act each approach the regulation of stranger-originated life insurance or "STOLI" differently, both provide needed and effective regulation of this growing predatory practice.

ACLI strongly supports legislation which protects consumers, particularly elderly consumers, from "STOLI".

What Is Stranger Originated Life Insurance?

An investor, usually a hedge fund or other institutional investor, arranges for the purchase of a policy insuring the life of a person over 70 years of age, who is insurable for at least $5M. The investor funds the policy with the expectation that policy benefits will ultimately flow to the investor. This is usually done by the insured individual's transferring the ownership of the policy to the investor after 2 years but it can also be effected by the insured's irrevocably assigning a large percentage of the policy benefits after this 2 year period to the investor.

The investor funds the cost of the insurance by making a non-recourse loan to the insured; that is, the insured is not personally liable on the loan – instead, the investor's only recourse is against the policy which secures the loan. The interest rate on the loan is comparable to a credit card. If the insured dies during the two year period, the policy benefits must first be used to pay off the loan and fees owed to the investor, but the remainder is paid to the insured's designated beneficiary. If the insured survives the 2 year period, the insured can either repay the loan and keep the policy or transfer the policy to the lender in full satisfaction of the debt. Due to the high interest rate and fees, the insured will almost invariably choose to transfer the policy to satisfy the debt.

If the offer of free insurance is not enough, the insured may be paid some sort of signing bonus in exchange for his participation in the deal.

ACLI believes that STOLI is wrong because it invites wrong-doing, preys on the elderly, is unfair to consumers and is detrimental to the life insurance industry.

HB 94, HD 1, prohibits STOLI transactions by prohibiting "life settlement contracts" at any time prior to policy issuance or within a 2 year period thereafter, unless otherwise exempted.

HB 94, HD 1, makes engaging in "STOLI" schemes a fraudulent life settlement act subject to regulatory and civil penalties. Further, any person damaged by the STOLI scheme may bring a civil suit for damages against the person committing the violation.

In prior written testimony the Life Settlement Institute ("LSI") has suggested that the definition of "STOLI" be "clarified" to read as follows:

> "Stranger-originated life insurance" or "STOLI" means ~~a practice or plan to initiate a policy for the benefit of a third party investor who, at the time of policy origination, has no insurable interest in the insured, and includes: Arrangements in which life insurance is purchased with resources or guarantees from or through a person or entity who at the time of policy inception, could not lawfully initiate the policy himself or itself, and where, at the time of inception, there is an arrangement or agreement, whether verbal or written, to directly or indirectly transfer the ownership of the policy, the policy benefits, or both, to a third party; and~~
> ~~(2)~~the procurement of new life insurance by persons or entities that lack insurable interests on the insured and, at policy inception, such person or entity owns or controls the policy or the majority of the death benefit in the policy and the insured or insured's beneficiaries receive little or none of the proceeds of the death benefits of the policy. Trusts created to give the appearance of insurable interest and used to initiate policies for investors.

The suggested change is objectionable as it limits the definition of STOLI to situations where the third party without an insurable interest owns or controls the policy at inception. This is already a violation of the insurable interest requirement under

current law. Accordingly, the suggested amendment adds no new provision to prevent STOLI.

The NCOIL definition picks up much more. Included within its definition are "practices or plans" to secure a policy for an investor; cases where the policy is paid for or guaranteed by the investor; and where there is an "arrangement" or an "agreement" to transfer the policy to the investor.

In support of the amendment LSI states that the STOLI definition in the Model Act was presented to the NCOIL Executive Committee at the last minute, suggesting that it was hastily drafted without careful thought and analysis. It was not. It was carefully crafted with the input of all stakeholders.

Further, LSI suggests that Kentucky Representative Damron's decision to revise the STOLI definition in his home state as described above is reflective of the NCOIL executive committee as a whole. It does not. In fact, in a letter dated February 7, 2008, NCOIL President Brian Kennedy sent a letter to all legislative colleagues reaffirming NCOIL support for its Model as drafted, with specific mention of the value of the Model's definition of STOLI.

Indeed, others in the life settlement industry support the NCOIL STOLI definition.

In a recent press release the executive director of the Life Insurance Settlement Association ("LISA") has characterized the NCOIL definition as a pioneering consumer protection measure. In commenting on the STOLI transaction which was the subject of a lawsuit filed in the U.S. District Court case of Life Product Clearing LLC, vs. Angel, ___ F. Supp.2d ___, 2008 WL170193 (Jan. 22, 2008, S.D.N.Y.) LISA observed:

> The Angel order repeatedly demonstrates the wisdom of the NCOIL Model . . . The NCOIL Model provides a legislative definition of STOLI as "a practice or plan to initiate a life insurance policy for the benefit of a third party investor." This is virtually identical language to the court's holding in Angel. And NCOIL's pioneering consumer affirmations – including written certifications stating "I have not entered into any agreement or arrangement providing for the future sale of this life insurance policy" and "I have not entered into any agreement by which I am to receive consideration in exchange for procuring this policy" – would likely have stopped issuance of this policy.

