# HOUSE BILL REPORT
# HB 3067

**As Reported by House Committee On:**
Insurance, Financial Services & Consumer Protection

**Title:** An act relating to adopting the life settlements model act.

**Brief Description:** Adopting the life settlements model act.

**Sponsors:** Representative Kirby.

**Brief History:**
**Committee Activity:**
Insurance, Financial Services & Consumer Protection: 1/31/08, 2/5/08 [DP].

**Brief Summary of Bill**

- Requires licensing of any person who buys or brokers a life insurance policy from the owner if the owner is a resident of this state.
- Establishes prohibited practices, disclosure requirements, and contractual provisions for life settlements.
- Establishes sanctions for violations of the act.

**HOUSE COMMITTEE ON INSURANCE, FINANCIAL SERVICES & CONSUMER PROTECTION**

**Majority Report:** Do pass. Signed by 8 members: Representatives Kirby, Chair; Kelley, Vice Chair; Roach, Ranking Minority Member; Hurst, Loomis, Rodne, Simpson and Smith.

**Minority Report:** Without recommendation. Signed by 1 member: Representative Santos.

**Staff:** Jon Hedegard (786-7127).

**Background:**

<u>Regulatory Authority of the Insurance Commissioner</u>.
The Office of the Insurance Commissioner (OIC) regulates insurance transactions in Washington. This includes life insurance policies that are issued or delivered in Washington.

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*This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.*

Insurance rates and insurance forms are filed with the OIC. The OIC ensures that those rates and forms comply with the Insurance Code.

Insurance Contracts and Insurable Interests.
A person may enter into an insurance contract in order to insure the life of another if the benefits are payable to the insured person (or their personal representative) or if the person procuring the contract has an "insurable interest" in the person insured.

Insurable Interest.
The insurable interest may be based in:
- a substantial personal or emotional interest in an insured stemming from close family ties;
- a substantial economic interest in the continuing life, health, or safety of an insured;
- specified financial interests related to certain contracts, business relationships, and stock option arrangements;
- certain interests of guardians, trustees, or other fiduciaries with respect to beneficiaries; or
- the interests of a nonprofit organization with respect to life insurance policies if certain criteria are met.

Viatical Settlements.
State insurance law regulates viatical settlements. A viatical settlement is when the owner of a life insurance policy insuring the life of a person with a catastrophic or life-threatening illness or condition, sells the policy to a third-party. The third-party pays a sum less than the death benefit and may also be required to continue any ongoing premium payments. In return, the third-party receives the right to collect the death benefit.

A person may act as the purchaser of a viatical settlement or act as a viatical settlement broker without being licensed by the OIC. All viatical settlement contracts and compensation must be filed for approval with the OIC.

Accelerated Death Benefits.
Insurers may include provisions in their life insurance contracts that allow an insured to trigger an early partial payment of the death benefit if the insured meets specific eligibility standards that indicates that the insured has a short life expectancy. These provisions are regulated under state law. Contracts must be filed for approval with the OIC.

Life Settlements and Insurance Regulation.
"Life settlement" is not currently defined in the Insurance Code. There is no insurance statutory framework for a policy owner selling a life insurance policy if the transaction does not fall within the structure of a viatical settlement or an accelerated death benefit.

Life Settlements and Securities Regulation.
A viatical or life settlement agreement is a security if the agreement falls within the definition of "security." A "viatical or life settlement agreement" is defined in securities rules as an agreement for consideration for the purchase of any portion of the death benefit under an insurance policy. A viatical or life settlement agreement does not include any agreement for

the original issuance of an insurance policy or an assignment of a death benefit under an insurance policy by the original owner, or a person who has an insurable interest in the insured, to any of the following:
- the insured;
- a person who has an insurable interest in the insured;
- a dealer;
- a person who is engaged in the business of purchasing the death benefit of insurance policies;
- an assignment of an insurance policy to a financial institution as collateral for a loan; or
- the exercise of accelerated benefits in the life insurance policy.

Life Settlements and National Insurance Regulatory Efforts.
The National Association of Insurance Commissioners (NAIC) and the National Conference of Insurance Regulators (NCOIL) have each adopted a model law on the subject of life settlements. The NCOIL Life Settlements Model Act was adopted on November 16, 2007. The NAIC revised their Viatical Settlements Model Act on June 4, 2007. The revised NAIC model is expanded to encompass life settlements.

