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JUDICIARY AND LABOR

TWENTY-FOURTH LEGISLATURE
Regular Session of 2008

Tuesday, March 25, 2008
9:45 a.m.

WRITTEN TESTIMONY ONLY

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

TO THE HONORABLE BRIAN TANIGUCHI, 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 or Senate Bill No. 3021 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 the Administration bill. 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 The Administration's bill 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.

The Administration's bill 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 the Administration's bill imposes a five-year ban.

At any time prior to or during the first five years after policy issuance, the Administration's bill 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 the Administration's bill requires the provider to report information as prescribed by form.

The Administration's bill 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 the Administration's bill in House Bill No. 3099 or Senate Bill No. 3021, 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 or Senate Bill No. 3021, SD1, as previously heard and passed out by this committee, be substituted into this bill.

AMERICAN COUNCIL OF LIFE INSURERS
TESTIMONY COMMENTING ON HB 94, HD 1, SD 1, RELATING TO INSURANCE

March 25, 2008

Via E Mail: testimony@capitol.hawaii.gov
Senator Brian T. Taniguchi, Chair
Senate Committee on Judiciary and Labor
Hawaii State Capital, Conference Room 016
415 S. Beretania Street
Honolulu, HI 96813

Dear Chair Taniguichi and Committee Members:

Thank you for the opportunity to comment HB 94, HD 1, SD 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, SD 1, enacts the National Conference of Insurance Legislators ("NCOIL") Life Settlement Model Act. The Model Act would require the licensing of brokers who negotiate life settlement contracts and providers who effectuate the life settlement contracts with the owner.

The NCOIL Life Settlement Act provides needed and effective regulation of a growing predatory practice in the insurance industry commonly referred to as stranger-originated life insurance or "STOLI".

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, SD 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, SD 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.

However, the definition of "STOLI", which is a critical component in the NCOIL Model, was recently amended as set forth below.

"Stranger-originated life insurance" or "STOLI" means ~~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~~ (~~2~~) the procurement of new life insurance by persons or entities that lack insurable interests on the insured and, at policy inception, the 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 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.

"STOLI' arrangements ~~does~~ do not include ~~those~~ the practices that are ~~set forth~~ listed in ~~subsection (b) of~~ the definition ~~of~~ for "life settlement contract" as practices that do not comprise a "life settlement contract"

As result of the amendment the definition of "STOLI" deviates from the NCOIL Model Act and is objection for several reasons.

The amended definition limits the definition of STOLI to situations where the third party without an insurable interest owns or controls the policy at the nanosecond of its "procurement" rather than whether the application and financing for and issuance of the policy was part of a "practice or plan" involving others, including investors and those financing payment of the premium who do not have an insurable interest. Indeed, the amended definition is already a violation of the insurable interest requirement under current law. Accordingly, the amended definition 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.

The ability of an insurance regulator to evaluate a "practice or plan" is well-established under the Unfair Trade Practices Act; and it should be relied upon for effective regulation of settlement of insurance policies.

Secondly, the amended definition only applies to a *new life insurance policy*. This eliminates the triggering mechanism in the NCOIL Model Act which was designed to prevent STOLI pay-off to investors – which typically occurs upon expiration of the two-year contestability period. Thus, the amended definition creates a loophole for later investor pay-offs as the policies in these transactions would not be *new policies* but instead *old* ones.

The amended definition would replace the regulator's ability to examine the entire picture of a transaction to determine whether the transaction constitutes STOLI with one that would allow the regulator to examine only a snapshot of a policy at the time of its "procurement". The deceptive act protected by the amended definition is the hiding of false insurable interest at procurement by a false alternative contract involving premium financing. An "alternative contract" is ". . . [a] contract in which the performing party may elect to perform one of two or more specified acts to satisfy the obligation; a contract that provides more than one way for a party to complete performance, usually permitting that party to choose the manner of performance." (Black's Law Dictionary 7th Ed.). The false alternative is for the applicant to either pay the finance loan off in 26 months from "procurement" or assign the policy as satisfaction for the debt. The alternatives are false because (1) the loan repayment costs are at predatory rates to compel policy transfer; (2) the 26 months of "insurance" are provided "free"; together proving (3) there was never a genuine intent to obtain the policy for insurance purposes but merely speculative purposes. The Internal Revenue Service calls these kinds of transactions "step transactions" because the events are separated from one another but when examined together evidence the illegal act *when* authorities would look for fraud, i.e., the moment of "procurement".

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.

In summary, ACLI strongly supports legislation which effectively deters STOLI and protects consumers in life settlement transactions. In its present form HB 94, HD 1, SD 1, does not. ACLI, therefore, respectively requests that this Committee amend the bill to reinstate the Model Act's definition of STOLI.

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March 25, 2008

TO: Senator Brian T. Taniguchi
Chair, Senate Committee on Judiciary & Labor
Hawaii State Capitol, Room 219

Via email: testimony@capitol.hawaii.gov

FROM: Gary M. Slovin & Chris Pablo

RE: **H.B. 94 HD1 SD1 – Relating to Insurance**
Hearing Date: Tuesday, March 25, 2008 at 9:45 am, Room 016

Dear Chair Taniguchi and Members of the Committee on Judiciary & Labor:

We are presenting testimony in **support** on behalf of the Life Settlements Institute (LSI). HB 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.

