Approved: 3-18-08

Date

MINUTES OF THE SENATE FINANCIAL INSTITUTIONS AND INSURANCE COMMITTEE

The meeting was called to order by Chairman Ruth Teichman at 9:30 A.M. on February 25, 2008 in Room 136-N of the Capitol.

All members were present.

Committee staff present:
Melissa Calderwood, Kansas Legislative Research Department
Ken Wilke, Office of Revisor of Statutes
Bev Beam, Committee Secretary
Jill Shelley, Kansas Legislative Research Department

Conferees appearing before the committee:
Jim Hall; ACLI
Michael Freedman, Life Settlement Institute
Steve Washington, Life Settlement Institute

Others attending:
See attached list.

Hearing on:

Continued hearing on: **SB 624 - concerning viatical settlements**

The Chair called the meeting to order. Jim Hall, Regional Vice President, American Council of Life Insurers (ACLI), testified in support of SB 624 and in opposition to SB 601. Mr. Hall stated that unlike SB 624, which contains a combination of amendments developed by the NAIC and NCOIL for the purpose of stopping a practice known as "stranger originated life insurance" or STOLI, SB 601 is a group of amendments developed by the life settlement industry for the purpose of thwarting the prevention of STOLI and instead, ensuring STOLI's continued existence. Mr. Hall continued that both SB 624 and SB 601 offer amendments to Kansas' existing viatical settlements act, which is the 2000 version of the NAIC Viatical Settlements Model Act. The difference is, he said, SB 624 incorporates the latest consumer protection and STOLI prevention amendments developed by the NAIC and NCOIL. SB 601 does not. Instead, SB 601 omits the consumer protections and offers a definition of STOLI that merely restates existing law, thereby preserving the ability of STOLI perpetrators to stay in business by continuing to circumvent current law. (Attachment 1)

Michael Freedman, Senior Vice President, Coventry, testified in opposition to SB 624 and in support of SB 601. Mr. Freedman said based on key provisions from the well-regarded model act of the National Conference of Insurance Legislators (NCOIL) it is a focused approach to concerns about stranger-originated life insurance (STOLI). SB 601 protects citizens against STOLI while preserving the property rights of Kansas insurance policy owners. SB 601 attacks STOLI while preserving the current settlement law that has demonstrably protected consumers who exercise their lawful right to sell their policy in a competitive market. He noted that if the motivation of SB 624 is consumer protection in life settlements, the change in law is not needed, as the current law is working to protect consumers. If the motivation is to stop STOLI, SB 624 fails in that regard, as it is based on the model of the National Association of Insurance Commissioners (NAIC), which model has been criticized by state legislators, by the NAIC's own insurance consumer advocates and by the life insurance industry's own trade association. He said a radical rewriting of the Kansas settlement law in the name of STOLI or consumer protection is simply not warranted. (Attachment 2)

Steven L. Washington, Managing Director of Business Development Life Equity, LLC, on behalf of The Life Settlement Institute, testified in opposition to SB 624 and in support of SB 601. Mr. Washington said while LSI believes SB 624 has some commendable improvements to add to Kansas' life settlement statute, we, both Life Equity and the other members of LSI, have significant concerns about certain provisions contained in SB 624. He continued that they also have concerns with other provisions that might appropriately be considered "technical amendments." (Attachment 3)

CONTINUATION SHEET

MINUTES OF THE Senate Financial Institutions and Insurance Committee at 9:30 A.M. on February 26, 2008 in Room 136-N of the Capitol.

Following Q & A, the Chair said she has asked that SB 601 and SB 624 be blessed in an attempt to reach an agreement or compromise between the parties before these bills are worked.

The meeting adjourned at 10:30 a.m.

SENATE FINANCIAL INSTITUTIONS & INS. COMMITTEE
GUEST LIST

DATE: 2-25-08

NAME	REPRESENTING
Jim Hall	ACLI
Bruce Ferguson	ACLI
Alex Kotoyantz	P.I.A.
Ron Hein	LSI
Steve Washington	Life Equity / LSI
Jeff Bottenberg	ACLI
John Meetz	KID
Michael Freedman	Coventry
Bill Sneed	AVIVA
Sonya Allen	OSBC
[illegible]	KSC
Dan Murray	Federico Consulting

Financial Security. For Life.

James D. Hall
Regional Vice President, State Relations

STATEMENT OF THE AMERICAN COUNCIL OF LIFE INSURERS

SENATE FINANCIAL INSTITUTIONS AND INSURANCE COMMITTEE

SENATE BILL 601

FEBRUARY 25, 2008

Madam Chair and members of the committee, my name is Jim Hall. I am a regional vice president of the American Council of Life Insurers (ACLI), a national trade association whose 353 members hold 93 percent of the life insurance in force in America today. I am here to testify in opposition to Senate Bill 601.

Unlike Senate Bill 624, which contains a combination of amendments developed by the NAIC and NCOIL for the purpose of stopping a practice known as "stranger originated life insurance" or STOLI, Senate Bill 601 is a group of amendments developed by the life settlement industry for the purpose of thwarting the prevention of STOLI and instead, ensuring STOLI's continued existence.

Both SB 624 and SB 601 offer amendments to Kansas' existing viatical settlements act, which is the 2000 version of the NAIC Viatical Settlements Model Act. The difference is, SB 624 incorporates the latest consumer protection and STOLI prevention amendments developed by the NAIC and NCOIL. SB 601 does not. Instead, SB 601 omits the consumer protections and offers a definition of STOLI that merely re-states existing law, thereby preserving the ability of STOLI perpetrators to stay in business by continuing to circumvent current law.

The SB 601 definition of "STOLI" merely re-states existing insurable interest law and deviates from SB 624's NCOIL Model definition in several dangerous ways.

The definition in SB 601 would reduce the scope of the legislation to an evaluation of whether an insurable interest exists for the applicant at the moment the life insurance is procured rather than looking at whether the application, the financing and the 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 who ultimately enjoy most of the benefits of the insurance policy. SB 601's definition of STOLI would reduce the law's ability to evaluate the entire transaction and would instead merely judge a snapshot of the policy at "procurement" – even though the US 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

F I & I Committee
February 25, 2008
Attachment 1

faith." *Grigsby v. Russell*, 222 U.S. 149 (1911). The sham sought to be protected by the deviant definition is the hiding of false insurable interest at procurement by a false alternative contract involving premium financing. An "alternative contract" is "A contract in which the performing party may elect to perform one of two or more specified acts to satisfy the obligation; a contract that provides more than one way for a party to complete performance, usually permitting that party to choose the manner of performance." (Black's Law Dictionary 7th Ed.). The false alternative is for the applicant to either pay the finance loan off in 26 months from "procurement" or assign the policy as satisfaction for the debt. The alternatives are false because (1) the loan repayment costs are at predatory rates that compel policy transfer; (2) the 26 months of "insurance" are provided "free"; together proving that (3) there was never a genuine intent to obtain the policy for insurance purposes but merely speculative purposes. The Internal Revenue Service refers to these kinds of schemes as "step transactions" because they step the evidence of legal violations away in time from *when* authorities would look for fraud, i.e., the moment of "procurement".

