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TWENTY-FIFTH LEGISLATURE
Regular Session of 2009

Friday, March 13, 2009
9:30 a.m.

TESTIMONY ON SENATE BILL NO. 53 – RELATING TO INSURANCE.

TO THE HONORABLE RYAN I. YAMANE, 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 this bill, which makes permanent the Life Settlements Act (the "Act") and removes the requirement for the Insurance Commissioner to report on the Act annually and recommend changes.

The Act was based on a model act from NCOIL and provides protections for consumers engaged in life settlements transactions, which can be complex to evaluate. These protections should be made into a permanent feature of the law. In 2008, we reported some of our technical concerns with the Act to the Legislature and we do not expect additional reports to be of significant value.

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

NAIFA
HAWAII

National Association of Insurance and Financial Advisors
516 Kawaihae Street, Suite E
Honolulu, HI 96825

House Committee on Health
Representative Ryan I. Yamane, Chair

Date of Hearing: March 13, 2009 **Time: 9:30 am**

RE: Senate Bill 53 – SCR 517: Relating To Insurance

Chair Yamane and members of the Committee, NAIFA Hawaii is an organization made up of life insurance agents who primarily sell life insurance, annuities, disability income, and long term care insurance throughout Hawaii.

We strongly support SB 53. This measure will repeal the requirement for the Insurance Commissioner to submit annual reports to the Legislature and **repeal the 2 year sunset enacted last session as Act 177**.

Act 177, (HB 94, HD1, SD2, CD1), the Life Settlement Model Act was adopted by the National Conference on Insurance Legislators ("NCOIL") 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. We are fine with life settlements under these circumstances.

However, there has been a new twist to life settlement policies -- stranger originated life insurance (STOLI) – which is banned in Act 177. SB 53 will continue to ban STOLI after the 2010 sunset provision.

STOLI policies are where investors with no insurable interest in the individual usually with high net worth, are initiating coverage on healthy older 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.

With this kind of "artificial" manufacturing of STOLI policies, they have an interest in the insured dying sooner than later. British law from the **1770s** required insurable interest in life insurance policies and has stood the test of time.

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, charities or a business entity as the beneficiary – this clearly explains the insurable interest for purchasing the policy.

We have always opposed efforts to expand state insurable interest laws to permit private investors to purchase life insurance on the lives of unrelated individuals purely for profit. 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.

Mahalo for the opportunity to share our views and we ask for your support in moving this measure forward.

Cynthia Hayakawa
Executive Director
Phone: 394-3451

AMERICAN COUNCIL OF LIFE INSURERS
TESTIMONY IN SUPPORT OF SB 53, RELATING TO INSURANCE

March 13, 2009

Via E Mail: hlttestimony@capitol.hawaii.gov
Honorable Representative Ryan I. Yamane, Chair
Committee on Health
State House of Representatives
Hawaii State Capital, Conference Room 329
415 S. Beretania Street
Honolulu, HI 96813

Dear Chair Yamane and Committee Members:

Thank you for the opportunity to testify in support of SB 53, 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 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 December 3, 2008, Hawaii is one of 13 states nationwide which have 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 these 13 states Hawaii is one of 7 states that enacted 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 next year effective June 16, 2010. Secondly, Hawaii's Insurance Division is required to deliver an annual report to the legislature on January 1 of this year and next year relating to (among other matters) the laws effectiveness in regulating STOLI.

The law should not be repealed and the reporting requirements by the Insurance Division are unnecessary.

The NCOIL Model Act was carefully crafted by NCOIL. Work on the Model Act began on March 7, 2007 and 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.

There are no provisions in the Act which would justify postponement of its permanent enactment until there is a track record of it effectiveness in preventing STOLI transactions.

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, 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.

The NCOIL Model Act is an effective tool in deterring STOLI.

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 SB 53, unamended.

Again, thank you for giving us the opportunity to testify in support of SB 53.

CHAR HAMILTON
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March 11, 2009

Representative Ryan I. Yamane, Chair
Representative Scott Y. Nishimoto, Vice Chair
Committee on Health
Hawaii State Capitol, Room 329
Honolulu, HI 96813

RE: SB53, Relating to Insurance

Dear Chair Yamane, Vice Chair Nishimoto and Members of the Committee:

Thank you for this opportunity to submit written testimony on SB53 which amends Act 177, Session Laws of Hawaii 2008 (Life Settlements Model Act) by repealing the requirement that the insurance commissioner report annually to the legislature on the implementation and effects of Act 177 and by making the Act permanent.

We support the language passed in HB 1439 HD1 which conforms more to the position of the National Conference of Insurance Legislators (NCOIL) and to the direction being taken in most states, and we respectfully urge that the language of SB 53 be amended to reflect that.

