

LINDA LINGLE
GOVERNOR
JAMES R. AIONA, JR.
LT. GOVERNOR

STATE OF HAWAII
OFFICE OF THE DIRECTOR
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS

LAWRENCE M. REIFURTH
DIRECTOR
RONALD BOYER
DEPUTY DIRECTOR

335 MERCHANT STREET, ROOM 310
P.O. Box 541
HONOLULU, HAWAII 96809
Phone Number: (808) 586-2850
Fax Number: (808) 586-2856
www.hawaii.gov/dcca

TO THE HOUSE COMMITTEES ON
CONSUMER PROTECTION & COMMERCE
AND JUDICIARY

TWENTY-FOURTH LEGISLATURE
Regular Session of 2008

Tuesday, March 18, 2008
2:45 p.m.

TESTIMONY ON SENATE BILL NO. 3021, S.D. 1, H.D. 1 – RELATING TO VIATICAL SETTLEMENTS.

TO THE HONORABLE ROBERT HERKES AND TOMMY WATERS, CHAIRS, AND MEMBERS OF THE COMMITTEES:

My name is J. P. Schmidt, State Insurance Commissioner (“Commissioner”), testifying on behalf of the Department of Commerce and Consumer Affairs (“Department”). Thank you for hearing this bill.

The Department strongly supports this Administration bill, with one suggested amendment.

The purpose of this bill is to regulate the viatical settlements industry by adopting the Viatical Settlements Model Act of the National Association of Insurance Commissioners (“NAIC”). This version of the bill has a defective effective date of January 1, 2050.

Viatical settlement transactions involve: (1) viators, or individuals who may have a terminal or chronic illness, need funds to meet their financial needs, and enter into a viatical settlement contract to sell their life insurance policies to a third-party for a lump-sum cash payment; (2) viatical settlement brokers, who represent the interests of the viator and arrange the sale of the party; (3) viatical settlement purchasers, or investors

who purchase the policy and collect a share of the death benefit from the viatical settlement broker when the viator dies; and (4) viatical settlement providers who represent the interests of viatical settlement purchasers.

This measure authorizes the Commissioner to: (1) license viatical settlement brokers and viatical settlement providers; (2) conduct examinations and investigations of viatical settlement brokers and viatical settlement providers; (3) mandate disclosure of information to the viator; (4) require the filing of advertising and promotional materials; and (5) require the filing of antifraud plans for detecting, investigating, and reporting possible fraudulent viatical settlement acts.

This measure is intended to protect consumers and policyholders, particularly seniors or the terminally or chronically ill, who may be interested in selling their insurance policies.

The Department respectfully requests correcting the defective effective date on page 92, line 16 in section 6 of the bill so that the effective date is July 1, 2008.

We thank the Committees for the opportunity to present testimony on this matter and ask for your favorable consideration.

House Committee on Consumer Protection & Commerce
Representative Robert Herkes, Chair
House Committee on Judiciary
Representative Tommy Waters, Chair

Senate Bill 3021, SD 1, HD 1: Relating to Viatical Settlements

Hearing Date: March 18, 2008

Time: 2:45 pm

Chair Herkes, Chair Waters 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 across Hawaii.

Mahalo for allowing us to express our **support for SB 3021, SD1, HD1**. This bill will add a new section to Chapter 431, HRS, to regulate the viatical settlements. This measure was adopted by the National Association of Insurance Commissioners (“NAIC”) as the Viatical Settlements Model Act in June 2007, designed to add consumer protection measures while not affecting legitimate life settlement and insurance transactions.

A viatical settlement is the sale of a life insurance policy by the policy owner for an immediate cash benefit. It is a tool that typically can provide the policy owner who sells the policy with more funds than could have been realized if the policy had been surrendered to the insurer. These transactions usually involve terminally or chronically ill individuals (the viator) who want to sell their insurance policy to a third party/secondary market, in return for a portion of the death benefit.

Life insurance is unique -- it receives special protections under federal and state law because its purpose is to protect the long-term interests that people with some connection to the insured, whether it be families, businesses, employees or charities. State insurable interest laws actually were developed to make sure that life insurance policies were taken out only by individuals, families, or businesses with an interest in the continued life of the insured.