The additional proposed limitation of the definition of STOLI to only a "new life insurance policy" would create a loophole by which the trigger event for STOLI pay-off to investors – which typically occurs upon expiration of the two-year contestability period – would arguably not pertain to a "new" policy but rather an existing policy.

SB 601 lacks SB 624's STOLI stopping 5-year moratorium on life policy settlements.

The NAIC's 5-year moratorium on policy settlements is the most effective anti-STOLI provision. It creates framework for life policy settlements that STOLI providers can't avoid. The 5- year moratorium operates from the standpoint that all settlement transactions are prohibited for five years, except those set forth in the exceptions. This closes the door to STOLI perpetrators' ability to circumvent the law. The reason the 5-year moratorium replaced the existing 2-year moratorium is because insurance regulators discovered that STOLI perpetrators were taking advantage of the 2-year moratorium by structuring their life settlement transactions to occur immediately after the 2-year moratorium had expired. By extending the moratorium to 5 years, the insurance regulators created an economic disincentive. STOLI perpetrators had demonstrated a willingness to wait two years to capture the death benefit; that is, investors are willing to risk capital for two years before realizing a return. Or, put another way, investors are willing to bet on a 75-year-old for two years. But, the odds that the 75-year-old will live to 80 are too long for investors; hence, the effectiveness of the 5-year moratorium. Of course, the 5-year moratorium contains consumer protective exceptions that preserve legitimate life settlements. Thus, the only transactions left to be prohibited are STOLI transactions.

The SB 601 definition of "viatical settlement contract" creates a loophole for affiliates and endangers insurance certificateholders.

The omission of inclusion of "a viatical settlement provider or affiliate establishing the terms etc..." (s.1(o)(1)) allows providers to establish affiliates to evade regulation. The omission of group insurance certificate holders from "...expected death benefits of the policy or certificate, in return for etc..." (s.1(o)(1)) invites providers to target group life certificate holders for evasion of regulation.

The SB 601 definition of "viatical settlement contract" creates a loophole for predatory financing STOLI.

The omission in s.1(o)(2)(C) of "...by the lender, provided that neither the default itself nor the transfer of the policy in connection with such default is pursuant to an agreement or understanding with any other person for the purpose of evading regulation under this act..." is contrary to the official guidance of the United States Office of the Comptroller of the Currency (OCC), the NCOIL Model and the NAIC Model. In contrast, SB. 624 gets it right at s. 5(p)(2)(C).

SB 601 hides STOLI from the Insurance Commissioner.

How much STOLI is happening in Kansas? SB 601's omission of provider data reporting hides STOLI from detection. Cf. SB. 624 s.7(a).

Consumer Protections Lacking

SB 601 is substantially inferior to SB 624 because it omits important consumer protections as follows:

- No fiduciary protections for consumers settling their policies[1]
- Insufficient consumer rescission rights for "settler's remorse"[2]
- Permits strangers to do health check contacts with consumer[3]
- No protection from moving the proceedings to avoid Kansas law[4]
- No consumer anti-gouging protection by settlement brokers and providers[5]
- No notice to consumer of policy ownership/beneficiary changes made by the viatical settlement provider[6]
- No protection for predatory practices against senior citizens' retirement funds[7]
- No payback to consumers ripped off by STOLI scams.[8]

There are provisions in SB 624 that provide consumer protections in all these areas. For the forgoing reasons, the ACLI opposes SB 601 and we urge the Committee to vote "No" on this bill.

---

[1] Cf. S. 624 s.8(a)(2) and also s. 8(b)(3)(C)
[2] Cf. S. 624 s.8(a)(6) enhancing consumer rescission right to 60 days.
[3] Cf. S. 601 s.2(a)(10) with S.624 s.8(a)(11) (consumers should be contacted only by licensed providers)
[4] Cf. S. 624 s.5(f)(5)
[5] Cf. S. 624 s. 8(b)(3)(B) and (D) and (E). Cf. S. 601 s.2(b)(3). The broker compensation disclosure should be in writing and in detail to protect consumers from predatory gouging.
[6] Cf. S. 624 s.8(b)(7)
[7] Because S. 601 sets senior citizens up as victims by excluding "accredited investors" from protection: See S. 601 s.1(q)(2) exclusion of "accredited investors" from definition of "viator". An "accredited investor" is a person with net worth greater than $1m – an amount often enjoyed by senior citizens with retirement funds who happen to be exactly the target of STOLI promoters. See also the dangerous inclusion of "accredited investors" as potential "viatical settlement purchaser" at S. 601 s.1((s)(2) – setting up the same targets for <u>investor</u> abuse. In contrast, S. 624 protects senior citizen "accredited investors".
[8] S. 601 completely fails to require providers to provide surety bond protection to consumers. Cf. S. 624 s.6(j) & (k).

Testimony of

Michael D. Freedman

Senior Vice President

Coventry

to the

Senate Financial Institutions and Insurance Committee

Kansas State Senate

Regarding

S.B. 601 and S.B. 624

Monday, February 25, 2008

FI & I Committee
February 25, 2008
Attachment 2

INTRODUCTION

Madam Chair and members of the committee, thank you for the opportunity to testify today on S.B. 601 and S.B. 624, introduced to make changes to the law governing viatical settlements. My name is Michael Freedman, Senior Vice President of Coventry, a leader of the secondary market for life insurance. Coventry is responsible for creating a marketplace where policyowners can sell unneeded or underperforming life insurance policies for more than cash value. As a result of our efforts, in just over six years, our company has paid consumers $1.5 billion over cash surrender value for policies that were no longer needed.

I am here to testify in opposition to S.B. 624 and in support of S.B. 601. In summary, S.B.601, based on key provisions from the well-regarded model act of the National Conference of Insurance Legislators (NCOIL) is a focused approach to concerns about stranger-originated life insurance (STOLI). S.B.601 protects citizens against STOLI while preserving the property rights of Kansas insurance policyowners. S.B.601 attacks STOLI while preserving the current settlement law that has demonstrably protected consumers who exercise their lawful right to sell their policy in a competitive market.

If the motivation of S.B. 624 is consumer protection in life settlements, the change in law is not needed, as the current law is working to protect consumers. If the motivation is to stop STOLI, S.B. 624 fails in that regard, as it is based on the model of the National Association of Insurance Commissioners (NAIC), which model has been criticized by your fellow state legislators, by the NAIC's own insurance consumer advocates and by the life insurance industry's own trade association.

A radical re-writing of the Kansas settlement law – in the name of STOLI or consumer protection is simply not warranted.

WHAT IS – AND WHAT IS NOT – INVESTOR-INITIATED LIFE INSURANCE?

Underlying S.B. 601 – and purportedly S.B. 624 – are concerns about Stranger-Originated Life Insurance (STOLI). As the name accurately describes it, STOLI is the origination – or initiation – of life insurance policies by persons who lack the requisite insurable interest in the insured whose life will be the subject of a life insurance policy.