The Hawaii Life Settlements Act, HRS Chapter 431E (the "Hawaii Act") was based on the Life Settlements Model Act of the National Conference of Insurance Legislators (NCOIL), adopted in November 2007 (NCOIL Model Act). The following is a summary of proposed amendments to the Hawaii Act (as contained in HB1439 HD1):

1. Most of the proposed amendments are based on the 2008 laws adopted in Kansas, Indiana, Maine, Connecticut, Kentucky, Oklahoma and Arizona. Likewise, the proposed amendments are similar or legislation passed by the California General Assembly and by the New York Senate.

2. The key interested parties – life insurance and life settlement organizations – supported and endorsed laws that included amendments similar or identical to the proposed amendments. The American Council of Life Insurers (ACLI) issued public statements praising the new laws in most of the aforementioned states, and praised the California legislation.

3. The majority of the proposed amendments are technical amendments to the NCOIL Model Act, correcting several errors that impair the effectiveness or enforcement of the law, as well as several scriveners' errors.

4. The definition of Stranger-Originated Life Insurance (STOLI) is amended to improve the detection and enforcement against such practices and in light of several recent federal court decisions. In 2008 eight state legislatures acted to amend the NCOIL Model Act definition. In particular, STOLI is

defined as the procurement of new life insurance BY a stranger (rather than by a person with an insurable interest) and not the lawful assignment of a life insurance policy.

5. The proposed amendments include measures to protect the property rights of Hawaii's life insurance policyowners and responds to documented evidence of anti-consumer market conduct of life insurers that impairs policyowners' access to information and assistance about the value of their life insurance and about life settlements. The proposed amendments:

    a. Ensure that policyowners are aware of the market value of their life insurance policy whenever they are faced with the lapse or surrender of the policy and under other limited circumstances;
    b. Ensure that policyowners are able to receive information and assistance from their trusted life insurance agent, as the law currently prescribes life agents are authorized and qualified to assist policyowners with life settlements;
    c. Prohibit life insurers from interfering with Hawaii consumers' property right to assign their life insurance, including life settlements, or from issuing false and misleading information about life settlements.

6. The proposed amendments clarify the Hawaii Legislature intent under the current law that duly licensed life insurance producers are deemed to meet all the requirements as a settlement broker, provided that they notify the Commissioner and acknowledge that they will comply with the provisions of this Act. Contrary to the Hawaii Act, the NCOIL Model Act and the model act of the National Association of Insurance Commissioners, the Department of Insurance has not followed this mandate and has required duly licensed life insurance producers to submit full applications for a life settlement broker license, which has resulted in a restriction on the availability of life settlements to Hawaii consumers.

Thank you for your consideration of these comments. We urge you to amend SB53 with these proposed amendments.

Respectfully Submitted,
Michael Freedman
Senior Vice President, Government Affairs

LIFE INSURANCE AND PROPERTY RIGHTS IN HAWAI'I LAW

Introduction/Summary

Hawai'i law is clear with respect to life insurance, insurable interest, and property rights, explicitly recognizing that:

- Any person may take out a policy on his own life and do with it as he pleases.
- Any other potential policyowner must have a valid insurable interest, which attaches specifically at policy inception in order for the arrangement to be valid.
- Once properly formed with insurable interest, the owner may alienate the policy on the open market to whomever she wishes for the best price available, regardless of whether the purchaser has an insurable interest or not.
- Life insurance policies are to be treated like other property in order to maximize their value for consumers.
- Wager policies where in investor funds premiums and takes control of the death benefit from policy inception are against public policy.

This is no academic concern. As many as 90% of life insurance policies lapse without paying a claim, and many policies marketed as an investment are, according to a leading life insurance industry actuary, sold with "grossly inadequate" cash surrender values. The secondary market remedies this market defect for the benefit of consumers by allowing them to capture the true value of their policies created by their premium payments. Legislation regulating this market should foster rather than impede the exercise of these property rights.

The Insurable Interest Statute Attaches At Policy Inception Only

The Hawai'i insurable interest statute allows any person to take out a policy on his own life and do with it as he pleases. HI Stat. § 431:10-204(a) ("Any individual of competent legal capacity may procure or effect an insurance contract upon the individual's own life or body for the benefit of any person.")

The statute requires that, in order to take out a contract on another, the purchaser must have insurable interest. This requirement explicitly only attaches at policy inception. HI Stat. § 431:10-204(b) ("No person shall procure or cause to be procured any insurance contract upon the life or body of another individual unless the benefits under the contract are payable to the individual insured or the insured's personal representatives, or to a person having, ***at the time the contract was made***, an insurable interest in the individual insured") (emphasis added).

