



Insurance, Banks & Financial Services Bulletin



June 2008

Bricker & Eckler LLP

100 South Third Street
Columbus, Ohio 43215-4291

Phone 614 . 227 . 2300
Fax 614 . 227 . 2390
info@bricker.com
www.bricker.com

COLUMBUS | CLEVELAND
CINCINNATI-DAYTON

Ohio's Anti-STOLI Legislation

The Ohio law firm of Bricker & Eckler LLP represents the Association of Ohio Life Insurance Companies, a statewide trade association of life insurers, and represented its interests throughout the legislative debate on Amended Substitute House Bill 404.

This Client Bulletin gives an overview of key provisions of the legislation.

Ohio's new law aimed at eliminating Stranger-Originated Life Insurance (STOLI) transactions in Ohio will take effect on September 11, 2008. Amended Substitute House Bill 404 (H.B. 404) revises Ohio's viatical settlement laws, and enacts significant new provisions to curb STOLI transactions.

STOLI transactions are designed to "manufacture" life insurance policies for the benefit of investors. In a typical STOLI scheme, a consumer receives some form of compensation in exchange for taking out a life insurance policy for the benefit of unrelated investors, who reap their profit when the insured dies.

H.B. 404 defines and prohibits "STOLI", imposes a five-year waiting period on the settlement of policies with STOLI characteristics, and expands state regulatory authority over secondary life insurance transactions. Many of the provisions in the bill are based on the relevant model laws of the National Association of Insurance Commissioners' (NAIC) and the National Conference of Insurance Legislators' (NCOIL). But H.B. 404 modifies many key provisions affecting STOLI, and includes unique provisions affecting insurers, settlement providers, agents and brokers.

Key provisions of H.B. 404 include:

- I. Limitations on STOLI Transactions
- II. Prohibition on Fraudulent Viatical Settlement Conduct
- III. Premium Financing, Contracts, & Trusts
- IV. Licensure Requirements
- V. Disclosure to Consumers
- VI. Advertising Materials

VII. New Requirements for Life Insurance Companies

A copy of the bill can be found at http://www.legislature.state.oh.us/bills.cfm?ID=127_HB_404

I. Limitations on STOLI Transactions

H.B. 404 defines and prohibits STOLI transactions, and imposes a five-year waiting period on the settlement of policies with STOLI characteristics.

STOLI Defined and Prohibited

Consistent with the NCOIL Model Act, H.B. 404 prohibits STOLI transactions. STOLI is defined as a "practice, arrangement, or agreement" primarily for the benefit of a person who lacks insurable interest in the insured, that transfers the legal or beneficial ownership or benefits of the policy, including through an assumption or forgiveness of a loan.

"STOLI" includes trusts or other entities such as LLPs that are created to give the appearance of insurable interest and are used to initiate life insurance for investors. The bill provides that these arrangements violate Ohio law.

H.B. 404 also prohibits marketing or selling life insurance for the purpose of or with an emphasis on settling the policy.

The Five-Year Moratorium on Settlement

H.B. 404 imposes a five-year moratorium on the settlement of policies with STOLI characteristics. Life insurance policies that do not have STOLI characteristics continue to be subject to a two-year moratorium on settlement.

This document has been prepared as a general reference document for informational purposes. The information contained herein is not intended to be and should not be construed as legal advice. Each circumstance should be considered and evaluated separately, and possibly with involvement of legal counsel.

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To avoid the five-year moratorium on settlement, a policy owner must certify that:

- Premiums were funded with personal assets, or that any financing agreement was secured by personal assets and disclosed to the insurer;
- The policy owner made no agreement to settle the policy before or during the first two years after policy issuance;
- The policy owner responded truthfully to the insurer's inquiry at application regarding whether a life expectancy evaluation was obtained and a copy of any evaluation was provided to the insurer; and
- Any financial arrangement, trust or other device that conceals ownership of the policy was disclosed to the insurer prior to policy issuance.

A policy owner may settle a policy at any time if one of the following "hardships" arises after issuance of the policy:

- Terminal or chronic illness
- Physical or mental disability
- Death of spouse
- Death of family member who is the sole beneficiary of the policy
- Retirement
- Bankruptcy or insolvency.

II. Prohibition on Fraudulent Viatical Settlement Conduct

H.B. 404 includes a list of activities defined as "fraudulent viatical settlement acts", including:

- Providing misleading material information in the application or underwriting process, claims payments, or financing of a viatical settlement contract or insurance policy.
- Failing to disclose to an insurance company that a life expectancy evaluation has been obtained in connection with issuance of the policy.
- Employing a plan or scheme intended to defraud in the secondary market.

III. Premium Financing, Contracts, & Trusts

Unique among state anti-STOLI measures, H.B. 404 includes provisions designed to facilitate an insurer's detection of STOLI transactions. To motivate compliance with these "transparency" requirements, H.B. 404 declares that contracts and agreements related to STOLI, including premium financing agreements that are not disclosed, are unenforceable as a matter of Ohio law.

Specifically,

- If a premium finance company fails to provide notice to the insurer within 30 days of entering into an agreement, the agreement is unenforceable.
- A contract, agreement, arrangement or transaction entered into "for the furtherance or aid of a STOLI act, practice, arrangement, or agreement" is void and unenforceable.
- Trusts, LLCs, LLPs, or other entities created as part of a STOLI transaction violate Ohio's insurable interest laws and the prohibition against wagering on life.