Insurable interest is a fundamental concept in a well functioning life insurance marketplace. The concept preserves the social purpose of life insurance and helps to assure that the product will not be abused. Insurable interest statutes demonstrate the widespread belief that society is diminished when life insurance is used as a vehicle for gambling on human life.

In a typical life settlement situation, an individual will purchase a life insurance policy for a legitimate purpose, to address a perceived need that may or may not arise. Life circumstances change and the policy owner no longer needs that policy and seeks a life settlement.

Changes to state viatical settlement laws, which deal with life and viatical settlement issues, are necessary to prevent stranger originated life insurance ("STOLI") promoters from

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evading state insurable interest laws and violating the social purpose of life insurance. The life insurance community recognizes that many circumstances may lead the owner of a life insurance policy to explore a life insurance settlement. We have always supported—and will continue to support—legitimate life settlements.

STOLI violates the concept of insurable interest.

How does STOLI work? A speculator or a promoter who has no relationship with the insured, basically seeks out and encourages senior citizens with high net worth to initiate insurance coverage on their own lives. Typically the promoter or speculator will arrange premium financing to help the insured cover the premium payments on the policy or an upfront cash payment. The key point is that everyone's intention at the time of the policy purchase, is that the insured is going to transfer the policy to some third party investors at the end of the policy's two year contestability period. The life insurance policy turns into an investment.

SB 3021, SD 1, HD 1, will deter STOLI without harming the interests of policy owners who acquired their coverage legitimately. Moreover, the amendments are self-executing, meaning that they will address STOLI without imposing major enforcement burdens on state insurance departments.

New tools are needed to reinforce public policies against wagering on human life and implement the public policy expressly supported by all participants in this segment of the industry—life insurance companies, agents, settlement brokers, settlement investors and premium finance companies—to prevent STOLI.

The heart of this legislation is a five-year moratorium on life settlements that applies only to those policies acquired in violation of the spirit and intent of insurable interest statutes that will help eliminate the financial incentive for STOLI transactions and prevent wrongdoers from skirting the law.

Legitimate life settlements, such as when policy owners no longer need coverage due to a change in their economic or family circumstances (divorce, illness, death of the beneficiary), would not be affected by this legislation. The five-year moratorium would remove much of the economic incentive for STOLI transactions by forcing investors to wait for their expected pay-off while having no impact on policy owners who purchased their policies legitimately and then decides to sell it in the secondary market.

Enabling investors to use life insurance as just another investment vehicle threatens the public policy foundation which supports the favorable treatment that life insurance products receive under federal law.

GOODSILL ANDERSON QUINN & STIFEL

A LIMITED LIABILITY LAW PARTNERSHIP LLP

GOVERNMENT RELATIONS TEAM:

GARY M. SLOVIN, ESQ.
CHRISTOPHER G. PABLO, ESQ.
ANNE T. HORIUCHI, ESQ.
MIHOKO E. ITO, ESQ.
JOANNA J. H. MARKLE*
LISA K. KAKAZU**

* Government Relations Specialist
** Legal Assistant

ALII PLACE, SUITE 1800 • 1099 ALAKEA STREET
HONOLULU, HAWAII 96813

MAIL ADDRESS: P.O. BOX 3196
HONOLULU, HAWAII 96801

TELEPHONE (808) 547-5600 • FAX (808) 547-5880
info@goodsill.com • www.goodsill.com

INTERNET:

gslovin@goodsill.com
cpablo@goodsill.com
ahoriuchi@goodsill.com
meito@goodsill.com
jmarkle@goodsill.com
lkakazu@goodsill.com

March 15, 2008

TO: Representative Robert N. Herkes
Chair, Committee on Consumer Protection & Commerce
Hawaii State Capitol, Room 320

Representative Tommy Waters
Chair, Committee on Judiciary
Hawaii State Capitol, Room 302

Via Email: CPCtestimony@Capitol.hawaii.gov

FROM: Gary M. Slovin
Christopher G. Pablo

RE: **SB No. 3021, SD1 HD1 – Relating to Viatical Settlements**
Hearing: Tuesday, March 18, 2008 at 2:45 p.m., Room 325

Dear Chair Herkes, Chair Waters and Members of the Committees on Consumer Protection & Commerce and Judiciary:

We are presenting testimony on behalf of the Life Settlements Institute (LSI). LSI membership consists of the world's leading institutional investors and intermediaries in the mortality and longevity marketplace.