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**Summary of Bill:**

Definitions.
The bill provides 26 definitions.

Insurable Interest and Stranger-Originated Life Insurance (STOLI).
STOLI is defined as a practice or plan to initiate a life insurance policy for the benefit of a third-party investor who has no insurable interest in the insured when the policy is originated. STOLI is prohibited under the act.

Licensing.
An unlicensed person may not enter into a contract to buy a life insurance policy or broker a policy if the owner is a resident of Washington. The Insurance Commissioner (Commissioner) must establish the duration of a license, fee, and required information for applicants. The term of a provider license is equal to that of a domestic stock life insurance company and the term of a broker license is equal to that of an insurance producer license. The Commissioner must investigate each applicant and may issue a license if the Commissioner is satisfied that statutory requirements are met by the applicant.

Licensing Suspension, Revocation, and Renewal.
The Commissioner may suspend, revoke, or refuse to renew the license of any licensee if the Commissioner finds that:
- there was a material misrepresentation in the license application;
- the licensee or any officer, partner, member, or director is guilty of fraudulent or dishonest practices, is subject to a final administrative action, or is otherwise shown to be untrustworthy or incompetent;
- the provider demonstrates a pattern of unreasonably withholding payments to owners;

- the licensee no longer meets the requirements for initial licensure;
- the licensee or any officer, partner, member, or director is convicted of a felony or misdemeanor of which criminal fraud is an element;
- the licensee pleaded guilty or nolo contendere with respect to any felony or any misdemeanor of which criminal fraud or moral turpitude is an element;
- the provider entered into a life settlement contract that was not approved by the OIC;
- the provider failed to honor contractual obligations set out in a life settlement contract;
- the provider assigned, transferred, or pledged a settled policy to a person other than a person allowed under the act; or
- the licensee or any officer, partner, member, or key management personnel has violated any provision in the act.

<u>Contract Requirements</u>.
A person must not use a life settlement contract form or provide a disclosure statement form in this state unless first filed with and approved by the Commissioner.  The Commissioner must disapprove a life settlement contract form or disclosure statement form if, in the Commissioner's opinion, the contract or provisions in the contract:
- fail to meet the requirements of this act; or
- are unreasonable, contrary to the interests of the public, or otherwise misleading or unfair to the owner.

<u>Reporting Requirements</u>.
For any policy settled within five years of policy issuance, each provider must annually file with the Commissioner a statement containing information required by the Commissioner by rule.  The annual statement must include:
- the total number, aggregate face amount, and life settlement proceeds of policies settled during the preceding calendar year;
- a breakdown of the information by policy issue year;
- the names of the insurers whose policies have been settled; and
- the names of the brokers that have settled the policies.

<u>Privacy</u>.
Nonpublic personal information is subject to the federal Gramm-Leach-Bliley Act (Public Law 106-102 [1999]) and all other state and federal laws relating to confidentiality of nonpublic personal information.  All medical information is subject to the applicable provision of state law relating to confidentiality of medical information.

<u>Examination</u>.
The Commissioner may examine the business and affairs of any licensee or applicant for a license.  The Commissioner may order any licensee or applicant to information reasonably necessary to determine whether a licensee or applicant has violated the law or acted contrary to the interests of the public.  Examination expenses incurred shall be paid by the licensee or applicant.  The Commissioner has the discretion to accept an examination report on the licensee prepared by the licensee's state of domicile or port-of-entry state.

<u>Advertising</u>.

Advertisements must be accurate, truthful, and not misleading. A person must not:

- directly or indirectly promote the purchase of a policy for the sole purpose of, or with an emphasis on, settling the policy; or
- use the words "free," "no cost," or similar words in marketing the purchase of a policy.

All advertisements must comply with rules adopted by the Commissioner. The Commissioner has the discretion to require the submission of advertising material.

<u>Disclosure to Owners</u>.
The provider must provide a written, separate disclosure document that are signed by the owner and provider. Included in the information that must be disclosed is:

- the fact that possible alternatives to life settlement contracts exist;
- the fact that some or all of the proceeds of a life settlement contract may be taxable and that assistance should be sought from a professional tax advisor;
- the fact that receipt of proceeds may adversely affect the recipients' eligibility for government benefits or entitlements;
- the fact that the owner has a rescission right within 15 days;
- that assistance should be sought from a professional financial advisor;
- the amount and method of calculating the compensation paid to the broker or any other person acting for the owner in connection with the transaction;
- the date by which the funds will be available;
- the fact that the insured may be contacted for the purpose of determining the insured's health status or to verify the insured's address;
- that a broker owes a fiduciary duty to the owner;
- a full, complete, and accurate description of all the offers, counter-offers, acceptances, and rejections relating to the life settlement contract;
- disclosure of any affiliations or contractual arrangements between the broker and any person making an offer in connection with the proposed life settlement contracts;
- the name of each broker who receives compensation and the amount of compensation received by that broker; and
- a complete reconciliation of the total amount bid by the provider to the net amount of proceeds or value to be received by the owner.