In addition to anti-STOLI provisions the NCOIL Model Act has (as does HB 94, HD 1) many important provisions designed to protect consumers.

In order to assure that the life settlement broker represents the insured consumer's interest (and only the consumer's interest), the NCOIL Model Act makes the broker the sole agent of the consumer by defining a "broker" as a person who ". . . owes a fiduciary duty to the owner to act according to the owner's instructions, and in the best interest of the owner, notwithstanding the manner in which the broker is compensated." Part 1, Section 1 of HB 94, HD 1.

The Model Act, therefore, prohibits a life settlement provider from purchasing a consumer's policy through a broker whom the provider owns a controlling interest.

In its prior written testimony before the House Finance Committee LSI has suggested that HB 94 be amended to allow a life settlement provider to purchase a consumer's policy or an entity to finance the purchase of a policy through its controlled broker provided that it fully discloses to the consumer its relationship to the broker. It is submitted that a broker who owes a fiduciary duty to the consumer should not be permitted to engage in sales involving a conflict of interest whether the nature of the conflict is disclosed to the consumer or not.

In summary, ACLI strongly supports legislation which effectively deters STOLI and protects consumers in life settlement transactions. HB 94, HD 1, does so. ACLI, therefore, respectively requests that this Committee pass HB 94, HD 1, ***UNAMENDED***.

Again, thank you for the opportunity to testify in support of HB 94, HD 1.

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Senate Committee on Commerce, Consumer Protection & Affordable Housing

Senator Russell Kokubun, Chair

RE: HB 94, HD 1 – Relating to Insurance

Hearing Date: March 11, 2008 Time: 9:00 am

Chair Kokubun and members of the Committee, my name is Cynthia Hayakawa, Executive Director of NAIFA ("National Association of Insurance and Financial Advisors") Hawaii, an organization made up of life insurance agents and financial advisors.

We support HB 94, HD1. This measure has been adopted by the National Conference on Insurance Legislators ("NCOIL") as the Life Settlement Model Act, at its December 2007 meeting.

Usually, in life settlement transactions, an elderly person **sells** his/her survivorship, whole, universal, variable, or term life insurance policy for a certain portion of the policy's face value. Percentages are based on life expectancy. Life settlement transactions are desirable because of many factors, including estate planning needs, rise in tax liabilities, a change of business, changes of coverage needs, or changes in life situations.

HB 94, HD 1, also includes provisions regulating Stranger Originated Life Insurance ("STOLI"). HB 94, HD1, provides needed regulation for this form of improper "wagering" of insurance policies. Our testimony will be directed at STOLI.

STOLI policies are where investors with no insurable interest in an elderly individual with high net worth, are initiating coverage on healthy elderly persons (who will be able to qualify for life insurance) and financing the premium payments. The intent is that at the expiration of the policy's two year contestability period, the insured will transfer ownership of the policy to the investors. These types of transactions circumvent the intent of the insurable interest laws and run contrary to the purpose of life insurance, which really enables families to protect their loved ones and businesses to plan for the future.

NCOIL's model law seeks to deter all manifestations of STOLI, whether in the form of a settlement, a trust or other scheme. The NCOIL model addresses STOLI by, among other things, defining and prohibiting STOLI transactions and requiring life settlement companies to annually report data to state insurance commissioners.

Insurable interest in a life insurance policy explains the relationship between the person or business entity that owns the policy (and therefore, pays for the policy premiums)

and the individual named on the policy. Most life insurance policies names the spouse, children,

other relatives or friends, trusts or business entity as the beneficiary – this clearly explains the insurable interest for purchasing the policy.

NAIFA continues to oppose efforts to expand state insurable interest laws to permit private investors to purchase life insurance on the lives of unrelated individuals. NAIFA along with the American Council of Life Insurers (the life insurance companies organization) has been working with both NCOIL and the NAIC (National Association of Insurance Commissioners) on this issue for the past few years.

The concept of insurable interest preserves the social purpose of life insurance...society is diminished when life insurance is used as a vehicle for wagering on human life.

It can leave insureds with unknown or undisclosed costs and legal implications and threatens to undermine the growing legitimate market for life insurance covering senior citizens – STOLI's targeted market.

We believe it is unsound public policy to turn life insurance products into commodities for investment by third parties that have no relation to the insured. This measure is necessary to prevent STOLI promoters from evading state insurable interest laws and violating the social purpose of life insurance.

Mahalo for allowing us to share our views.

NAIFA
HAWAII