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THE VIATICAL SETTLEMENT INDUSTRY: DOES THE CURRENT LAW ADEQUATELY PROTECT FLORIDA'S CONSUMERS?

SUMMARY

The viatical settlement industry is a billion dollar business in Florida and across the country. Viatical settlement transactions involve an agreement by the owner of a life insurance policy, known as the "viator," to sell the policy to another entity for less than the expected death benefit under the policy. The amount paid for the policy is normally based upon the projected life expectancy of the insured, along with other criteria, and the purchaser of the viaticated policy, known as the "viatical settlement provider," may sell all or a part of the policy to one or more investors, known as "viatical settlement purchasers," or may group together a number of policies and resell them in fractions to many investors. In return for providing funds, investors receive the death benefit, or a proportionate share thereof, upon the passing of the insured.

Enacted initially in 1996, Florida's viatical settlement law regulates the sales of life insurance policies by the owners of the policies; provides licensing requirements and administrative oversight over the activities of viatical settlement providers, brokers, and life insurance agents; mandates disclosures to viators and purchasers; and contains fraud prevention provisions. The state agencies which regulate viatical settlement transactions report that they have received almost 1,000 complaints, primarily from investors, who are elderly and have invested substantial sums and lost millions in viatical settlement investments due to misrepresentations as to the risk and return of viatical investments or the life expectancy of the insured, lack of full and fair disclosures, and fraud committed by providers, agents, and brokers.

The Office of Financial Institutions and Securities Regulation (OFIR) investigates investor complaints as to whether a viatical investment meets the criteria of a "security," and as such, requires registration under

Florida's securities law, the full and fair disclosure of the security to investors, and registration by the person selling the security. Currently, forty six states regulate viatical settlement investments as securities, with the exception of Florida, Connecticut, Nevada and Wyoming.

Viatical industry representatives assert that the current insurance regulatory framework provides adequate oversight over viatical transactions which involve both the consumer as a viator or as an investor, and therefore securities regulation is unnecessary.

Based on the findings in this report, committee staff recommends that in order to protect Florida's consumers, viatical settlement investments be regulated as securities under the Florida's securities law.¹ The benefits to consumers would be threefold:

1. All persons that sell viatical settlement investments would be licensed and subject to securities regulation.
2. All viatical settlement investments would be registered as securities.
3. Full and fair disclosure of all material terms and conditions of transactions would be made to the investor so that the investor could make a realistic appraisal of the merits of the securities and exercise informed judgment in determining whether or not to purchase such securities.

BACKGROUND

A viatical² settlement transaction is a written agreement under which the owner of a life insurance policy, the "viator,"³ sells the policy to another person or

¹ The securities law would only apply *after* the viator has viaticated (sold) the policy to the viatical provider.

² The word *viatical* is derived from the Latin word, *viaticum*, which described the payment or provisions given to travelers or soldiers embarking on a long journey.

³ Generally the viator/policyholder is also the individual whose life is insured by the policy, although the holder of

company, the “*viatical settlement provider*,” for less than the expected death benefit under the policy.⁴ The amount paid for the policy is usually based upon the projected life expectancy of the insured and other criteria.⁵ There is usually a third party involved in the transaction, the “*viatical settlement broker*,” who for a fee, negotiates the viatical settlement arrangements. The viatical settlement provider then assumes responsibility for the premium payments and upon the death of the insured, receives the full amount of the

the policy may be a spouse or business partner of the insured, or the group insurance plan itself. Note: The type of life insurance policy sold by the viator may vary, i.e., whole life, term, universal, or a group certificate.

⁴ The terms utilized under the Viatical Settlement Act, Part X, Ch. 626, F.S., mean the following:

Viator: the owner of a life insurance policy who enters into a viatical settlement agreement by selling the policy ownership and beneficiary rights in exchange for a cash payment.

Viatical settlement provider: the entity which purchases the policy ownership and beneficiary rights from the viator. The provider may subsequently sell the investment opportunity in the death benefit of a viaticated policy to a single investor or multiple investors. Providers must be licensed by the Office of Insurance Regulation (OIR).