The failure to provide the disclosures is an unfair trade practice.

<u>Disclosure to Insurers</u>.
An insurer may inquire whether the proposed owner intends to pay premiums with the assistance of financing from a lender that will use the policy as collateral. If the loan provides funds which can be used for a purpose other than obtaining and maintaining the life insurance policy and loan, the application must be rejected. If the financing is not in violation of this act, the insurer may make specific disclosures to the applicant and the insured.

<u>General Requirements</u>.
A provider entering into a life settlement contract with the owner of a policy where the insured is terminally or chronically ill must obtain the insured's consent to the release of his or her medical records. If the owner is the insured, a provider must obtain a written statement from a

licensed attending physician that the owner is of sound mind and under no constraint or undue influence to enter into a settlement contract.

Before or at the time of execution of the settlement contract, the provider must obtain a witnessed document in which the owner:
- consents to the settlement contract;
- represents that the owner has a full and complete understanding of the settlement contract, and the policy; and
- acknowledges that the owner is entering into the settlement contract freely and voluntarily.

If a person has a terminal or chronic illness or condition, the document must acknowledge that the insured has a terminal or chronic illness and that the terminal or chronic illness or condition was diagnosed after the policy was issued.

All life settlement contracts must provide that the owner may rescind the contract within 15 days after the date it is executed. The owner must repay all sums paid by the provider within the rescission period. If the insured dies during the rescission period, the contract is considered rescinded subject to repayment of sums by the owner or the owner's estate to the provider.

A person must not enter into a life settlement contract within two years of the beginning of a policy. This does not apply if the policy was issued upon the owner's exercise of conversion rights and the total of the time covered under the conversion policies is at least 24 months. It also does not apply if the owner submits independent evidence to the provider that one or more of the following conditions have been met within the two-year period:
- the owner or insured is terminally or chronically ill;
- the owner or insured disposes of his or her ownership interests in a closely held corporation under an agreement in effect when the policy was issued;
- the owner divorces his or her spouse;
- the owner retires from full-time employment;
- a physician determines that a mental or physical disability prevents the owner from maintaining full-time employment; or
- a final order, judgment, or decree is entered by a court of competent jurisdiction.

<u>Authority to Adopt Rules</u>.
The Commissioner may adopt rules implementing this act and regulating the activities and relationships of providers, brokers, insurers and their agents.

<u>Prohibited Practices</u>.
It is unlawful for any person to engage in prohibited practices, including:
- entering into a life settlement contract if such person knows or reasonably should have known that the policy was obtained by means of a false, deceptive, or misleading application;
- engaging in any transaction or practice if the person knows or reasonably should have known that the intent was to avoid the notice requirements of this chapter;

- engaging in any fraudulent act involving an owner who is a resident of this state; or
- promoting the purchase of an insurance policy for the purpose of, or with, an emphasis on settling the policy.

A violation of this section constitutes a fraudulent life settlement act.

Fraud Prevention.
A person must not:
- commit a fraudulent life settlement act;
- knowingly and intentionally interfere with the enforcement of this act or investigations of suspected or actual violations of this act;
- knowingly or intentionally permit any person convicted of a felony involving dishonesty or breach of trust to participate in the business of life settlements; or
- fail to provide to the Commissioner the information required regarding a fraudulent life settlement act.

Every life settlement contract and application for a life settlement contract must state that it is a criminal violation to knowingly include false information in an application for an insurance or life settlement contract.

Any person engaged in the business of life settlements having knowledge of a reasonable belief of a fraudulent life settlement act must provide the information to the Commissioner.

Providers and brokers must have antifraud policies and must submit an antifraud plan to the Commissioner.

Injunctions and Civil Remedies.
The Commissioner may issue a cease and desist order upon a person who violates any provision of this act, any rule or order of the Commissioner, or any written agreement entered into with the Commissioner. The Commissioner may seek an injunction in court.