SB3021 SD1 HD1 is patterned after the Viatical Settlements Model Act of the National Association of Insurance Commissioners ("NAIC"). The Model Act protects those with terminal or chronic illnesses from unscrupulous brokers who trade in life insurance policies of the sick, by requiring disclosure of the consequences to the consumer, providing the right to rescind the contract, and prohibiting the transfer of the life insurance benefits to the new owner for five years.

While LSI supports the intent of SB 3021 SD1 HD1 and many of the proposals contained in this legislation, we have reservations with certain provisions.

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Five year prohibition on life settlements interferes with an insured's property rights.

LSI's most significant concern with SB 3021 SD1 HD1 is the language requiring a five year prohibition on life settlements. This provision will impose a significant restriction on a consumer's ability to transfer his or her life insurance policy. This restriction will decrease the value of a consumer's policy. LSI proposes instead a two-year prohibition on settling a life insurance policy commencing from the date of policy issuance.

This two year prohibition is logically tied to the two year contestability period of a life insurance policy, and has been endorsed by the National Conference of Insurance Legislators and by a number of states that presently regulate life settlements. Furthermore, we note that other states that have considered revised viatical settlement statutes in the past several months also have determined that the extension of the prohibition period may not serve the purpose of addressing stranger-originated programs. Stranger originated and other ill-conceived transactions are best deterred by regulating conduct at the time a life insurance policy is issued.

Rescission period is overly restrictive. With respect to the rescission period, LSI feels the proposed period is overly restrictive and does not take into consideration the actual amount of time a consumer has participated in the process prior to consummating a transaction. We note that a 15 day rescission period is standard in the industry. A typical life settlement transaction takes several months from start to finish, and the insured has many opportunities during that period of time to reconsider whether he or she wishes to enter into a transaction. Accordingly, there is no need to extend the rescission period beyond 15 days. An extension of the rescission period beyond 15 days could create unforeseen risks and uncertainties that may drive certain participants from the market resulting in fewer options and lower settlement prices for Hawaii residents. To address this concern LSI proposes maintaining the present 30 calendar day after the signing of the contract or 15 calendar days after the viator receives the viatical settlement proceeds.

Prefer HB 94 HD1 (NCOIL Life Settlements Model Act) LSI notes that the subject matter of SB 3021 is addressed by HB 94 HD1 which is patterned after the "Life Settlements Model Act" which was recently adopted at the NCOIL Annual Meeting in November 2007. LSI prefers the language contained in HB 94 HD1 with certain amendments. We urge your Committee to amend SB 3021 by inserting the contents of HB 94 HD1 with the amendments we have proposed regarding the definition of "STOLI", disclosure requirements and common control.

Thank you very much for this opportunity to submit testimony.

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AMERICAN COUNCIL OF LIFE INSURERS
TESTIMONY IN SUPPORT OF SB 3021, SD 1, HD 1, RELATING TO
VIATICAL SETTLEMENTS

March 18, 2008

Via E Mail: cpctestimony@capitol.hawaii.gov
Representative Robert N. Herkes, Chair
Committee on Consumer Protection and Commerce
Representative Tommy Waters, Chair
Committee on Judiciary
State House of Representatives
Hawaii State Capital, Conference Room 325
415 S. Beretania Street
Honolulu, HI 96813

Dear Chair Herkes, Chair Waters and Committee Members:

Thank you for the opportunity to testify in support of SB 3021, SD 1, HD 1, relating to Viatical Settlements.

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.

SB 3021, SD 1, HD 1, enacts the National Association of Insurance Commissioners ("NAIC") Viatical Settlement Model Act. The National Conference of Insurance Legislators ("NCOIL") Life Settlement Model Act has been introduced this session as HB 94.

While each of the Model Acts approaches the regulation of stranger-originated life insurance or "STOLI" differently, both provide needed and effective regulation of this growing predatory practice.