STOLI is NOT the lawful assignment of a policy – either in a life settlement or as collateral to secure a loan. Likewise, STOLI is not the intent of a lawful policyowner to lawfully assign her policy. S.B. 624 would impair Kansas policyowners' lawful assignment of a life insurance policy and punish the educated and informed consumer who evidences an awareness of the secondary market.

The Kansas insurance code, backed by bedrock common law, grants an individual an unlimited interest in her own life to take out a policy on herself and do with it as she pleases. *See* KS Stat. 40-450 ("Life insurance; insurable interests," instructing that "A person of competent legal capacity may insure such person's own life and, either at the time the contract of insurance is entered into or thereafter, name any person as the beneficiary thereof irrespective of whether the person named has an insurable interest in the life of the insured."); *Hoffman v. Federal Reserve Life Ins. Co.*, 123 Kan. 554 (1927) (Ruby C. Hoffman O'Donnell had an insurable interest in her own life, and, in the absence of any statute, or of any bylaw, rule, or other provision of the insurance company to the contrary, she could, acting in good faith, take out a policy of insurance upon her own life and name whom she pleased as beneficiary. In 37 C. J. 389, the rule is thus stated: 'A person may in good faith and without fraud, collusion, or an intent to enter into a wagering contract, lawfully take out a policy of insurance on his own life and make the benefit payable to whomsoever he pleases, either himself or his estate or a third person, regardless of whether or not the latter has an insurable interest; insured has an unlimited insurable interest in his own life which is sufficient to support the policy.'")

The insurance code also explicitly requires that insurable interest apply – but only at policy inception and not thereafter. *See* KS Stat. 40-453(a), "Life insurance; insurable interest" ("Determination of the existence and extent of the insurable interest under any life insurance policy shall be made **at the time the contract of insurance becomes effective but need not exist at the time the loss occurs**." (emphasis added)).

As such, any policy taken out by a person who lacks insurable interest in the insured is STOLI. But a lawful policyowner who names a beneficiary who lacks insurable interest is not STOLI.

And, most importantly, the lawful policyowner who lawfully assigns her policy is not STOLI. As expressly provided in your law, a lawful owner of a life insurance policy has the contractual and property right to assign that policy to any person – that is a life settlement. It is not and cannot be STOLI.

Where SB601 properly addresses concerns about STOLI where they occur – at the inception of a policy, SB624 improperly attacks the property rights of all Kansans by directly restricting the rights of most all policyowners, in a poorly designed effort to indirectly get at some investors who might be manufacturing policies.

KANSAS LAW SUPPORTS THE PROPERTY RIGHT OF ASSIGNMENT OF LIFE INSURANCE

The Kansas courts have aggressively protected the right of assignment. As recently as 2000, a Kansas appeals court stated that:

> "[n]o law shall be construed as prohibiting a person whose life is insured under an individual life insurance policy from making an assignment of all or any part of his or her rights and privileges under such policy" and that "[n]either K.S.A. 40-434, K.S.A.1999 Supp. 40-435, nor any other law shall be construed as prohibiting a person whose life is insured under an individual life or accident and health policy from making an assignment of all or any part of his or her rights and privileges under such policy." *Johnson County Bank v. Ross*, 28 Kan.App.2d 8 (Kan. App. 2000).

Kansas courts have also specifically recognized that assignments may be for consideration and as collateral for a loan. Quoting from several decisions of Kansas courts:

> "The petition alleged that, for a valuable consideration, the policy had been assigned by John C. Spickler to the plaintiff. ... The insured assigned the policy.... The policy is of such a nature that the insured had absolute control over it until the time of his death so far as the beneficiaries are concerned. At that time, he had done what he could to assign the policy to the plaintiff. The assignment was made for a valuable consideration." *Elmore v. Continental Life Ins. Co.*, 131 Kan. 335 (Kan. 1930)
>
> "Each of the policies expressly recognized the right of the insured to make an assignment.... It is well established that policies such as these may be assigned by the insured during his lifetime. *Shawnee State Bank of Topeka v. Royal Union Life Ins. Co. of Des Moines, Iowa*, 127 Kan. 456 (1929)
>
> "It is familiar law that .... a policy of insurance may be pledged or assigned to a creditor as security for a debt.". *Bank of Idana v. Illinois Life Ins. Co.*, 135 Kan. 129 (1932)

THE LIFE SETTLEMENT MARKET

It is this right of assignment – to any person – that establishes the true market value of life insurance and has been the basis of a burgeoning life settlement marketplace. Life insurance policyowners can – and are – selling their policies in a growing competitive market.

Almost 9 of 10 of life insurance policies that are issued never end in a claim. That means that nearly ninety percent of all policyowners never collect their benefit. Historically, these policies were either surrendered to the insurance company for a price called "cash

surrender value." Or they are lapsed, in which case the consumer just stops paying premiums and receives nothing at all. Truly, consumers had no good choices.

Over six years ago, Coventry started buying these policies. We determined that many policies that were being surrendered or lapsed carried much more value than was being recognized by the insurance companies. By offering consumers significantly more than surrender value, we created a free market for life insurance policies. Suddenly life insurance had a market value.

Now, policyowners can access the market value contained within their policy – significantly more than cash value. To date, we have purchased over $11 billion in face amount and delivered more than $1.5 billion over cash surrender value to consumers.

Concerns about higher rates resulting from the growth of the secondary market is empirically erroneous: The secondary market has been strong and growing for nearly a decade—during which time life insurance rates have gone down or stayed the same. And it serves to obscure the real issue: The natural result of secondary market competition is reduced insurer profits and higher cash surrender values, both of which are good for consumers.

In an article, by Northwestern Mutual Chief Actuary William Koenig, explained that life insurers' heavy reliance on most policies lapsing without paying a claim is an extraordinarily anti-consumer development in the history of life insurance:

> The major consumer beef about permanent life insurance involves early surrenders. Since the mid-1990s, the Consumer Federation of America and others have decried the "billions of dollars" that consumers waste on cash-value life insurance when they terminate early. The consumerists' point is that someone who surrenders a cash-value policy in the early years receives a cash value (or nonforfeiture benefit) far less than premiums paid....
>
> These policies ... have an Achilles' heel. [T]he policies depend on lapse-supported pricing, a pricing method facilitated by the absence of nonforfeiture requirements. This pricing method is unfair to consumers....
>
> Simply put, companies count on policies to lapse in order to support those that don't....
>
> The 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....

> Some permanent policies are being sold with grossly inadequate cash values.

Koenig concluded that products aggressively marketed by carriers today—which produce low cash surrender values for the enormous majority of those policyowners who never receive a death benefit—are a modern tontine. In doing so, he accurately predicted that the secondary market would grow rapidly as a market based response to consumer demand for fair treatment.

