HB 1439

Proposed SD1

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TO THE SENATE COMMITTEE ON
COMMERCE AND CONSUMER PROTECTION

TWENTY-FIFTH LEGISLATURE
Regular Session of 2010

Wednesday, March 31, 2010
10:00 a.m.

TESTIMONY ON HOUSE BILL NO. 1439, HD1, Proposed SD 1 – RELATING TO INSURANCE.

TO THE HONORABLE ROSALYN H. BAKER, CHAIR, AND MEMBERS OF THE COMMITTEE:

My name is J.P. Schmidt, State Insurance Commissioner, testifying on behalf of the Department of Commerce and Consumer Affairs ("Department"). The Department supports this bill which extends the Life Settlement Act for an additional five years. It is too early to determine conclusively the merits of the Act and therefore it is prudent to wait for more experience before determining whether to sunset the law.

That said, we wish to share two observations from our experience to date:

1. The reporting from life settlements provided to date shows that there are very few of these transactions occurring in Hawaii;
2. Life settlement transactions are essentially resale transactions and do not present the same issues for regulation as a typical complex insurance product;

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

AMERICAN COUNCIL OF LIFE INSURERS
TESTIMONY IN SUPPORT OF HB 1439, PROPOSED SD 1,
RELATING TO LIFE SETTLEMENTS

March 31, 2010

Via E Mail: cpntestimony@capitol.hawaii.gov
Honorable Senator Rosalyn H. Baker, Chair
Committee on Commerce and Consumer Protection
State Senate
Hawaii State Capital, Conference Room 229
415 S. Beretania Street
Honolulu, HI 96813

Dear Chair Baker and Committee Members:

Thank you for the opportunity to testify in support of HB 1439, Proposed SD 1, relating to Life Settlements.

Our firm represents the American Council of Life Insurers ("ACLI"), a national trade association whose three hundred (300) legal reserve life insurer and fraternal benefit society member companies operating in the United States account for over 90% of the assets and premiums of the U.S. life insurance and annuity industry. ACLI member company assets account for 93% of the life insurance premiums and 98% of the annuity considerations paid in the State of Hawaii. Two hundred thirty-six (236) ACLI member companies currently do business in the State of Hawaii.

In 2008 the legislature passed into law Act 177 which enacted the National Conference of Insurance Legislators ("NCOIL") Life Settlements Model Act (the "NCOIL Model Act") which became effective on June 16, 2008.

As of April 8, 2009, Hawaii was one of 13 states nationwide which had enacted laws that address Stranger Originated Life Insurance ("STOLI") – a growing predatory practice by investors who purchase life insurance on the lives of consumers, particularly elderly consumers, for profit. Of the 13 states that enacted STOLI legislation Hawaii was one of 7 states that adopted the NCOIL Model Act. The others are Arizona, Connecticut, Indiana, Kansas, Maine and Oklahoma. However, unlike any of these other states, unless Hawaii's legislature provides otherwise Hawaii's NCOIL Model Act is repealed this year effective June 16, 2010.

The law should not be repealed.

STOLI is morally wrong and wrong for the life insurance industry and consumers for the reasons stated in the attached Exhibit "A".

The NCOIL Model Act was carefully crafted by NCOIL. The Act was the product of intense discussion and debate that began nearly 2 years prior to its adoption by NCOIL. With the assistance and approvals of all stakeholders in the Life Settlement Insurance industry, including ACLI, National Association of Independent and Financial Advisors (NAIFA), Association of Advanced Life Underwriters (AALU), Life Insurance Settlement Association (LISA), Coventry, Institutional Life Markets Association (ILMA), Life Insurance Financing Association (LIFA) and Life Settlement Institute (LSI), the Act was adopted by NCOIL at its annual meeting on November 7, 2007.

While ACLI supports HB 261 (which was introduced last session that would make the law permanent and repeal the requirement that the insurance commissioner report annually to the legislature on the implementation and effects of the Act) ACLI is in strong support of HB 1439, Proposed SD 1. The proposed bill would extend the NCOIL Model Act's sunset provision for an additional 5 years. The Act would, therefore, sunset on June 16, 2015.

