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TO THE SENATE COMMITTEE ON COMMERCE, CONSUMER
PROTECTION, AND AFFORDABLE HOUSING

TWENTY-FOURTH LEGISLATURE
Regular Session of 2008

Thursday, February 7, 2008
9:00 a.m.

TESTIMONY ON SENATE BILL NO. 3246 – RELATING TO INSURANCE.

TO THE HONORABLE RUSSELL S. 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 supports the intent of this bill, but prefers the
Administration’s version in Senate Bill No. 3021 (the previous bill on today’s agenda)
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
Senate Bill No. 3021. 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

Senate Bill No. 3021 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.

Senate Bill No. 3021 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.

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 Senate Bill No. 3021 requires the provider to report information as prescribed by form.

At any time prior to or during the first five years after policy issuance, Senate Bill No. 3021 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.

Senate Bill No. 3021 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 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 Committee pass out Senate Bill 3021 rather than this bill.



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Senate Committee on Consumer Protection and Affordable Housing
Senator Russell Kokubun, Chair
Senator David Ige, Vice Chair

Senate Bill 3246: Relating to Insurance

Hearing Date: February 7, 2008 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 across Hawaii.

SB 3246 is similar to the National Conference on Insurance Legislators ("NCOIL") "Life Settlement Model Act" that was adopted at its December 2007 meeting. However, this measure deviates from the Life Settlement Model Act in that it does not include the prohibition on "Stranger Originated Life Insurance" ("STOLI") provision.

Since the anti-STOLI provision is not included in SB 3246, we do not support this measure.

Our testimony on the previous bill, SB 3021 on today's hearing agenda explains our position on STOLI regarding life settlements.

Usually, in life settlement transactions, an elderly person sells a 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 (divorce, death, illness).

STOLI attempts to circumvent state insurable interest statutes—laws that are intended to assure that people who buy life insurance have a true and meaningful interest in the life of the insured. The investment firms fully finance the transaction and continue paying premiums throughout the life of the contract. Two years into the contract, the investment firms—speculators—purchase the policy and stand to profit from the death benefits from policies on lives of strangers.

Investors will identify older, high-net-worth individuals, generally people 70 or older with a net worth of more than \$1 million. These individuals are targeted because of their relatively short life expectancy and their wealth qualifies them for substantial amounts of life insurance.

From an insurance standpoint, STOLI threatens to undermine the life insurance market for senior citizens. Life insurers have increasingly found ways to make life insurance both available and affordable to senior citizens who want to secure the financial future of a child, a grandchild or other family member. However, if millions of dollars in benefits are paid for contrived arrangements, who can predict what will happen to this market?

Should this growing market be impaired due to skyrocketing and inappropriate claims, the real victims of STOLI could well be those senior citizens who have legitimate needs for life insurance.

We ask that this measure be held in Committee.

We appreciate this opportunity to share our views. Mahalo.

AMERICAN COUNCIL OF LIFE INSURANCE
TESTIMONY IN OPPOSITION TO SB 3246,
RELATING TO INSURANCE

February 7, 2008

Via E Mail: testimony@capitol.hawaii.gov
Senator Russell S. Kokubun, Chair
Committee on Commerce, Consumer Protection and Affordable Housing
State Senate
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 opposition to SB 3246, 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.

ACLI strongly supports legislation which protects consumers, particularly elderly consumers, from a growing predatory practice known as stranger-originated life insurance or "STOLI" .

ACLI opposes SB 3246 because it provides no protection 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 within 2 years but it can also be effected by the insured's irrevocably assigning a large percentage of the policy benefits within 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.

There are essentially two bills introduced this session which prohibit STOLI.

SB 3021 and HB 3099 enact the National Association of Insurance Commissioners ("NAIC") Viatical Settlement Model Act; and HB 94 enacts the National Conference of Insurance Legislators ("NCOIL") Life Settlement Model Act.

While each of the Model Acts approaches STOLI differently, both provide needed regulation of these practices.

ACLI strongly opposes SB 3246 because it does not address STOLI transactions.