> Lapse-supported pricing already has been 'field tested' in the United States, and it didn't work then, either. The tontines of 100 and more years ago were also built on lapse-supported pricing. These policies ... provided nonforfeiture benefits only to survivors who lived to the end of a certain period of time. The consumer dissatisfaction they generated contributed to the 1905 Armstrong investigation, which led to stricter supervision by New York and other state insurance departments.
>
> 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.

Unfounded warnings about higher premiums, therefore, obscure the real issue: The secondary market simply responds to consumer demand for a fair return on their premiums in the face of anti-consumer carrier business practices, as Koenig presciently explained seven years ago.

S.B. 601 ADDRESSES STOLI AND PROTECTS CONSUMERS' PROPERTY RIGHTS

S.B. 601 addresses STOLI in significant ways. Overall, S.B. 601 helps detect, prevent and enforce against STOLI as follows:

- Defines STOLI as "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 the insured's beneficiaries receive little or none of the proceeds of the death benefits of the policy." and makes STOLI a fraudulent life settlement act.

- Prohibits the transfer for sale of the ownership or beneficial interest in a trust or other entity that owns a policy if the trust or other entity was formed or availed of for the principal purpose of acquiring one or more life insurance contracts.

- Prohibits "pre-arranged settlements" whereby there is an agreement to sell the policy PRIOR to the application or issuance of the policy or for a two year period from the date of inception of the policy.

- Prohibits premium financing transactions whereby (A) the proceeds of the loan are not used to pay premiums or (B) there is a guarantee of the future settlement value of the policy and prohibits the sale of any policy initiated pursuant to such prohibited premium financing transactions.

- Prohibits advertising the purchase of new insurance for the "sole purpose or the primary benefit" of selling it.

- Protects consumers against STOLI schemes by authorizing the issuance of consumer disclosures of certain risks related to premium financing where the life insurance policy is used as collateral.

OPPOSITION TO S.B. 624

S.B. 624 is effectively a solution looking for a problem. It does not address STOLI and it impairs the property rights in life insurance of Kansas policyowners. It harms the current life settlement market in Kansas.

S.B. 624 presumes that the solution to STOLI is to take away nearly every Kansas policyowners' ability to assign their life insurance policies for 5 years from the inception of the policy. It – wrongly, in our view – attacks the assignment of life insurance when the problem is the manufacturing of life insurance.

An examination of S.B. 624, which is drafted substantially from the NAIC Viatical Settlements Model Act, reveals that it has already been roundly criticized by your fellow legislators from around the country, from several insurance regulators, consumer advocates and even from the life insurers for failing to address stranger-originated life insurance schemes.

Having been adopted as a model by the NAIC in June 2007, two key regulators, both members of the NAIC's Life Insurance Committee – the Washington, D.C. commissioner and the New York insurance superintendent – have already rejected the 5 year ban in their own proposed legislation for 2008.

In addition, an Indiana bill nearly identical to S.B. 624, initiated by the ACLI, was roundly rejected there. And for all of their high praise for the NAIC Model and its five year ban, the ACLI didn't even bother to seek its introduction in several states, instead opting to introduce the NCOIL model or various iterations of the NCOIL Model in the states of Washington, Arizona and Maine.

The NAIC's own funded consumer representatives have harshly criticized the 5 year ban. As reported by the National Underwriter on September 11, 2006, Birny Birnbaum, Executive Director of the Center for Economic Justice, stated that the five year ban:

> "'**is a terrible proposal. It not only takes away fundamental consumer rights of ownership and disposition of policies,' but also does not address the issue of stranger-owned life insurance**. It will be 'a nuclear bomb for the secondary market,' he adds. One of the things that is a concern, according to Birnbaum, is that '**regulators are letting insurance companies kill the secondary market without a policy debate. It reinstalls a monopoly for insurers.**'"

Furthermore, the members of the NCOIL Life Settlements Subcommittee – your colleagues – spent considerable time examining the NAIC model and, ultimately concluded that it failed to address stranger-originated life insurance. Consider their statements about the NAIC Model Act:

> "We reviewed the proposal under consideration at the NAIC and believe it is not the appropriate model to follow because it is contrary to NCOIL's stated policy goals and does not correct the primary problems associated with STOLI. **The NAIC Proposal's five year ban on life settlements from policy inception and ban on so-called non-recourse premium financing, while well-intentioned, ultimately fall short of our two core goals, which are preventing investors from manufacturing life insurance policies and ensuring that we do not "impair, or interfere with Life Settlements or Viatical Settlements." Since the NAIC Proposal only focuses on the potential subsequent transfer of ownership in a life insurance policy, it does not correct the problem of investors taking an interest in a life insurance policy from policy inception – while inadvertently attacking policyowners' right of lawful and proper assignment in an attempt to discourage investors from investing in problem STOLI schemes.** (Joint Letter from Six Members of NCOIL Life Settlements Subcommittee to the NCOIL Life Insurance and Financial Planning Committee Chairman, March 1, 2007).

> **"The NAIC Model as written is anti-consumer and is unacceptable because it impairs legitimate life settlements and rolls back private property rights while doing nothing about STOLI... By the author of the NAIC new amendments' own admission, the NAIC model does not address STOLI schemes where investors provide funds for premiums and receive 95% of the death benefit *at policy inception.*"** (Memorandum from Kentucky State Representative Robert R. Damron to

Members of the NCOIL Subcommittee on Life Settlements, July 17, 2007.)

Perhaps the most important criticism of the NAIC Model Act, which S.B. 624 is based on, are the words of the American Council of Life Insurers. According to the minutes of a meeting between the ACLI and the author of the NAIC Model Act, the ACLI complained that the amendments to the NAIC Model Act **"failed to address the fundamental concerns with STOLI"** because they do not stop "finance programs permitting investor participation prior to or at issuance where the policy does not settle and the policy owner derives some modest percentage of the policy death benefit," (ACLI Memorandum for STOLI Task Force, October 29, 2007).

S.B. 624, by incorporating certain NCOIL provisions, does attempt to address STOLI. But the underlying approach of the NAIC model indiscriminately restricts the rights of Kansas consumers which makes it an anti-consumer and anti-competitive proposal.

S.B. 624 PROTECTS LIFE INSURERS, NOT CONSUMERS.

The notion that insurers cannot underwrite for STOLI on their own—and that the only the way the State can protect consumers from STOLI is to over-regulate by banning settlements for five years—is badly undermined by numerous of public statements made by the insurers that the Department regulates, and whose conduct it is presumably aware of. These insurer assertions include the following:

- "We have the top 30 life company CEOs that are on the American Council of Life Insurance Board have all agreed that we will not write STOLI which is stranger owned life insurance or investor owned life insurance.... **So I think you've seen for the large life companies a fall-off in STOLI or IOLI.**" (ING CEO during Q4 2006 earnings call; February 15, 2007.)

