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COMMISSIONER
OFFICE OF INSURANCE
REGULATION

September 25, 2008

Florida Office of Insurance Regulation
Florida Department of Financial Services
200 East Gaines Street
Tallahassee, FL 32399

RE: Informational Hearing on Stranger-Originated Life Insurance Transactions

Dear Commissioner McCarty:

Please accept this letter as CFC of Delaware II LLC's (CFC) formal submission to the record of the public hearing on Stranger-Originated Life Insurance (STOLI), held on August 28, 2008, by the Office of Insurance Regulation (Office). CFC supports the recent expansion and clarification of Florida's insurable interest law under Fla. Stat. § 627.404, and categorically opposes STOLI arrangements in which an insured is induced into obtaining life insurance for the ultimate benefit of an unrelated investor. While CFC believes that present law sufficiently protects against STOLI transactions, if the Office concludes that further regulation of the industry is necessary, CFC specifically urges the Office to recognize that premium financing is not the only vehicle used to originate STOLI transactions and to delineate between legitimate premium financing and premium financing used to transact STOLI arrangements.

CFC currently engages in premium financing transactions outside the state of Florida and has a vested interest to protect a lender's ability to engage in legitimate premium financing transactions in all 50 states. As a life insurance premium finance company, CFC has concerns about STOLI practices. These practices erode principles designed to ensure that life insurance is used to protect the interests of parties associated with the insured. CFC believes that STOLI arrangements are not consistent with the intended purposes of insurable interest statutes within the various states.

As a result of these concerns, CFC takes the following positions with regard to life insurance premium financing:

1) A legal opinion that insurable interest is present must be provided before a loan will be made.
2) A legal opinion that addresses the legality of the loan must be provided before a loan will be made.
3) No premium finance loan will be made that includes incentives paid to the owner of the life insurance.
4) There will be no participation of any kind by CFC in any life settlement transaction.
5) CFC will not take any ownership interest in a financed policy nor will it control the sale of a financed life insurance policy.

Life insurance premium financing has served the interests of purchasers of life insurance, as well as life insurers and their agents for more than 100 years, long before the emergence of the concept of STOLI. CFC believes that the best way to serve policyholders, their professional

advisors, and the insurance carriers is through complete transparency in all life insurance premium finance transactions. Full and accurate disclosures will be made to all parties to the transaction.

During the STOLI hearing, the legitimacy of premium financing was brought into question. At its core, premium financing remains a legitimate and financially prudent method for insureds to leverage their assets, and has been an accepted practice within the insurance industry for decades. When a bona-fide need for life insurance exists and the insurable interest requirements under Fla. Stat. § 627.404 and similar statutes of other states are satisfied (*i.e.* the insurance is not related to a STOLI scheme), certain high net-worth individuals and closely-held business owners can realize a number of legitimate benefits through premium finance programs, namely wealth transference, business succession planning, and the ability to avoid liquidating assets to fund premium payments. Furthermore, the beneficiary of a life insurance policy is ensured of having the liquidity necessary to pay the Federal Estate Tax or purchase price in a buy-sell agreement when the insured dies.

Premium financing helps insureds address liquidity, tax, and wealth transference issues. To demonstrate the potential benefits of funding the cost of insurance through a premium financed loan, assume that Client has a net-worth of $10 million, with assets principally consisting of real estate currently generating an above-market return. In order to provide his estate with liquidity to pay the taxes and costs that will be incurred as a result of his death, Client needs a large amount of life insurance that will carry substantial policy premiums. Not wishing to dispose of his real estate because of its favorable return, and not having enough other liquid assets to pay the insurance premiums, Client decides to take out a premium financed loan. If the return on Client's real estate during the loan period continues to exceed the total interest and fees on the loan, Client will enhance his current financial position and accomplish his estate planning objectives. Alternatively, Client could have contributed cash to an irrevocable life insurance trust (ILIT) to own the insurance policy and pay the associated premiums. In this scenario, Client would be subject to gift tax on the contributions he makes to the ILIT. In a premium financing transaction, the lender loans the funds directly to the trust, thereby ensuring that Client is not subject to gift tax (*i.e.* Client has not made a gift). Thus, premium financing addressed Client's liquidity, tax, and wealth transference concerns, and also provided Client the opportunity to enhance his current financial position. Florida law should permit its citizens to obtain life insurance by engaging in legitimate premium financing transactions.

When addressing the legitimacy of premium financing, the National Association of Insurance Commissioners (NAIC) suggested that non-recourse premium financed loans exist solely for purposes of engaging in STOLI arrangements. Such a claim fails to recognize the insurance industry's historical acceptance of premium financing, and demonstrates a fundamental misunderstanding of the role that premium financing plays in the acquisition of life insurance. Premium financed loans, whether recourse or non-recourse, provide a *means* for obtaining insurance. When a genuine need for life insurance coverage exists, premium financing is a legitimate and effective asset management tool providing the benefits previously mentioned. If an improper motive drives the insurance application, such as a desire to realize the potential economic gain from pre-arranging settlement of the policy with an outside investor, then the

parties may attempt to abuse any one of a number of otherwise valid transaction structures, including premium finance programs. Thus, contrary to the NAIC's assertion, the mere existence of a premium financed loan does not necessarily indicate a STOLI scheme. Rather, an applicant's intent is the primary factor in determining whether the transaction is entered into in accordance with the law.

