AMERICAN COUNCIL OF LIFE INSURERS
TESTIMONY IN OPPOSTION TO HB 1439, RELATING TO INSURANCE

February 11, 2009

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

Dear Chair Herkes and Committee Members:

Thank you for the opportunity to testify in opposition to HB 1439, relating to Insurance.

Our firm represents the American Council of Life Insurers ("ACLI"), a national trade association whose three hundred forty (340) member company's account for 94% 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 fifty-three (253) ACLI member companies currently do business in the State of Hawaii.

Last session the legislature passed Act 177 which enacted into law the National Conference of Insurance Legislators ("NCOIL") Life Settlement Model Act.

In its current form the Act provides an effective tool in the regulation of stranger-originated life insurance or "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 relinquishing 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 relinquish 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 relinquish 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 opposes passage of HB 1439. Its objections include (but are not limited to) the matters set forth below.

HB 1439 weakens and does not prevent STOLI transactions.

As currently enacted, the law faithfully tracks the NCOIL Model Act and makes engaging in "STOLI" 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.

Paragraph 4 of Section 1 HB 1439 (page 6, lines 18 – 21, page 7 and page 8, lines 1 – 5 of the Bill) weakens the protections afforded to consumers by the Model Act against STOLI by changing its definition 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: (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 used to initiate policies for investors.~~(1) Means 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 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" does~~
> (2) Does not include the lawful assignment of a life insurance including a life settlement contract as defined in this chapter, or those practices set forth in ~~subsection (b)~~ paragraph (2) of the definition of "life settlement contract".

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

The original NCOIL definition of STOLI set forth in Paragraph 4 of section 1 (page 7, lines 1-9) includes within its definition "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", "whether verbal or written", to transfer the policy to the investor.

Removing these provision from the definition will limit whether an insurable interest exists in the applicant at the nanosecond of the "procurement" rather than whether the application and financing for and issuance of the policy was part of a "practice or plan" involving numerous parties including the investors and financiers who do not have insurable interest but ultimately enjoy most of the benefits of the insurance policy. The proposed language would prevent looking at the entire transaction by limiting the application of the law to a snapshot of a policy at the time of its "procurement" – even though the United States Supreme Court has made clear that if an entire "arrangement was a cover for a speculating risk, contravening the general policy of the law, it would not be sustained" (Warnock v. Davis, 104 U.S. 775, 779 (1881) (emphasis added)." And cases in which a person having an interest lends himself to one without any, as a cloak to what is, in its inception, a wager, have no similarity to those where an honest contract is sold in good faith." Grigsby v. Russell, 222 U.S. 149 (1911). And according to Webster's Ninth New Collegiate Dictionary, e.g., "arrange" means "plan", and "plan" means "an orderly arrangement..." According to Black's Law Dictionary, Fourth Edition, "plan" means "a method of action, procedure, or arrangement." In short, as NCOIL originally determined (without settlement industry objection), "plan" is the correct word.

Limiting the Model Act's provisions to "new life insurance" would enable the STOLI pay-off to investors after expiration of the two-year contestability period; and the deletion of the existing law's reach to "an arrangement or agreement, whether verbal or written" would create a loophole for verbal STOLI agreements.

Further, HB 1439 would exclude from the definition of STOLI a "lawful assignment of a life insurance (sic) including a life settlement contract" (page 8, at lines 1-5). This would prevent the regulator from characterizing other forms of transactions that are in substance STOLI transactions.

HB 1439's proposed amendment of a "life settlement contract" in Paragraph 3 of Section 2 of the bill (page 3, lines 7-9) would open the definition up to predatory finance arrangements typical in STOLI transactions.

Section 7 of HB 1439 which amends Section 431E-32, HRS (beginning on page 22, lines 19 -22 and page 23, lines 1-22), shifts the life settlement providers marketing and promotional costs to insurers under the guise of "consumer disclosure".