Viatical settlement broker: the entity who, on behalf of a viator and for a fee, negotiates an agreement between a viator and a viatical settlement provider. The broker has a fiduciary duty to act according to the viator’s best interests, and collects a fee from the provider after the contract is executed. Brokers must be licensed by the Department of Financial Services (DFS), however, individuals licensed as life agents may perform the duties of brokers without obtaining a separate brokers license.

Viatical settlement sales agent: an individual who solicits viatical settlement purchasers to invest their money in viatical settlements and must be licensed by the DFS.

Viatical settlement purchaser: an individual who invests money to purchase an interest in a life insurance policy as part of a viatical settlement purchase agreement.

Escrow agent or independent viatical trustee: the entity that holds the documents and money until ownership rights of the policy have been transferred from the viator to the viatical settlement provider. Agents or trustees are not licensed by the state.

Viatical settlement contract: the written agreement between the viator and the viatical settlement provider.

Viatical settlement purchase agreement: the written agreement entered into by a viatical settlement purchaser (investor), to which the viator is not a party.

⁵ The purchase price for each policy must be calculated depending upon the type, size, and cash value of the policy involved, the amount and nature of any loans against the policy, the amount of outlay needed to maintain the coverage, and the rating and financial condition of the insurer.

death benefit from the policy. However, rather than retaining the policy, the provider usually sells all or a part of the policy to one or more investors, the “*viatical settlement purchasers*,” or may group together a number of policies and resell them in fractions to many purchasers. In return for providing funds, purchasers receive the death benefit, or a proportionate share thereof, upon the passing of the insured. This benefit is designed to be more than the original investment, creating a “return on investment.”

Viatical settlements emerged about 25 years ago as a way for policyholders with terminal illnesses and short life expectancies to sell or “*viaticate*” their life insurance policies to third parties, usually private, individual investors, and obtain ready cash for medical expenses and other needs.⁶ The market for viatical settlements expanded in the 1980s and 1990s, when companies bought policies from AIDS patients who were seeking to sell the death benefits of their life insurance policy at a discount for cash in order to pay their medical bills. At that time, AIDS patients were dying at an alarming rate and investors, who purchased these death benefits, experienced enormous returns on their investments. The viatical industry has grown rapidly across the country, brokering between \$2 billion and \$3 billion of viaticated policies in 2002.⁷

However, in early 1992, the first life-prolonging drugs for AIDS patients were introduced and these drugs significantly extended their life expectancies. According to representatives with the Florida Office of Insurance Regulation (OIR),⁸ as life insurance policies of terminally ill individuals became more difficult to obtain, unscrupulous individuals began to devise ways to cheat policyholders out of the proceeds of their life insurance policies and viators would either be too sick or lack the financial ability to contest or litigate the theft of their policies. Consequently in 1996, Florida began regulating viatical settlement transactions through the Department of Insurance (DOI) in an effort to protect the individual whose life is insured.⁹ As the number of viatical settlement transactions declined during the mid-1990’s, transactions involving a healthy

⁶ *Life Settlements: How They’re Affecting the Business*, LOMA Research Brief, July 2003.

⁷ Viatical and Life Settlement Association of America.

⁸ Effective January 7, 2003, the Department of Insurance was transferred to the Dept. of Financial Services (DFS) and to the Office of Insurance Regulation (OIR) (ch. 2002-404, L.O.F.; ch. 2003-261, L.O.F.). The OIR and DFS are responsible for regulating viatical transactions under part X of Ch. 626, F.S.

⁹ Ch. 96-336, L.O.F.

owner of a life insurance policy increased. Known as “life or senior settlements,”¹⁰ these transactions do not take the policyowners’ immediate mortality into consideration, but involve the sale of unwanted or unneeded life insurance policies to third parties for a fraction of the face amount.¹¹ In response to this changing market, Florida expanded viatical settlement regulation to apply to life settlement agreements in 2000.¹²