Premium finance companies that are dedicated to engaging in legal transactions implement and adhere to detailed policies and procedures designed to verify an applicant's intent regarding the insurance coverage. Contrary to comments at the hearing contending that premium financing is one of the only red flags to identifying a STOLI scheme, various facts and circumstances signal that a client may have been improperly induced to purchase the insurance by an investor. In fact, identifying and investigating these red flags is the focus of the life insurance underwriting and premium finance application process. Before being approved by an insurance carrier for a premium-financed policy, an applicant must certify his or her intent regarding the insurance in the loan application; the application will not be approved if the applicant's intent is to dispose of the policy within several years. The applicant must also confirm that no up-front payments or other consideration from an unrelated investor have been received as an inducement to obtain the insurance. In a legitimate premium financing transaction, the applicant must not only collaterally assign the financed policy to the lender, but the insured must also provide additional collateral as security for the loan. Some commentators at the hearing suggested that the additional collateral is illusory, but legitimate premium financing companies, such as CFC, have collected such collateral when the borrower has defaulted on a loan. Additionally, CFC engages in added measures to ensure they are not financing STOLI transactions. For example, CFC makes calls to every insured to further confirm the validity of the representations made within the insurance and loan applications. Again, statements during the telephone call that are inconsistent with the written representations are investigated in detail to ensure the transaction is proper.

Besides verifying the written and oral statements made by the insured, independent facts and circumstances are considered in determining whether insurance is being obtained for legitimate reasons. CFC requires that insureds provide financial statements prepared by a third-party accountant or financial advisor to validate his or her net-worth; applying for an excessive amount of insurance is a common signal of a STOLI transaction. CFC also encourages insureds to seek independent legal advice regarding the premium financed loan; the involvement of an insured's legal counsel is another independent factor suggesting that the applicant is acquiring the insurance and taking out the loan for legitimate reasons. Furthermore, CFC carefully screens the agents submitting business to CFC. If an agent has a demonstrated history of settling policies for clients shortly after being acquired, then the transaction is more likely part of a STOLI scheme.

Legitimate premium financing programs do exist, and currently have mechanisms in place to detect and prevent STOLI arrangements. Undeniably, not all financing programs operate with a view to avoiding STOLI transactions. Indeed, the so-called "stealth" programs deliberately conceal their identity from the carrier, require no additional collateral from the applicant, and assist with and encourage settlement of the policy from the contract's inception. Because legitimate programs do not conduct business in this manner and employ every effort to make the transaction transparent to the carrier, many premium finance programs are carrier approved. The

Office must consider an important question before adopting new regulations concerned with STOLI schemes – are the stealth programs that currently operate in an unethical and often illegal manner any more likely to abide by the law because of new rules that further prohibit their business conduct? Most likely, the only businesses that will respond are the ones already operating ethically and within the bounds of the law.

If the Office decides to adopt regulations proscribing STOLI arrangements, CFC respectfully requests that the Office distinguish Stranger-*Originated* from Stranger-*Owned* Life Insurance. As Mr. Head of the Life Insurance Settlement Association (LISA) testified at the STOLI hearing, there is an important and significant difference between Stranger-*Originated* and Stranger-*Owned* life insurance. Assuming an insurable interest exists at the inception of the insurance contract as required by Fla. Stat. § 627.404(1), the policyholder may freely dispose of property (the policy) as he or she sees fit. Since circumstances often change after insurance is purchased, sometimes making it necessary for a policyholder to sell, exchange, or otherwise dispose of the policy in the secondary market, the Office should not infringe on the right of Florida citizens to engage in such a transaction merely because the policy is subsequently owned by a stranger who would not have had the requisite insurable interest at the policy's inception. Again, Florida law expressly states that "the insurable interest need not exist after the inception date of coverage under the contract." Fla. Stat. § 627.404(1). This language indicates the legislative intent to continue to allow policyholders to explore the secondary market for life insurance. If the Office determines that further regulation of the insurance industry is necessary, CFC supports appropriate measures, including criminal penalties, for those engaging in Stranger-*Originated* Life Insurance transactions (*i.e.* those transactions where a stranger or investor induces the applicant to acquire the insurance by promising a future, pre-arranged settlement). However, CFC specifically requests that such measures be drafted narrowly so as to prohibit only Stranger-*Originated* Life Insurance, while expressly permitting Stranger-*Owned* Life Insurance.

CFC would welcome the opportunity to be used as a resource for the Office to learn more about legitimate financing of insurance premiums. In closing, CFC encourages the Office to continue its efforts to protect Florida citizens but respectfully requests that such measures not infringe upon a citizen's right to enter into basic consumer transactions, including an insured's ability to finance life insurance premiums.

Respectfully submitted,

Traci Kratish, Esq., LL.M., CPA
General Counsel and Chief Compliance Officer

CFC of Delaware II LLC
c/o BNC National Bank
333 South 7th Street, Suite 150
Minneapolis, MN 55402
(877) 466-1066