- "I assume you're referring to IOLI/STOLI on universal life. Number one, just to give you some context -- if you look at our business mix today, our in force business mix, less than 5% is in the target range for an age group for a life settlement. So from that perspective we feel very good. In terms of new business we do a number of things. First of all **we do frequent audits to see what's coming in**. The second thing is that **we're adding a question to our application and we're reviewing our trust agreements because this is usually where you pick it up**. And **we have also told our distribution partners that we do not want the IOLI/STOLI business**. (Genworth Financial EVP at Wachovia Securities CEO Summit, est. June 26, 2007)

- With respect to market conditions and IOLI and SOLI, we did see, in the first quarter, a little more aggressiveness on the part of distribution in trying to move

that type of product through. **We continued to put up filters, both on the distribution side and the manufacturing side. I think it has backed off quite substantially in the last quarter. I think our success is a combination of factors -- great products, great distribution, great underwriting**. (Lincoln National CEO, Q2 2007 Lincoln National Earnings Conference Call published August 1, 2007.)

- "**[W]e've put up some great screens, we think we have a good idea of where that business is being produced.**" (Nationwide Sr. VP at 32nd AIFA conference, March 2007.)

- "[M]any of our competitors are following in our footsteps as evidenced by -- if you look at total life sales for the industry, what you would see is that it really started off with a bang and ended with kind of a whimper.... And so what you can see is that many of our competitors are getting out of this business and **we can actually see a time possibly a year from now when there is no more IOLI business.** So we see the market is coming back to us over time, and we **are going to continue to stick to strong fundamentals of the business and doing the business in the right way**." (MetLife Chief Admin. Officer, Q4 2006 earnings call; February 14, 2007.)

- "**[W]e greatly strengthened our measures to eliminate the IOLI cases coming through that we all want to prevent from issuing.**" (John Hancock CEO, Q4 2006 earnings call; February 13, 2007.)

- "As we discussed at our investor day, in the latter half of 2006 you began to see the industry tighten down on the investor-owned life insurance sale. **We believe we took a leading position in trying to tighten that down and stem the tide of that. We, like several other companies, did it through a combination of changes in our underwriting process, certifications by both agents and by customers, reviewing trusts, and generally reviewing the entire process, specifically in the older age marketplace at the higher face amounts where that type of business tended to come in. We stemmed the tide fairly successfully**, so much so that we saw a fairly significant drop in our universal life sales at the older ages. In the second half of 2006, we indicated to you, as I believe has come true, that we were going to establish a fairly new baseline from which to grow. **We believe that that has occurred and we have indicated that we believe most of the investor-owned life insurance sales have stopped coming through our reported numbers.**" (American General CEO on Q4 2006 AIG earnings call; March 2, 2007.)

- **"In an effort to screen out IOLI sales, the company stopped accepting premiums financed on a non-recourse basis in February 2006, and it has taken proactive steps to improve its surveillance/detection capabilities and its product designs."** (Phoenix Life, Fitch report quoted in BestWire, Feb. 27, 2007.)

- "And then U.S. retail life sale, the rebound in the last quarter, a lot of it came actually from the Transamerica Group where **there was a period of time there where the IOLI, the industrial life sales and our stance on that slowed things down a bit. But we think that, as a whole, we're back to work there and doing better**." (Aegon President and CEO on Final Year Earnings Call; March 8, 2007.)

These statements unequivocally demonstrate that insurance companies, agents and life settlement companies can detect and weed out these schemes, which harm the value of life insurance for all policyowners. According to the American Council of Life Insurers:

> Insurance departments around the nation are stepping up to the plate to warn senior citizens about abusive STOLI transactions. In California, Texas, North Carolina and Florida, insurance regulators have issued bulletins or backed legislation reasserting the need for an insurable interest to exist at the time an insurance policy is purchased. ("STOLI Alert", September 2007, Volume 1, Issue 3)

In addition, the states of New York, Louisiana, Utah, Alabama, and Idaho have issued bulletins and opinions that reinforce that existing law protects against strangers' originating life insurance and promoting enforcement of those laws to detect and prevent STOLI policies from being issued. The Kansas Department's recent consumer bulletin is an appropriate first step in addressing STOLI by encouraging enforcement of existing laws.

CONCLUSION

For the foregoing reasons, we urge the Senate Financial Institutions and Insurance Committee to reject S.B. 624 and to support S.B. 601.

Thank you for the opportunity to testify on this important issue.

Senate Financial Institutions and Insurance Committee
February 25, 2008

Senate Bills 624 and 601
Testimony
Presented by:

Stephen L. Washington
Managing Director of Business Development
Life Equity LLC
on behalf of The Life Settlement Institute

Good morning, my name is Steve Washington. I am the Managing Director of Business Development at Life Equity LLC, a life settlement provider located in Hudson, Ohio and licensed in, among other states, Kansas. I am here representing my company as well as the Life Settlement Institute, a trade association of institutionally-funded life settlement providers and service providers which advocates for regulation of the life settlement market.

I would like to thank you, Madam Chair, and the other members of the Senate Financial Institutions and Insurance Committee for the opportunity to speak briefly today regarding Senate Bills 624 and 601.

About Life Equity LLC

Before addressing SB 624 and SB 601, I would like to provide some background on my company. Life Equity was founded in August 2000 as an Ohio-based life settlement provider. The founders and principals of our company came from large companies. Life Equity's CEO was the President and COO of Cole National Corporation, a Cleveland-based company, that he grew to $1 billion+ company and took public on the New York Stock Exchange in 1994. Our Chairman was a managing partner at Arthur Andersen in Cleveland until early 2000 and managed Arthur Anderson's Ohio and Kentucky offices. I joined Life Equity in April 2006. Prior to joining Life Equity, I practised corporate and securities law for more than 11 years beginning at Debevoise & Plimpton, an internationally-recognized law firm in New York and moved to Jones Day in Cleveland, Ohio. I also have a master's degree in public administration from Columbia University and worked from 1987 to 1992 in the New York City Mayor's Office.

The founders of Life Equity recognized in late 2000 that there was a need that was currently not being met by the insurance industry. People had changing insurance needs, but were often unable to change insurance coverage in a way that made economic sense because their policies offered cash surrender values that were substantially below market value, which made it uneconomic to alter coverage. To address this need, the founders started Life Equity.

FI & I Committee
February 25, 2008
Attachment 3

Life Equity was established with two goals at its inception: First, to work exclusively with institutional investors because institutional investors have the sophistication and financial wherewithal to be able to invest in life settlements, unlike individual investors; and, second, to promote regulation and introduce standards that would level the playing field among participants in the life settlement market and have the effect of eliminating unscrupulous actors from the market. Life Equity has adhered to these goals since its inception. Today, Life Equity is recognized as a leader in the life settlement market and has developed a national reputation for its commitment to ethical and transparent practices.

About the Life Settlement Institute

Life Equity is a founding member of the Life Settlement Institute, and Brian Smith currently serves as its President. LSI is a not-for-profit corporation that was formed in December 2001 in order to present the viewpoint of institutionally funded life settlement providers to consumers, state regulators and other regulatory and legislative bodies such as the NAIC and NCOIL.