IV. Licensure Requirements

Under current Ohio law, any person that operates as a viatical settlement provider or viatical settlement broker must be licensed by the Ohio Department of Insurance. H.B. 404 modifies those licensure requirements.

Settlement Providers

At the time of initial licensure, a settlement provider must provide evidence of financial responsibility, and a description of the method used to determine life expectancies.

Once licensed, a settlement provider must file:

- Quarterly and annual financial statements, and
- Aggregate information regarding the provider's settlement transactions.

The Department has authority to request proof of financial responsibility from a settlement provider at any time. And under its market conduct authority, the Department may request detailed transactional information from settlement providers.

Settlement Brokers

H.B. 404 requires that settlement brokers complete 15 hours of continuing education every two years.

H.B. 404 also exempts the following professionals from the settlement broker licensure requirements:

- Life insurance agents who are in good standing with the Ohio Department of Insurance, who have been licensed in Ohio for at least five years, and whose settlement broker activities are an incidental part of their business, and
- Attorneys, CPAs, and accredited financial planners who are not compensated by a settlement provider or purchaser.

VI. Disclosure to Consumers

H. B. 404 strengthens requirements related to disclosures to consumers involved in settlement contracts. The following must be disclosed:

- Rescission rights
- That the consumer may be contacted to determine his/her health status

- All offers, counter-offers, acceptances, and rejections related to the settlement contract
- Any affiliations between the broker and anyone making a settlement offer
- Any affiliations between the settlement provider and settlement purchaser
- The amount and method of calculating broker compensation.

VII. Advertising

Settlement providers and brokers must maintain a system of control over the content, form, and method of dissemination of all advertisements of its contracts, products, and services.

VIII. New Requirements for Life Insurance Carriers

Two specific provisions in H.B. 404 reflect the legislature's view that insurance companies must play a role in identifying and preventing STOLI.

Annual Certification of anti-STOLI Efforts

Every insurer issuing life insurance in Ohio must file a certified statement with the Ohio Department of Insurance describing the company's efforts to "detect and prevent" STOLI. These filings are confidential and not a public record. The Department will specify the format for making these electronic filings.

STOLI-Related Questions on Applications

H.B. 404 states that every insurer issuing life insurance in Ohio must include questions related to STOLI on its applications. The bill specifically charges the Department of Insurance with adopting a rule to implement

this requirement. During discussion of this provision in the Senate, the Committee Chair stated that the rule is expected to prescribe the types of policies to which this requirement applies. Compliance by insurers will be required 12 months after adoption of the rule.

Implications of H.B. 404

In 2001, Ohio's viatical settlements law was enacted to address problems of fraud and deception affecting policy owners and investors. In 2008, H.B. 404 will amend that law to reflect the growth of the secondary market for life insurance policies, and the phenomenon of stranger-originated life insurance.

H.B. 404 includes significant disincentives to participate in STOLI transactions, and encourages both the primary and secondary markets to detect and prevent the issuance and settlement of STOLI policies.

Life insurance companies and agents, as well as settlement companies and brokers doing business in Ohio, must familiarize themselves with H.B. 404. Documents used in connection with settlement contracts may need to be revised, and insurance companies may need to incorporate the standards of H.B. 404 into their underwriting procedures. Consideration should also be given to unique provisions in H.B. 404 that may create new avenues for challenging transactions involving STOLI.

For more information about this legislation or legal issues related to STOLI, contact Faith M. Williams at 614.227.2374 or fwilliams@bricker.com, Kurtis A. Tunnell at 614.227.8837 or ktunnell@bricker.com, or Oyango A. Snell at 614.227.2349 or osnell@bricker.com. Visit our website at www.bricker.com.

Insurance, Banks & Financial Services Group

Faith M. Williams
Chair
614 . 227 . 2374
fwilliams@bricker.com

Jeffery E. Smith
Vice-Chair
614 . 227 . 2352
jsmith@bricker.com

John P. Beavers
614 . 227 . 2361
jbeavers@bricker.com

Jonathan T. Brollier
614 . 227 . 8805
jbrollier@bricker.com

John W. Cook, III
614 . 227 . 2383
jcook@bricker.com

Natalie Trishman Furniss
614 . 227 . 8918
nfurniss@bricker.com

Stephen C. Gray
614 . 227 . 2329
sgray@bricker.com

Molly E. Heald
614 . 227 . 8896
mheald@bricker.com

Stephen Intihar
614 . 227 . 2376
sintihar@bricker.com

Robert H. Katz
614 . 227 . 2397
rkatz@bricker.com

Donald R. Keller
614 . 227 . 2341
dkeller@bricker.com

Miranda C. Motter
614 . 227 . 4810
mmotter@bricker.com

Terrence O'Donnell
614 . 227 . 2345
todonnell@bricker.com

James G. Petrie
614 . 227 . 2373
jpetrie@bricker.com

Nelson M. Reid
614 . 227 . 8812
nreid@bricker.com

Justin Ristau
614 . 227 . 4857
jristau@bricker.com

James P. Schuck
614 . 227 . 8839
jschuck@bricker.com

Anne Marie Sferra
614 . 227 . 2394
asferra@bricker.com

Christopher N. Slagle
614 . 227 . 8826
cslagle@bricker.com

Oyango A. Snell
614 . 227 . 2349
osnell@bricker.com

Elisabeth A. Squeglia
614 . 227 . 2396
esqueglia@bricker.com

Kurtis A. Tunnell
614 . 227 . 8837
ktunnell@bricker.com

Maggie F. Weber
614 . 227 . 2382
mweber@bricker.com