

**House Subcommittee on Stranger Originated Life Insurance
South Hearing Room
Tuesday, December 11, 2007 - 2:30 pm
Testimony of Mary Jo Hudson, Director
Ohio Department of Insurance**

Introduction

Chairman Hottinger and members of the House Subcommittee, good afternoon. I am Mary Jo Hudson, Director of the Ohio Department of Insurance, and I would like to thank you for inviting me here this afternoon to discuss HB 404 and the proposed amendments to Chapter 3916 of the Ohio Revised Code, otherwise known as the Viatical Settlements Act.

Viatical Settlements have been regulated in Ohio since 2000. A viatical settlement allows a consumer who owns a life insurance policy to sell the policy to a third party/investor, who would then receive the death benefit when the consumer dies. The proposed amendments to the Viatical Settlements Act that we are discussing today would limit a type of viatical settlement or life settlement known as Stranger Originated Life Insurance, or STOLI transactions. We are advocating for adoption of these proposed amendments in order to protect Ohio consumers, especially seniors, and also to assure that Ohio's insurable interest law is not violated by allowing speculation on the lives of others.

Viatical Settlements – How Did We Get Here?

In order to understand why we are recommending an amendment to the Viatical Settlement Act, it is important to understand and the concept of "insurable interest", as defined in Section 3911.09 of the Ohio Revised Code, and also how viatical settlements moved into the insurance market.

Insurance laws, and the concept of "insurable interest" developed centuries ago, when groups of investors would pool their funds, and agree that the last surviving member of the group could keep the funds. This arrangement, known as a "tontine", was actually used to finance public works and made many rich. However, it was a risky investment, and eventually outlawed, because investors were killing each other to receive the investment pool.

In 1774, England outlawed tontine – the practice of wagering or gambling on the lives of others. Before the Act of 1774, anyone could buy a life insurance policy on the life of another—bets were made on the lives of total strangers to the insured.

The Act required that a person buying life insurance must have an insurable interest. This basic principle of insurance became part of our common law heritage.

Ohio's "insurable interest" law defines who can benefit from insurance proceeds. The law provides that family, friends, charities and employers can benefit from an individual's life insurance policy. However, an insurance policy cannot be purchased solely for an investor to profit from the death of the insured - in effect, Ohio's prohibition on "tontines."

Next, it is important to distinguish a tontine from a viatical settlement. Viatical settlements, also known as life settlements, developed in the late 1980's during the AIDS crisis and were first known as "living benefits." Individuals who were diagnosed with AIDS received a virtual death sentence - there was no cure and death was almost guaranteed within a short time after diagnosis. Many of these individuals were young, and they were losing their jobs, housing and health insurance—reaching epidemic numbers in just a few years..

For those AIDS victims who were fortunate enough to hold life insurance policies, a market developed where the policyholder could, in effect, sell their policy to an investor for a fraction of the policy's value. Thus, viatical sales, or life settlements, were born. Under the Health Insurance Portability and Accountability Act of 1996 (HIPAA), terminally ill individuals could receive these accelerated benefits from their life insurance policies tax-free.

As this market developed, two things happened. First, fraud became a common problem—the demand was so heavy for the high rates of promised returns and the number of "real" life insurance policies was so few, individuals began "creating" life insurance for the viatical settlement market. Second, as better treatments for AIDS were developed, the virus did not become as much of a death sentence, and the investors were having to pay premiums long after they had been promised their profits.

In order to curb these abuses in the viatical market, the Viatical Settlements law was enacted. In fact, Ohio was the first state in the nation to enact this law to protect Ohioans and also maintain stability in the Ohio life insurance market.