LSI has been the leading organization in the life settlement industry promoting and supporting sensible regulation of the life settlement market. We also work to develop and promote "best practices" within the industry and our members adhere to same. LSI's mission is to:

- Educate financial planning professionals and advisors about the life settlement industry;
- Increase the awareness amongst policyowners of the life settlement market and the value proposition offered thereby;
- Promote the use of institutional financing in the life settlement industry; and
- Support the development and adoption of sensible laws and regulations that facilitate the growth and evolution of the life settlement market while preventing fraudulent or dishonest life settlement transactions.

To achieve these objectives, LSI works closely with state regulators and others to promote regulation and develop public policy concerning life settlements. LSI has been at the forefront of efforts to ensure that sellers receive adequate compensation for their life insurance policies, guaranteeing that sellers receive full disclosure of broker compensation, and protecting the confidentiality of insureds' personal information. In this vein we are pleased to submit comments regarding SB 624.

LSI members have been responsible for the introduction of nearly all legislation that has been proposed since 2001. LSI has been very successful in shaping legislation that now governs in a majority of states. LSI's members have also actively participated in the development of model legislation since 2000 at both the NAIC and NCOIL.

STOLI vs. Life Settlements

A concern these days of legislators, regulators, life settlement market participants and insurance carriers is the phenomenon commonly referred to as "stranger-initiated life insurance" or "stranger-originated life insurance", or "STOLI," for short. What is STOLI?

Generally, STOLI is considered to be an agreement or arrangement at the time of policy issuance to purchase a life insurance policy for the benefit of a person or entity that lacks at such time an insurable interest in the person who is to be the named insured under the policy.

Members of LSI would like the Committee to understand that we oppose any such agreements or arrangements and support legislation that is targeted at eliminating such practices, though we also note that the concern about STOLI is not new—people have for years tried to take advantage of insurance—and it is therefore already illegal in most states today, whether by statute or as a matter of case law (e.g., as a violation of a state's insurable interest law).

STOLI is not the same as, and should not be confused with, life settlements. A life settlement is the sale of a life insurance policy by a policy owner for an amount greater than the policy's stated cash surrender value, but less than the policy's net death benefit. By contrast with STOLI, a life settlement does not involve an upfront agreement; instead, an agreement to sell one's policy must occur at some point following the expiration of the contestability period—anywhere from two years following the date of policy issuance to years later.

A life settlement may provide a better alternative than allowing a policy to lapse or be surrendered for its stated cash surrender value. Life settlements are considered for a variety of reasons, such as:

- A policy is no longer needed or wanted (e.g., spouse dies, divorce, children are grown up and financially responsible, etc.);
- Changes in estate, tax or financial plans or changes in law, etc., occurring subsequent to policy issuance can cause an individual to consider lapse or surrender of a policy;
- Funds are needed to pay for long-term care or healthcare costs;
- Premium payments have become unaffordable as policy owners grow older; or
- Investment in the insurance is no longer appropriate.

Life settlements typically involve seniors whose needs or life circumstances have changed and who are considering surrendering or letting their policies lapse. They have acquired their policies for a variety of reasons—personal, financial, business and other reasons—and, correspondingly, they have a variety of reasons for terminating

their policies. Rather than voluntarily terminating their policies and accepting what the insurance carriers offer, they now have a new option with life settlements. Life settlements can offer consumers a multiple of the amount that they would receive from carriers. Industry figures are in the range of three to four times the cash amount that they would receive from carriers. Accordingly, consumers benefit because life settlements can provide an alternative to the depressed cash surrender values that most carriers provide when policy owners surrender their policies.

Members of this Committee should be aware of the high voluntary termination rate—that is, both the surrender rate and lapse rate—that exists for life insurance policies, even within the first five years of a life insurance policy. According to the Life Insurers Fact Book, a publication prepared by the American Council of Life Insurers that uses data compiled by the NAIC, the lapse rate for all life insurance is approximately 35% during the first five years of policies and has ranged as high as 50% even five years ago. This reported lapse rate is consistent with other reports and our own experience at Life Equity. Policies surrendered in their early years are subject to significant termination penalties, which reduce significantly the cash amount returned to consumers, to an amount that is even less than the stated cash surrender value. Life settlements permit many who terminate their policies early to recoup premium payments because the true market value of their policies is often significantly higher than the cash surrender value offered by life insurance carriers.

NAIC Viatical Settlement Model Act vs. NCOIL Life Settlement Model Act

The issue of STOLI was examined recently by two national organizations, the National Association of Insurance Commissioners ("NAIC") and the National Conference of Insurance Legislators ("NCOIL"). Each organization took different approaches to address STOLI. Broadly speaking, the NAIC recommended placing a five-year mandatory holding period on life insurance policies that have been paid for through the use of borrowed funds and not permitting the lender to value a life insurance policy, for collateral value purposes, at more than a policy's stated cash surrender value. The NAIC also adopted amendments that would reduce the number of exemptions that would be available to seniors to do a life settlement in the event of unforeseen hardships or other circumstances where a senior may want to terminate a policy within the first five years after the policy issuance date.

The legislators who participated in lengthy hearings at NCOIL—an estimated 30 to 40 hours in 14 public hearings—met to consider amendments to NCOIL's model act on life settlements and considered, among other issues, STOLI. NCOIL rejected the approach taken by the NAIC, and determined that consumers would be best served by defining the practice of STOLI, making it illegal (as a fraudulent life settlement act), specifically prohibiting any sale or agreement to sell life insurance policies during the two-year contestability period following policy issuance, and providing carriers with the tools to ask consumers at the time of policy application whether they intended to use borrowed funds to pay for their policy and, if so, to permit carriers to provide certain warnings to consumers and obtain specific certifications from them to establish their understanding

of the limitations and other restrictions that may apply if they subsequently engaged in a life settlement.

All of NCOIL's meetings occurred on the record, and I would commend this Committee to consider NCOIL's life settlements model act, or certain of its provisions, as a superior alternative to certain of the provisions that are contained in SB 624. We believe that the process that took place at NCOIL, and the approach taken by the legislators at NCOIL, was a more thoughtful and carefully tailored approach to the concerns about STOLI. We also believe that NCOIL's approach maintains an appropriate balance between the property rights of policy owners and the concerns of insurance regulators for addressing STOLI.

Comments on SB 624

While we believe that SB 624 has some commendable improvements to add to Kansas' life settlement statute, we, both Life Equity and the other members of LSI, have significant concerns about certain provisions contained of SB 624. We also have comments concerning other provisions that might appropriately be considered "technical amendments." For purposes of today's hearing, I will touch on only a few items. If permitted, LSI will furnish a markup of SB 624 that will address the comments and concerns of LSI.

Mandatory Five-Year Holding Period. While the members of LSI have a number of comments on SB 624, we would urge that this Committee reject the proposed mandatory five-year holding period (§ 9 (K.S.A. 2007 Supp. 40-5010)), which prohibits consumers from transferring life insurance policies between the second and fifth years if certain conditions are not satisfied. Why?