The NAIC Model Act (SB 3021 and HB 3099) addresses STOLI transactions by prohibiting "viatical settlement contracts" at any time prior to policy issuance or within a 5 year period thereafter, unless otherwise exempted. 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 NCOIL Model Act prohibits "life settlement contracts" (which has a similar definition to the NAIC's "viatical settlement contract") prior to policy issuance or within 2 years, unless exempted. In addition, the NCOIL Act makes engaging in "Stranger-originated life insurance" 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.

SB 3246 contains a number of provisions similar to the NAIC Model Act, including the licensing of brokers who negotiate life settlement contracts and providers who effectuate the life settlement contracts with the owner. The Bill also prohibits entering into a "life settlement contract" prior to or within 2 years of policy issuance.

However, SB 3246 neither prohibits STOLI transactions as in the NCOIL Model Act nor does it include a 5 year moratorium on policy transfers as does the NAIC Model Act. Thus, SB 3246 invites rather than prohibits STOLI and legitimizes these predatory practices by unscrupulous companies wagering on human life.

For these reasons, ACLI requests that this Committee hold this bill.

Again, thank you for giving us the opportunity to testify in opposition to SB 3246.

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February 6, 2008

TO: Senator Russell S. Kokubun
Chair, Committee on Commerce, Consumer Protection, and Affordable
Housing
Via Email: testimony@capitol.hawaii.gov

FROM: Gary M. Slovin

RE: S.B. 3246 – Relating to Insurance
Hearing on Thursday, February 7, 2008 at 9:00 am

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

I am Gary Slovin appearing on behalf of the Life Settlement Institute (“LSI”) to comment on Senate Bill No. 3246 which creates a new part to Chapter 431, article 10D relating to life settlements. LSI’s membership consists of the leading life settlement providers in the life settlement industry.

Consistency in Premium Financing Provisions

While LSI broadly supports SB 3246, there are a few amendments that should be made to ensure conformity with certain provisions contained in the NCOIL Model Act that would result in increased transparency for consumers. The definition of “Life Settlement Contract” should be modified to be consistent with the language of the NCOIL Model Act relating to the costs incurred in a premium finance loan. In connection with making a premium finance loan, a lender may incur certain costs and expenses, such as closing costs, documentation fees, legal fees, collateral support fees and hedging costs that are properly charged to the borrower.

On page 10, line 1, subsection (1) should read as follows:

“The loan proceeds are not used solely to pay the premiums for the policy and any other costs or expenses incurred by the lender or borrower in connection with the financing;”

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Disclosure of Common Control

Additionally, LSI believes that the prohibition of common control between a broker and a provider (as called for in Sec. 431:10D--L (4) and (5) of SB 3246 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. 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 amendment:

On page 54, subsection (4) should read as follows:

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

On page 54, subsection (5) should read as follows:

“(5) With respect to any life settlement contract or insurance policy 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 purchaser, life settlement investment agent, financing entity, or related provider trust that is involved in such settlement contract, unless such relationship is disclosed to the owner.”

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Clarify STOLI Definition

SB 3246 contains no definition of Stranger Originated Life Insurance (“STOLI”), unlike that found in the NCOIL Model Act and in HB 94, HD 1, the House companion. It should be noted that this definition in the NCOIL Model Act was presented to the NCOIL Executive Committee literally at the very last minute, only one half hour before the final vote on approval of the Act, after more than a year of intense deliberations on its provisions. A primary mover on the NCOIL Executive Committee for the inclusion of a STOLI definition was Representative Damron of Kentucky, who, upon reflection, has decided that the definition in the NCOIL Model 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. The proposed definition is below and should be inserted on page 17, line 15 if the Committee so chooses.

“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. 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 those practices set forth in the definition of “Life Settlement Contract.”

Broker Disclosure

The proposed legislation is a significant step in pursuing consumer protection in the life settlement market and curbing improper transactions. In particular, Section 431:10D contains significant consumer protections in requiring both providers and brokers to make many disclosures to policy owners so that all facets of a life settlement transaction are as transparent as possible. In particular, Section 431:10D—H(c) requires that certain disclosures be made by a broker to an owner regarding compensation received by the broker in a life settlement transaction. As a result of this language included in the NCOIL Model Act, LSI members require the use of a broker disclosure form that has been submitted for approval in 23 states at this time.

Thank you for the opportunity to comment on this important matter.