Where a senior (defined as 60 years or older) or terminally or chronically ill insured seeks to surrender his/her life insurance policy, secure an accelerated (discounted) death benefit, collaterally assign his/her policy for a loan or allow his/her policy to lapse, Section 7 of the Bill would require a life insurer to provide written notice that a life settlement of the policy is available to him/her as an alternative transaction.

Whether a life settlement is in the consumer's best interest is questionable.

Research reveals that for most seniors, a life insurance settlement may not make economic sense. Recent news reports indicate that life settlements are paying seniors only a fraction of the policy's face value, 5 to 8 cents on the dollar.

A Life Insurance Marketing and Research Association study found that only 10% of seniors who own a life policy might ever have an interest in a life settlement. Moreover, only 1-in-5 of those who are interested is a viable candidate. Yet all insurance consumers, including seniors and others having no interest in a life settlement would have to bear their share of the compliance costs.

Requiring life insurers and ultimately the consumer to bear the marketing cost of a life settlement where the settlement itself may not be in the consumer's best interest is simply a bad law.

ACLI strongly objects to the removal of the bill's fraudulent settlement acts in Section 8 of the Bill (page 24, lines 16-22, page 25, lines 1-22, and page 26, lines 1-5) and the proposed removal of an insurer's ability to test applications for insurable interest in Section 7 of the bill which deletes the first sentence in section 431E-32 (page 20, line 1-4).

ACLI strongly supported passage of the NCOIL Model Act last session in its entirety, without any changes. It is our belief that the current law is good law protecting all Hawaii insurance consumers and policy owners. Let it be.

For the foregoing reasons, ACLI respectively requests that this Committee withhold passage of HB 1439.

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House Committee on Consumer Protection and Commerce
Representative Robert Herkes, Chair

House Bill 1439 – Relating to Insurance

Hearing Date: Wednesday -- February 11, 2009 Time: 2:00 pm

Chair Herkes and Chair Karamatsu and members of the Committees, the National Association of Insurance and Financial Advisors (NAIFA) Hawaii is an organization made up of life insurance agents and financial advisors across Hawaii.

We oppose HB 1439. HB 1439 negates Act 177, 2008 Session Laws of Hawaii, (House Bill 94) that was passed last session as the "Life Settlements Act." Act 177 bans STOLI transactions for 2 years. HB 94 was NCOIL's life settlement model act to deter all manifestations of STOLI (stranger originated life insurance), 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.

HB 1439 through the various definitions contained in the bill will allow for stranger originated life insurance policies to be sold in Hawaii.

In its simplest terms, STOLI is a **plan** or **practice** to coax or entice someone to apply for a life insurance policy using fraudulent means for the benefit of speculators/investors who seek to profit by purchasing a life insurance policy on a stranger. Many STOLI transactions involve seniors, who can be victimized by participating in these transactions. Material facts and risks may be undisclosed.

In a traditional life insurance purchase, an **insurable interest** exists between the policyholder and the policy's named beneficiaries. For example, an individual has an insurable interest in his own life, in that of his spouse, and in that of his business partner. **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.

To the contrary, **in a STOLI transaction, there is no insurable interest.** Seniors are induced to purchase the life insurance, usually receiving some incentive, often a cash payment for buying the policy. In most cases, the "stranger" even pays the premium for the policy. Under the STOLI agreement, the policy is later "sold" to the stranger, who is paid the proceeds of the policy upon the death of the insured. The incentives, especially cash payments, used to lure seniors to participate in STOLI schemes are taxable as ordinary income. Stranger/investors will identify older, high-net-worth individuals. These senior individuals are targeted because of their relatively short life expectancy and their wealth qualifies them for substantial amounts of life insurance.

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.

Usually, in a life settlement transaction, 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).

From an insurance standpoint, STOLI threatens to undermine the life insurance market especially 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 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 will allow STOLI promoters to evade state insurable interest laws and violate the social purpose of life insurance.

We ask that this measure be held due to the detrimental effects on sound public policy. Thank you for allowing us to share our views.

Cynthia Hayakawa
Executive Director