When the Model Act was unanimously adopted by its members, NCOIL's then President, Brian Kennedy, said of the Act:

> . . . [W]e believe that it is a strong model that protects the property rights of individual policyowners while addressing STOLI abuses.
>
> NCOIL believes the model act, as adopted at its 2007 Annual Meeting, will isolate and make illegal STOLI transactions through clear definitions, disclosures, and a strong penalties section. It includes a first-of its- kind definition of STOLI, and requires certain disclosures to owners and insurers as well as provider reporting of settled policies as part of an annual statement, and disclosure of broker compensation information.

Act 177 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.

The NCOIL Model Act 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.

The centerpiece of the Act's regulatory scheme is its definition as to what constitutes "Stranger Originated Life Insurance".

In a press release the executive director of the Life Insurance Settlement Association 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, 530 F. Supp.2d 646, (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.

ACLI strongly supports legislation which effectively deters STOLI transactions.

The protections afforded to consumers in preventing STOLI should not be taken away.

For all of the foregoing reasons, ACLI respectively requests that this Committee pass HB 1439, Proposed SD 1.

Again, thank you for giving us the opportunity to testify in support of proposed measure.

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EXHIBIT "A"

WHY STOLI IS WRONG

1. Wagering on the lives of people is wrong and harmful to consumers.

   - "Insurance" is defined as coverage by contract whereby one party undertakes to indemnify or guarantee another against ***loss*** by a specified contingency or peril". Investors' purchase of life insurance on a consumer's life for profit and not to compensate the consumer for loss to those having an interest in his continued good health is not "insurance".
   - STOLI violates the intended purpose of life insurance. Life insurance is designed to provide financial protection to an individual's family and estate and, in the case of a business, to compensate the business owner for the loss of its key employee in the event of his 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.
   - While the cost of life insurance continues to fall, STOLI enables investor groups to profit from the death of the insured. These profits may come at the expense of consumers as they may jeopardize consumers' ability to purchase affordable life insurance to provide financial protection for their families.
   - STOLI, if permitted by law, 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.

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

END OF EXHIBIT "A"

NAIFA
HAWAII Phone: 808-394-3451

Senate Committee on Commerce & Consumer Protection
Senator Rosalyn Baker, Chair
Senator David Ige, Vice Chair

House Bill 1439, HD 1, Proposed SD 1 – Relating to Insurance

Hearing Date: March 31, 2010 Time: 10:00 am

Chair Baker and members of the Committee, the National Association of Insurance and Financial Advisors (NAIFA) Hawaii is an organization made up of life insurance agents and financial advisors across Hawaii, who primarily sell life insurance, disability income and long term care insurance.

We strongly support HB 1439, HD1, Proposed SD 1. The proposed SD 1 will **repeal** the sunset provision in Act 177, 2008 Session Laws of Hawaii, (House Bill 94) that was passed in the 2008 legislative session as the "Life Settlements Act." Act 177 bans STOLI transactions for 2 years, until June 16, 2010. Act 177 is 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, HD 1, through the various definitions contained in the bill **will allow** for stranger originated life insurance policies to be sold in Hawaii after June 16, 2010.

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.

In a STOLI transaction, there is no insurable interest. Seniors are induced to purchase the life insurance, usually receiving some incentive. 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 — the 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 passed out to continue to protect our insurance consumers with principles designed to ensure that life insurance is used to protect the long-term interest of parties associated with the insured: families, businesses, business associates, and/or charities. Thank you for allowing us to share our views.

Cynthia Takenaka, Executive Director

**SENATE COMMITTEE ON
COMMERCE AND CONSUMER PROTECTION**

March 31, 2010

House Bill 1439, HD 1, Proposed SD 1 Relating to Insurance

Chair Baker and members of the Senate Committee on Commerce and Consumer Protection, I am Rick Tsujimura, representing State Farm Insurance Companies, a mutual company owned by its policyholders.

We support the extension of Act 177 (SLH 2008) until June 16, 2015.

Thank you for the opportunity to present this testimony.