- Fundamentally, the proposed five-year mandatory holding period seriously interferes with the long-established property rights that policy owners lawfully have in their policies—if a person buys a policy, he or she owns it. What asset can anyone in the United States purchase and then be prohibited by law from selling? No other asset that one can buy, whether in the form of real estate, shares of stock, or other types of property, is burdened with the type or length of transfer restriction that the government proposes here for life insurance. The proposed five-year mandatory holding period benefits only one group—life insurance carriers—to the detriment of policy owners, because the lapse and surrender rate (voluntary terminations)—by policy owners remains very high today—35% to 50%, depending on the source of one's information—within the first five years of issuance of policies. This provides tremendous profits for carriers who collect premiums and never have to pay out the death benefits on such policies.

- The proposed five-year mandatory holding period discriminates between those who can pay out of pocket for a life insurance policy and those who, for very legitimate reasons, may need to borrow to pay for a policy, e.g., persons whose assets are tied up in illiquid investments, such as real estate, restricted stock, or the like. This is like discriminating between someone who can pay cash for a new car and someone who

leases or takes out a loan for the purchase. Going further, SB 624 discriminates against those who may not have available "unencumbered assets" against which to borrow.

- SB 624 misplaces the problem of STOLI by shifting the burden from insurance carriers, who have a duty to police their own underwriting and issuance of policies; to the backs of consumers, both retroactively (i.e., persons who have purchased life insurance with borrowed funds prior to enactment of SB 624) and prospectively. If SB 624 were to be adopted, consumers will unwittingly acquire life insurance without understanding that Kansas law imposes a 5-year mandatory holding period on the sale of such policy. SB 624 confuses when STOLI occurs (as discussed above, it occurs at policy issuance) and seeks to curb the problem at the time when a consumer may legitimately seek to sell a policy through a life settlement, rather than choosing to let the policy lapse or surrendering it to the issuing carrier for an artificially depressed cash surrender value. Kansas legislators should be loathe to accept the proposed five-year mandatory holding period when more than a doen public life insurance companies have reported in analyst calls that they were able to adequately screen policies at policy application and, in so doing, were able to effectively eliminate STOLI. This means that the insurance industry is able to effectively stamp out STOLI through proper underwriting and screening prior to policy issuance.

- SB 624 embodies an ill-fated effort by the NAIC to regulate abusive premium finance schemes, which are a legitimate source of concern. What the commissioners at the NAIC came to appreciate, however, is that premium finance is outside of their jurisdiction—and that it falls, instead, under federal and state banking laws. Since they were unable to alter directly banking law, they sought to address STOLI by proxy. However, the NAIC's effort to regulate STOLI was flawed because it does not squarely address the problem of STOLI, and in so doing, places an across-the-board burden on all purchasers of life insurance who may, within the 2-5 year mandatory holding period, have a legitimate need or desire to terminate a policy and, if the option is available to them, enter into a life settlement.

- SB 624 does not require insurance carriers to warn consumers that, if they borrow money to pay for their policies, they may be obligated to hold the policy for five years, unless they resell the policy back to the carrier at the carrier's artificially depressed cash surrender value. Consider this ... If the policy owner, for any reason, changes his/her mind and desires to sell the policy within the 2-5 year mandatory holding period, will the insurer be prepared to provide financing arrangements to enable that policy owner to pay for such extra months or years of premiums? We cannot comprehend how any legislator or law can force a person to continue "bleeding" on premium payments (whether or not they can afford such) to avoid taking a legalized mandatory loss through lapse or surrender for the sole benefit and profit of the insurer. If the five-year mandatory holding period is legislated, legislation should stipulate that the insurer provide some minimal cost financing arrangement that covers the policy cost until the owner can sell the policy following the holding period to avoid taking a loss. Perhaps this can be

accomplished by establishing the value of the policy at the time the owner wants to sell. If the value exceeds the cash surrender value, then the insurer must provide affordable financing to the owner.

- You have likely been assured that SB 624 contains a number of exemptions that will enable consumers to do a "traditional" life settlement during the mandatory 2-5 year holding period. Our view of this is that language that attempts to define exceptions to the longer holding period will, by definition, not be sufficiently comprehensive, because no one can foresee all future situations where a person may reasonably decide to terminate a policy. Take the following, as examples: (1) I am a senior and I experience a health problem for which I need cash to pay for my health care expenses—SB 624 removes the financial hardship exemption that currently exists under Kansas law (K.S.A. 40-5010(b)(1)(H))—so I must continue to pay premiums on my policy for five years, or give up the policy at a loss (when a higher value may be obtained through the secondary market); (2) I am a senior and find that my insurance premiums are much more expensive than I had anticipated and are continuining to rise, or I find insurance from another carrier that is less expensive than my current policy—SB 624 mandates that I must hold my current policy for five years or give it up at a loss when a higher value may be obtained through the secondary market; or (3) in connection with the issuance of my life insurance policy, my financial advisor discusses with me the option of a life settlement should I decide not to keep my life insurance until my demise—SB 624 may bar a life settlement, whether or not I financed my policy (K.S.A. 40-5010(c)(3)). SB 624 provides only a few very limited exemptions—divorce, death of a sole beneficiary, retirement (most seniors have already retired, so this is not helpful)—which currently serve as limited exemptions under today's two-year mandatory holding period. Remarkably, when the NAIC elected to extend the mandatory holding period, rather than broaden the exceptions that would allow individuals to do life settlements, the NAIC narrowed the exceptions, as does SB 624. Kansas should not adopt legislation that is anti-consumer.

- Proponents of SB 624 may argue, as they did at the NAIC, that the five-year holding period is necessary to disincentivize predatory lending to induce seniors to take out policies. No information was offered up at the NAIC to support this assertion, nor does it seem very plausible. Why? Because lenders are just as eager to offer five-year loan terms to structure around SB 624's restriction. And carriers, for their part, are eager to accept new "hybrid" financing for their policies that provides 25% recourse against borrowers. Is there any magic to the figure 25%? None whatsoever, but it will enable insurance carriers to continue to write significant amounts of new business that will be premium financed. A substantial portion of the growth of new policy sales by life insurance carriers is attributable to the availability of premium finance through carriers and lenders.

- Insurance advocates argue that insurance is purchased for the benefit of widows and orphans, and that consumers should not treat life insurance as an investment. While it is true that some amount of insurance is sold for widows and orphans, insurance is heavily marketed by carriers as a valuable investment, whether for

estate, tax or other financial planning reasons. Consumers should, accordingly, be permitted to treat life insurance as an investment, including the decision whether to terminate a life insurance policy. State law should not bar a life settlement if the option would otherwise be available to him or her.

- SB 624 does not grandfather those policy owners who may have purchased life insurance with financing that would not qualify under this legislation for a life settlement from two to five years after the policy issuance date—in effect, this legislation would effect an unconstitutional property taking.