Today's Viatical Settlement Market Development - Stranger Originated Life Insurance Transactions

So what is stranger-originated life insurance, or a "STOLI" and why is the Ohio Department of Insurance so concerned with STOLI transactions occurring in Ohio? A STOLI arrangement is a transaction where an investor agrees with a consumer to finance the purchase of life insurance, from the first dollar of premium paid on the life insurance policy, in order to benefit the investor. The insured is often paid a fee, up front, in order to participate in the transaction. We have heard of seniors being promised a "referral fee" for providing the names of other seniors who would be willing to help "farm" life insurance policies. The insured may also be promised that his or her beneficiaries may receive a small portion of the policy proceeds.

A STOLI transaction is, in effect, an arrangement where an investor - a stranger to the insured - owns the right to receive the death proceeds. The only way to recover the investor's money is for the insured to die—the sooner the better. As I discussed earlier, a STOLI transaction is completely contrary to the Ohio "insurable interest" law. It also is a Wall Street version of a tontine.

STOLI Transactions and Ohio Seniors

In addition to our concerns regarding the Ohio "insurable interest" law, the Ohio Department of Insurance is also concerned about the significant, adverse impact that STOLI transactions can have on Ohio seniors. STOLI transactions are generally directed to seniors, over age 65. These transactions are commonly billed as "free" insurance. However, these deals are anything but free for the senior.

STOLI transactions can have adverse consequences for seniors, including unexpected income tax liability, credit score issues, limited future insurability and higher life insurance rates. When a senior enters into a STOLI transaction, the senior often receives an up-front fee. This fee may be the only remuneration that the senior receives in the transaction. Unlike life insurance proceeds, which are exempt from income tax liability, STOLI transaction payments are fully taxable.

Also, a STOLI transaction is a first dollar, premium financed transaction. There is often a loan issued to the insured, or at least in the name of the insured. If the loan is in the insured's name, the debt obligation is reported on the insured's credit history. High debt loads can lower credit scores, and adversely impact future credit applications that the senior might undertake.

Similar to credit history, an individual can only be issued a certain amount of life insurance before the individual would be considered a poor insurance risk. If an individual enters into a STOLI transaction, then needs to apply for life insurance for family or business succession purposes, the insured's application may be denied due to excessive prior insurance coverage.

As noted above, STOLI transactions are counter to Ohio's insurable interest laws. Life insurance rates are established on actuarial principles, assuming the insurer has full knowledge of the risk it is assuming. The premium rates do not consider third parties investing in life insurance proceeds, or the other risks associated with such investments. If STOLI transactions are allowed to continue, unchecked, in Ohio, we can anticipate that life insurance for senior applicants will become more expensive, as insurers begin to try to protect themselves from these artificial transactions.

Key Provisions of the Proposed Amendments

Our current Viatical Settlements Act makes it a violation to enter into a viatical settlement contract within a two-year period after the policy is issued. The proposed amendments would change this waiting period to five years. The amendments also permit selling a policy in a viatical transaction within the five years if certain conditions are met, such as the sale of a life insurance policy that was purchased with a genuine insurable interest, purchasing a policy that was financed through a full recourse loan, or if the insured becomes chronically or terminally ill.

The proposed amendments add extra protection for consumers by requiring full disclosures by viatical settlement providers and viatical settlement brokers, including any relationship between the provider and the broker, and the total compensation that the broker is making on the transaction.

The amendments also adjust the rescission period in a viatical sales transaction from 15 days to 30, after the insured receives the settlement proceeds, or 60 days after the insured signs the agreements, so long as the insured repays any loan amounts and interest. If a rescission occurs, then the broker must refund his or her commission as well.

Finally, the amendments also require the broker to obtain regular continuing education on life settlement issues.

Conclusion

HB 404 is an important amendment to Chapter 3916 of the Ohio Insurance Code. The amendments help to protect Ohio seniors against inappropriate insurance sales, and also preserve the venerable, long-standing principle of "insurable interest" in Ohio.

The Ohio Department of Insurance is in full support of these amendments, and encourages this Subcommittee to adopt these amendments. Thank you for your time and attention. I would be happy to address any questions you might have at this time.