It is for this reason, LSI offered amendments to the definition of *Stranger Originated Life Insurance* or "STOLI" and additional language to the provisions related to Disclosure of Common Control before the Committees that have heard HB 94 before your Committee on Judiciary & Labor. **LSI is pleased that the Senate Committee on Consumer Protection & Housing has addressed our amendment to the definition of STOLI in SD1. We urge you to preserve this definition.**

We would like you to consider two amendments to HB 94 HD1 SD1 in the following areas:

1. Disclosure of common control; and

2. Conform language in Miscellaneous Provisions to Definitions regarding costs and expenses incurred in a premium finance loan.

I.
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, line 54, 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, line 22, 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.

II.

Conforming §41 Prohibited Practices of Part V. Miscellaneous Provisions, to §2 Definitions of Part I. General Provisions, re "Life settlement contract" (a)(3)(B)(i) re premium finance loan costs

This is a technical and non-substantive amendment to §41 Prohibited Practices to insert language from the definition of "life settlement contract" relating to premium finance loan costs that appears to have been left out of the relevant section in §41 Prohibited Practices.

§2 Definitions-"Life settlement contract" [Page 5, lines 20 to page 6, line 6]	Amendment to §41 Prohibited practices, Part V Miscellaneous Provisions [Page 51, line 1 to line 19]
(3) (A) A written agreement for a loan or other lending transaction, secured primarily by an individual or group policy; or (B) A premium finance loan made for a policy on or before the date of issuance of the policy where: (i) The loan proceeds are not used solely to pay premiums for the policy and ***any costs or expenses incurred by the lender or the borrower in connection with the financing***;	§ -41 Prohibited practices. (a) It is unlawful for any person to: [Note: subparagraphs (1)-(4) omitted for brevity] (5) Enter into a premium finance agreement with any person or agency, or any person affiliated with the person or agency, pursuant to which the person shall receive any proceeds, fees, or other consideration, directly or indirectly, from the policy or owner of the policy or any other person with respect to the premium finance agreement or any life settlement contract or other transaction related to such policy that are in addition to the amounts required to pay the principal, interest, **[and]** service charges, ***and any costs or expenses incurred by the lender or the borrower in connection with the financing*** related to policy premiums pursuant to the premium finance agreement or subsequent sale of such agreement; provided that any payments, charges, fees or other amounts in addition to the amounts required to pay the principal, interest, **[and]** service charges, ***and any costs or expenses incurred by the lender***

	or the borrower in connection with the financing related to policy premiums paid under the premium finance agreement shall be remitted to the original owner of the policy or to the owner's estate if the owner not living at the time of the determination of the overpayment;

Explanation:

1. This amendment conforms the language in the MISCELLANEOUS PROVISIONS, Prohibited Practices section 41 (5) to that found in Part I. General Provisions § -2 Definitions of the bill, in the definition of Life Settlement Contract at (a) (3) (B) thereof, to ensure that costs and expenses incurred in a premium finance loan are properly included therein.

2. The Life Settlement Contract definition relating to the payment of the costs and expenses of the premium finance loan state that they could be paid from the proceeds of the premium finance loan. These would include hedging and other legitimate financing costs that are not necessarily articulated in the language of the miscellaneous section of the bill. This was an affirmative change made by the NCOIL Executive Committee in its last session in recognition of this fact, but it was not discovered that it needed to be conformed to the miscellaneous provisions section of the bill. It would be a contradiction to allow these costs to be paid with the proceeds of a premium finance loan in one part of the bill but make it a prohibited practice to do the same thing in another part of the bill.

Thank you for taking the time to consider these amendments. We look forward to working with you and other stakeholders in developing a workable law to protect the interests of all parties to a life settlement agreement.

Senate Committee on Judiciary and Labor
Senator Brian Taniguchi, Chair

Hearing Date: March 25, 2008 at 9:45 AM

RE: House Bill 94, HD1, SD1 – Relating to Insurance
(Life Settlements Model Act / Stranger Originated Life Insurance)

Chair Taniguchi and members of the Committee, NAIFA (National Association of Insurance and Financial Advisors) Hawaii **opposes the definition of stranger oriented/originated life insurance ("STOLI") as defined in HB 94, HD1, SD1.**

This measure was adopted by the National Conference on Insurance Legislators ("NCOIL") as the Life Settlement Model Act, at its December 2007 meeting. In life settlement transactions, the policyholder **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.

STOLI policies are where investors with no insurable interest in the individual with high net worth, are initiating coverage on healthy 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, that really enables financial protection for families and businesses to plan for the future.

We ask that this SD1 be amended with the "STOLI" definition as contained in HB 94, HD1, 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 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
(2) Trusts created to give the appearance of insurable interest and sued to initiate policies for investors.

The Senate CPH Committee amended HB 94, HD 1, with a new definition of "STOLI" in SD2, as follows:

"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, the 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 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. STOLI arrangements do not include the practices that are listed in the definition for "life settlement contract" as practices that do not comprise a "life settlement contract".

We do not support this definition. HB 94, HD1, SD2, limits STOLI transactions only to new policies. This definition creates a loophole for later investor payoffs after the two year contestability period. We also agree with ACLI (American Council of Life Insurers) that this new definition will stymie the regulator's ability to examine the entire plan or practice as a "STOLI" transaction.

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 have been working with both NCOIL and the NAIC (National Association of Insurance Commissioners) on this issue for the past few years. **We fully support ACLI's position on HB 94, HD1.**

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.

Thank you for allowing us to submit our comments.

Cynthia Hayakawa, Executive Director