Insurable interest in Hawai'i is statutory and mirrors the categories in the common law and other States' statutes, including "individuals related closely by blood or law"; individuals with "a lawful and substantial economic interest in having the life ... of the individual insured continue"; business partners; and certain charities. *See* HI Stat. § 431:10-202.

The Well-Established Property Rights In A Life Insurance Policy In Hawai'i

The property rights in a life insurance policy were established nearly a century ago by Hawai'i's highest court. Citing and quoting at length the seminal U.S. Supreme Court case of *Grigsby v. Russell*, Hawai'i's high court explained:

> In *Grigsby v. Russell*, 222 U.S. 149, 154, the court says: "Of course the ground suggested for denying the validity of an assignment to a person having no interest in the life insured is the public policy that refuses to allow insurance to be taken out by such persons in the first place. A contract of insurance upon a life in which the insured has no interest is a pure wager that gives the insured a sinister counter interest in having the life come to an end. * * * But when the question arises upon an assignment it is assumed that the objection to the insurance as a wager is out of the case. * * * This being so, not only does the objection to wagers disappear, but also the principle of public policy referred to. * * * The danger that might arise from a general license to all to insure whom they like does not exist. Obviously it is a very different thing from granting such a general license, to allow the holder of a valid insurance upon his own life to transfer it to one whom he, the party most concerned, is not afraid to trust. * * * So far as reasonable safety permits it is desirable to give to life policies the ordinary characteristics of property."
>
> If a man can assign a policy of life insurance to one having absolutely no interest in his life, it would be absurd to assert that a man may not insure his own life in favor of one who has no insurable interest in it. This conception of the position of the parties is fully sustained by the authorities.

Rumsey v. New York Life Ins. Co., 25 Haw. 141 (1919).

The Practical Importance Of Property Rights As A Remedy To Insurers' Anti-Consumer Cash Surrender Practices

By specifically quoting *Grigsby's* key formulation that "[s]o far as reasonable safety permits it is desirable to give to life policies the ordinary characteristics of property," Hawai'i law has long established the basic property rights in a life insurance policy which form the legal and intellectual underpinnings of the secondary market for life insurance.

This market has sprung to life in an institutional manner in the last decade as life insurers began to emphasize sales of products with, as a leading insurer actuary described it, "grossly inadequate cash values." This is of great practical importance, because it is estimated that as many as 90% of life insurance policies lapse without paying a claim, leaving the consumer with only cash value—or the opportunity to seek market value through a life settlement.

In an influential article published in 2000 in *Best's Review*, Northwestern Mutual chief actuary William Koenig explained that it has become common in many life insurance products for "someone who surrenders a cash-value policy in the early years [to] receive[ ] a cash value (or nonforfeiture benefit) far less than premiums paid." These policies "depend on lapse-supported pricing," a "pricing method ... unfair to consumers" since "[t]he vast majority of policyholders who lapse their policies before death are the 'losers.' They receive much less at surrender than what any reasonable person would perceive as acceptable value."

Koenig warned that—because of the market defect caused by insurers' "unfair" treatment of consumers—policyowners would seek a market solution which would allow them to receive a fair return on their investment. "The current environment suggests that if an issuing company does not provide fair value, policyholders will proceed directly to a secondary market—presumably, a viatical company—to get a better deal. There will be a secondary market for these contracts, and this will not be good for

the life insurance industry."

That is precisely what has happened. Responding to consumer demand, the secondary market is now well established, paying out billions of dollars a year over cash surrender value to consumers who would otherwise have lapsed their policies. Consumers have benefited from competition, and life insurers have lost a source of profits (lapsed policies where they pay out no death benefit and instead a "grossly inadequate" cash surrender). This explains why carriers are today seeking protectionist legislation from the States to, in effect, codify their "unfair" practices by insulating them from competition from the secondary market. These efforts by life insurers should be rejected because regulation of commerce in the public interest is supposed to remedy—not perpetuate—market defects.

Ensuring Property Rights While Preventing Wager Policies

Good legislation would give honor to both of the key instructions in *Grigsby v. Russell*, the recognized law of the land passed down by the U.S. Supreme Court and specifically followed by Hawai'i courts.

In *Grigsby*, Justice Oliver Wendell Holmes aggressively articulated the importance of recognizing and honoring the property rights in a life insurance policy—key to which, he said, is the ability to alienate the policy on the open market to any willing buyer, regardless of that purchaser's insurable interest.

> [L]ife insurance has become in our days one of the best recognized forms of investment and self-compelled saving. So far as reasonable safety permits, it is desirable to give to life policies the ordinary characteristics of property.... To deny the right to sell except to persons having such an [insurable] interest is to diminish appreciably the value of the contract in the owner's hands.

Grigsby v. Russell, 222 U.S. 149.