ACLI supports legislation which protects consumers, particularly elderly consumers, from "STOLI". Accordingly, ACLI is in strong support of SB3021, SD 1, HD 1.

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.

STOLI is wrong.

1. STOLI is morally wrong and wrong for the life insurance industry and consumers.

Wagering on the lives of people is wrong.

- STOLI violates the intended purpose of life insurance. Life insurance is designed to protect an individual's family and estate in the case of a death – not to financially benefit a group of strangers gambling on a person's life.

- STOLI benefits investment groups and hedge funds, not families. It circumvents insurable interest laws and does not protect consumers.

2. STOLI invites wrong-doing.

- STOLI investors are betting on the early deaths of consumers, not on their continuing good health. This gaming scheme simply invites wrong-doing that targets elderly seniors.

- With STOLI, consumers do not have control over their own life insurance policies. Their life insurance is owned by or sold to strangers who do not have their health and welfare at heart.

- Under STOLI transactions, consumers do not know who owns their life insurance policy and what that person or persons intend to do with it.

3. Preying on the elderly is wrong.

- STOLI takes advantage of the elderly – inducing them to buy something they would not normally buy and do not need.

- There may be hidden tax consequences for elderly consumers that investors do not warn them about.

- If people enter into a STOLI arrangement, they may not be able to obtain more life insurance at a time they really need it.

- STOLI is an unregulated business that preys on the elderly.

4. STOLI is unfair to consumers.

- While the cost of life insurance continues to fall, enabling more Americans to obtain good coverage, STOLI could reverse this positive trend at the expense of all consumers.

5. STOLI is detrimental to the life insurance industry.

- STOLI will likely alter the way life insurance companies do business. Insurance companies have been consistently able to raise the age at which they are able to provide affordable life insurance. STOLI may eventually result in fewer choices for insurance consumers.

SB3021, SD 1, HD 1, prohibits STOLI transactions by prohibiting “viatical settlement contracts” at any time prior to policy issuance or within a 5 year period thereafter.

A “viatical settlement contract” is defined under the Act as an agreement between the policy owner and another under which the owner receives payment in an amount less than the death benefit in exchange for his policy.

The 5 year moratorium on the settlement of the policy only affects suspicious transactions. The Bill provides consumer property protection reflecting public policy determinations by permitting certain “any time settlements”. These include exceptions for:

- Chronic or terminal illness (genuine viaticals);
- Death of a spouse;
- Divorce;
- Physical or mental disability; or
- Personal insolvency.

SB 3021, SD 1, HD 1, goes further to protect consumer interests by barring settlement of a policy for only two years if:

- The policy owner posts some cash or collateral for a loan against the policy or limits the loan to the net cash surrender value of the policy; and
- There is no agreement evidencing intent to settle the policy prior to two years from policy issuance; and
- There has been no evaluation of the insured or the policy for settlement prior to two years from policy issuance.

After application of the foregoing exceptions to the five year moratorium what's left to be prohibited is only stranger originated transactions.

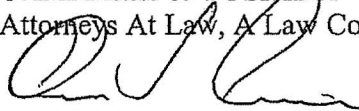
The five year moratorium will reduce the economic incentives for STOLI. STOLI investors will be far less likely to engage in these transactions if their investment dollars will be tied up for five years. Moreover, this limited five-year moratorium will deter STOLI without imposing any significant additional enforcement burdens on the Insurance Division.

STOLI undermines the integrity of the life insurance product while flouting state insurable interest laws. It is in everyone's interest – consumers, insurance regulators and insurance companies – to end this abusive practice.

ACLI, therefore, respectfully requests that this Committee pass SB 3021, SD 1, HD 1.

Again, thank you for giving us the opportunity to testify in support of SB 3021, SD 1, HD 1.

CHAR HAMILTON
CAMPBELL & YOSHIDA
Attorneys At Law, A Law Corporation



Oren T. Chikamoto
737 Bishop Street, Suite 2100
Honolulu, Hawaii 96813
Telephone: (808) 524-3800
Facsimile: (808) 523-1714
E mail: ochikamoto@chctlaw.com