- Legislators should be aware that several life insurance carriers have announced their plans to enter life settlements and that carriers have proposed to offer policy loans to policy owners to enable them to receive a lumpsum payment in exchange for a reduced death benefit. Legislators should be wary of passing legislation that provides advantages to one industry over another. For example, it appears that SB 624 would not prohibit carriers from offering a product to compete with life settlements within the mandatory 2-5 year holding period (see revision at K.S.A. **[complete]**

Further Information on the Transferability of Life Insurance. It has long been established that the ability to alienate or assign a life insurance policy is a fundamental property right of a policy owner. The U.S. Supreme Court in 1911 explained that a life insurance policy derives much of its value from the consumer's right to assign the policy, even to a party without an insurable interest in the life of the insured:

> "[W]hen the question arises upon an assignment, it is assumed that the objection to the insurance as a wager is out of the case. . . . 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 interest is to diminish appreciably the value of the contract in the owner's hands.*" (Grigsby v. Russell, 222 U.S. 149, 155 and 156 (1911) (emphasis added)

The only exception to the transferability of life insurance is provided at law and pertains to the two-year contestability period. K.S.A. 40-20(2) provides that every policy shall be incontestable after it has been in force during the lifetime of the insured for a period of not more than two years from its date, except for nonpayment of premiums and except for violations of the conditions, if any, relating to naval or military service, or to aeronautics and, except also at the option of the company, with respect to provisions relative to benefits in the event of total and permanent disability and provisions which grant additional insurance specifically against death by accident or by accidental means.

Kansas' two-year contestability provision is the rule throughout the country. The history of the incontestability statutes, as explained both in the academic literature and by the courts, makes clear that incontestability laws are a fundamental consumer protection which act in similar fashion as statutes of limitation, and which were passed in response to "public distrust of insurers" resulting from "numerous charges of corruption, fraud, and

dishonesty" among life insurance carriers which prompted legislatures to "enact laws to remedy the dishonesty then rampant in the life insurance industry." (Excerpted from Erik K. Fosaaen, AIDS and the Incontestability Clause, 66 N.D. L. Rev. 267 (1990).) The history of the incontestability provision is too lengthy to include here, but its origin merits understanding in the present context.

The Grigsby Court also noted that "life insurance has become in our days one of the best recognized forms of investment and self-compelled saving." 222 U.S. 149, at 156. The proposed mandatory five year holding period runs contrary to the notion that life insurance is an investment and would, in effect, deny to consumers—primarily seniors—who may subsequently decide to terminate a policy within the second and fifth year of the mandatory holding period, the possibility of recouping some portion of the premiums that they have paid into a policy by requiring them to sell their policies back to the insurer at artificially low prices.

Finally, SB 624's mandatory five-year holding period catches up all transfers within the first five years and places, in addition to other proposed revisions, impediments at a number of places in the process to make it much more difficult for consumers to sell their policies. For instance, the NAIC and insurance industry participants have argued that the NAIC's model act preserves "traditional" life settlements that can be accomplished after two years of ownership. However, the model act, like SB 624, extends the required holding period for any policy owner who has been evaluated for a life settlement. The qualification is without reference to time—the evaluation could have taken place years earlier or three or four years after policy issuance—and yet the policy owner will nevertheless be barred for five years from transferring her policy. More problematic is that consumers may not be aware that they have been evaluated for a life settlement and may unwittingly run afoul of this provision.

Other Provisions.

SB 624 includes a number of other provisions that we do not support, such as:

- Definition of STOLI [*Proposed new Section 5(m)*]. While we support the approach to include a definition of STOLI, we believe that the version offered under SB 601 is tighter and clearer. Additionally, the second sentence in the definition of Section 5(m) should be deleted. It describes STOLI practices to "include but are not limited to" and then describes certain elements of what would constitute a STOLI. Legislative drafting should not be so open-ended. Definitions should be as specific as possible and not subject to speculation as to whether a particular practice might or might not constitute a STOLI transaction.

- Rescission Rights [*Proposed New Section 2(c) and proposed amended Sec. 8(a)(6) (K.S.A. 40-5008(a)(6))*]. SB 624 proposes to double the rescission periods for policy owners. The proposed revision does not address any abuses, nor were any abuses raised with respect to rescission rights at NAIC. NCOIL did not see the need to alter the rescission rights—which gives a policy owner up to 15 days after the transfer of funds to such person to unwind a life settlement. The proposed change, like a

number of other provisions reflected in SB 624, is merely intended to make life settlements more difficult to accomplish for both life settlement participants and policy owners. The Committee should reject this proposed change.

- Reporting Requirements to Carriers [*Proposed amended Sec. 8(b)(8) (K.S.A. 40-5008(b)(8))*]. This provision was proposed by the carriers at the NAIC and was proposed by the commissions without explanation or any justification. The provision requires life settlement providers and brokers to "fully disclose" to insurance carriers, among other things, plans to continue policies less than five years old. By definition, life settlement providers continue all policies that they purchase. The provision would, on its face, require reporting to all carriers. This is wholly unnecessary—SB 624 already requires licensing and reporting requirements to the Kansas Insurance Department. It is also inappropriate as, on its face, it would be anticompetitive to require providers and brokers to report to a competing industry. The committee should strike this provision.

- Common Control Prohibitions [*Proposed New Section 3(a) and (b)*] We believe that the prohibition of common control between a broker and a provider, as called for in proposed new Section 3(a) and 3(b) should be modified. Transparency is critical to consumer protection and we would propose an amendment that would provide such transparency. A broker who is under common control with a provider might be able to make the best offer, or might be necessary for securities law purposes, for the sale of a policy. Common ownership should not preclude an owner from obtaining the maximum amount in disposing of the policy.

- Provision Concerning Premium Financing [*Proposed New Section 3(g)*] Proposed new Section 3(g), while inartfully drafted, appears to prohibit one from being engaged in or affiliated with both the business of premium finance and life settlements. This appears to us to be an unnecessary restraint against business because it would have the government dictating which business or businesses one can or cannot be in. This does not make sense, nor is it the place of the government to take such positions, unless to prohibit anticompetitive conduct. Legislators should bear in mind that this provision would not prohibit life insurance carriers from, on the one hand, entering into or offering premium financing in connection with the underwriting of life insurance and, on the other hand, engaging in life settlements. Government should not adopt legislation that would tie the hands of one industry, and in so doing, put another industry at a competitive advantage.

- Technical Amendments In addition to the foregoing principal comments, LSI will have other technical amendments to suggest to the Committee, which we will furnish in a separate markup of the bill.

Certain of these provisions were adopted at the last minute by NAIC without public discussion. From the life settlement participants' perspective, a number of these measures will have the intended effect of impeding life settlements because they will limit the number of persons who can engage, and will sanction greater interference by

carriers, in life settlements, a phenomenon that we and viators experience with great frequency today.

Conclusion

I would like to thank you and the members of the Committee for the opportunity to comments on this important matter. We look forward to working with you in the development of life settlement legislation in the state of Kansas. At this point, I would welcome any questions that you may have.