Any person damaged by a violation of this act or any rule implementing this act may bring a civil action for damages.

Penalties.
A person that commits a fraudulent life settlement act is guilty of committing insurance fraud and is subject to additional criminal penalties. Additionally, the Commissioner may impose a civil penalty not exceeding $1,000 and the amount of the claim for each violation upon any person who has committed a fraudulent act or violated any other provision of this act.

Application of the Consumer Protection Act (CPA).
A violation of the act is a violation under the CPA (Chapter 19.86 RCW).

Conflict of Laws.
The laws of the state of the owner take precedence in a conflict in the laws between an owner and a purchaser in a transaction.

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**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date:** The bill takes effect 90 days after adjournment of session in which bill is passed.

**Staff Summary of Public Testimony:**

(In support) There are NAIC and NCOIL models. This bill is based on the NCOIL model and is modified for Washington law. There are other stakeholders that may want additional changes. While the NAIC model has some features that are preferable, the NCOIL model has certain unique features that make it preferable to the regulator and the life settlements industry. The life insurance industry is willing to find common ground with those other stakeholders and use the NCOIL model as the base. Life insurers are concerned about the insurable interests of purchasers. In recent years, people have begun to take out policies on a person or at a time when the beneficiary has no insurable interest. Elderly people have been paid so a third-party can take out a policy on the elderly persons' life. Life insurance developed to protect widows and orphans. It requires an interest in continuing the life of the insured person. When a policy is originated by a stranger who does not have an insurable interest in the life of the insured, it is an illegal transaction. This is the principle reason why the NCOIL model is so useful as a base. The NCOIL model has clear provisions banning STOLI. The life insurance industry does not oppose legitimate sale of an existing policy. It opposes the origination of a policy for the purpose of selling it to a third-party. The bill is a comprehensive regulation. Much of it is parallel to insurance regulation. There are not many complaints in this field but that is because the area is so new. The life insurance industry is willing to work with all stakeholders to try to develop consensus solutions to issues in the bill.

(In support with concerns) It took a year of stakeholder work to fit the NAIC Model Act on market analysis into Washington law. That consensus bill was adopted last year. While this model act is a very good base, there are details to work through prior to adoption. This is a new and complicated issue. The OIC has been meeting with stakeholders on some of the issues for quite some time. The 2009 session was targeted for a bill. The life settlements industry wants to be regulated and is generally in accord with this bill but the details need a lot of work. Most life insurance policies lapse or are surrendered. Today, a person may be able to find a purchaser for that policy that would otherwise lapse. The ability to sell a policy is not new. It has been recognized by the courts for many decades in Washington. It is a property right. The market to sell a policy is new. Insurers have sold policies on employees to corporations as investments for years. Those policies never lapse. Individual policies do lapse at a high rate. The insurers are subsidizing those corporate policies with the individual policies. Consumers should have the same investment options that insurers provide to corporations. The STOLI definition should be modified. STOLI is an illegal transaction at the time the policy is issued because there is no insurable interest. That should be the focus of the definition of STOLI. Life insurers tell their investors that they can identify and prevent STOLI transactions today.

The bill is generally a very good piece of policy.  There are a few contradictory provisions.  There are conflicts in the provisions involving disclosure.  There are other technical amendments that provide more transparency and better disclosure.  The STOLI provisions on the NCOIL model were drafted quickly before a meeting.  Over time, imperfections have appeared in that definition.  The sponsor of that NCOIL language revised it in the bill that he offered in Kentucky.

The OIC supports the NCOIL model as a base.  It protects consumers and offers a level playing field.  The bill does not align well with Washington law.  There are issues that need to be worked on.  The proponents have been willing to work on these issues but there may not be enough time to resolve the issues this session.

The Department of Financial Institutions (DFI) is concerned that the current jurisdiction of the agency is not affected.  The DFI would like to add a reference to Washington securities law.

**Persons Testifying:**  (In support) Carol Sureay, Office of the Insurance Commissioner; Mel Sorensen, American Council of Life Insurers and National Association of Insurance and Financial Advisors; and John Mangan, American Council of Life Insurers.

(In support with concerns) Carrie Tellefson and Michael Freedman, Coventry; Bill Beatty, Department of Financial Institutions; and Tom Brooks, Institutional Life Markets Association.

**Persons Signed In To Testify But Not Testifying:**  None.