Holmes also reaffirmed the importance of insurable interest at policy inception as a means of preventing wager policies which are against public policy. "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." *Id.* Holmes explained what constitutes "a cloak to what is, in its inception, a wager": "the policy having been taken out for the purpose of allowing a stranger association to pay the premiums and receive the greater part of the benefit, and having been assigned to it at once." *Id.*

The National Conference of Insurance Legislators (NCOIL), in its recently adopted amendments to its Life Settlements Model Act, specifically codified this formulation of what constitutes a violation of insurable interest, and otherwise followed *Grigsby's* teachings. Legislation in Hawai'i should likewise codify these established rules, best articulated by the U.S. Supreme Court, pertaining to insurable interest and property rights:

- The law should foster, rather than impede the principal that life insurance policies should be given "the ordinary characteristics of property."

- Limiting the right of resale "is to diminish appreciably the value of the contract in the owner's hands."

- Schemes where investors pay premiums and receive immediate assignment of the policy are "a cloak to what is, in its inception, a wager."

STATE STATUS AS OF DECEMBER 8, 2008

- THE **OVERWHELMIING MAJORITY OF STATES** that have taken up life settlement/anti-STOLI legislation in 2008 **CONSIDERED AND REJECTED THE NAIC MODEL and ADOPTED NCOIL MODEL BASED PROVISIONS**. According to an October 2008 report by the NAIC, of twenty six states that introduced settlement/anti-STOLI legislation in 2008, only two adopted the NAIC Model Act.

- The NCOIL Model or NCOIL Model provisions that were adopted in 2008 were almost universally amended to strengthen the administration and enforcement of the laws and to address scrivener's errors and operational matters.

- THE ACLI and its subsidiary organizations supported nearly every bill that adopted the NCOIL Model or amended NCOIL Model provisions.

- A growing number of state insurance regulators have supported the adoption of the amended NCOIL Model or amended NCOIL Model Provisions, including Kansas, Connecticut, Indiana, Maine, Kentucky and Rhode Island. Likewise, the insurance regulators in New York, Washington State, Idaho and the District of Columbia rejected the 5 year ban while supporting other NAIC provisions.

- The so-called "new NAIC/NCOIL" or "hybrid" bill is like lipstick on a pig, since the NAIC Model was a near total failure in 2008 because it is anti-consumer and protectionist, as has been determined by NCOIL members, the NAIC's own consumer advocates and numerous state legislatures.

TO DATE in 2008:

NCOIL Bills that PASSED:

Kansas, Indiana, Maine, Connecticut – Introduced NAIC Model, but passed NCOIL anti-STOLI provisions.

Hawaii – Introduced NAIC Model, but passed NCOIL Model.

Oklahoma – Introduced NAIC Model, but passed NCOIL anti-STOLI provisions.

Kentucky – Introduced and passed NCOIL Model provisions.

Arizona – Introduced NCOIL STOLI definition, passed amended STOLI definition.

Rhode Island – Introduced NCOIL; Passed with no amendments. Vetoed.

California – Introduced NCOIL Model; PASSED BOTH CHAMBERS, Vetoed

NAIC and so-called "hybrid" Bills:

Nebraska and West Virginia – Introduced and passed NAIC Model without consideration of NCOIL model.

Ohio and Iowa – Adopted NAIC with NCOIL provisions. Ohio's 5 year ban unique (not NAIC).

Other 2008 Action to date (including actions for 2009):

New York – NY Insurance Superintendent introduced a unique bill with no 5 year ban; Senate Passed modified NCOIL bill; Identical Bill on the Floor of the Assembly, awaiting a vote.

Georgia – Introduced NCOIL; Passed Senate; no action in House; modified bill expected for 2009.

Washington – Introduced NCOIL; Held for consideration; NCOIL modified bill pending for 2009.

North Carolina – Introduced NAIC in 2007, died in committee; in 2008 attempted NCOIL without amendments and bill was not heard by the committee.

Massachusetts – NAIC introduced and study bill introduced – both sent to study till 2009.

District of Columbia – Commissioner introduced NAIC Model, without the 5 year ban or anti-premium finance provisions; strong consumer protections. Did not pass. NCOIL to be introduced in 2009

Illinois and Minnesota– Both NAIC and NCOIL introduced; no action taken.

Idaho – Commissioner proposing NAIC without 5 year ban or anti-premium financing provisions for 2009.

Wyoming – Interim Committee rejected hybrid for 2009.

Arkansas – Department rejected NAIC and is proposing NCOIL for 2009.

Utah – Interim Committee pulled hybrid bill from consideration for 2009.

Alaska – Department proposed 5 year ban; Department pulled regulation.

Wisconsin – Department proposed hybrid for 2009; pulled from immediate action pending further study.