Legislative History of Florida’s Viatical Settlement Act

In 1996, Florida enacted the Viatical Settlement Act,¹³ which was designed to protect the “viator.” The Act mandated disclosures to viators; provided viators with the right to rescind viatical settlement contracts within 15 days after the viator received the viatical settlement proceeds, conditioned on the return of such proceeds; protected the confidentiality of viator medical and other records; established licensure requirements for viatical settlement providers and brokers; required prior approval by the DOI of viatical settlement contracts and forms; and allowed examination of providers’ records by the DOI. Violations of specified viatical provisions were declared to be unfair insurance trade practices. Two years later, the Act was amended to establish protections for investors, defined as “*viatical settlement purchasers*,” by requiring providers to disclose to purchasers in writing pertinent information regarding the viatical settlement investment.¹⁴ Other changes authorized the viatical provider to establish a *related provider trust* for the sole purpose of entering into or owning viatical settlement contracts. The effect of establishing this trust was to shield the viatical investment from liabilities of the provider that were not

related to the viatical settlement contract. In 1999, comprehensive legislation was enacted which increased consumer protections and heightened the DOI’s regulatory authority over viatical transactions.¹⁵ The legislation strengthened disclosure requirements viatical settlement providers and sales agents must give to viatical settlement purchasers; gave the DOI cease and desist powers against persons violating provisions of the Act; made certain actions prohibited practices; provided that the use of misrepresentations in advertising or in the sale of viatical settlement purchase agreements were unlawful, including the buying and selling of policies obtained by means of a false, deceptive, or misleading application for a life insurance policy.

In February 2000, the Fifteenth Statewide Grand Jury released its report on fraud within the viatical industry in Florida. The Grand Jury found that “fraud in the viatical settlement industry is rampant; as much as 40 to 50 percent of the life insurance policies viaticated by viatical settlement providers may have been procured by fraud.” The Grand Jury examined the issues of investor fraud and the deceptive practice called “cleansheeting,”¹⁶ and recommended a number of legislative changes designed to protect viatical investors and curtail fraud, many of which were subsequently enacted during the 2000 session.¹⁷ These provisions included increasing criminal penalties for viatical fraud; requiring written disclosures to viatical settlement purchasers by providers; allowing purchasers to void a purchase agreement within 3 days of receipt of disclosures; clarifying regulation of agreements and contracts involving Florida residents and residents of other states; and limiting transfers within the two-year contestability period with certain exceptions.¹⁸ The legislation also expanded viatical regulation to apply to senior or life settlement agreements.

¹⁰ Many life settlement companies purchase policies from individuals who are over the age of 65, have experienced a decline in health, and have remaining life expectancies of between six and twelve years (although in some cases life expectancies outside this range are considered). *The Benefits of a Secondary Market for Life Insurance Policies*, Neil A. Doherty and Hal J. Singer, (2002).

¹¹ These policies are not lapsed or matured, but are sold to third parties (investors) who hold the contracts until the insured’s death. *The Brewing Storm: Securities Regulation and Lifetime Settlements*, Ron Rowland, Journal of Financial Services Professionals, May, 2003.

¹² Ch. 2000-344, F.S. Florida changed the definition of a viator by removing the “diagnosed with a chronic or terminal illness” qualification to cover anyone willing to sell the death benefits of his or her life insurance policy for less than the death value.

¹³ Ch. 96-336, L.O.F.

¹⁴ Ch. 98-164, L.O.F.

¹⁵ Ch. 99-212, L.O.F.

¹⁶ “Cleansheeting” is a fraudulent criminal act committed by a life insurance applicant, and a life agent who assists or conspires with the applicant, for failing to disclose a pre-existing medical condition on a life insurance application in order to obtain a policy. The Grand Jury report also returned three Indictments charging individuals and one corporation with 155 felony counts relating to criminal fraud in the viatication of life insurance policies. The face value of these policies was \$12.7 million

¹⁷ Ch. 2000-344, L.O.F.

¹⁸ Life insurance companies require a two-year “contestability clause” to investigate and rescind policies obtained using fraudulent information.

The following year the Legislature amended the Act to require the viatical settlement provider to “track” the insured, e.g., to keep track of the insured’s whereabouts and health status, submission of death claims and the status of payment of premiums until the death of the insured.¹⁹ The legislation also contained disclosures and other protections for persons engaged in viatical settlement transactions on the “secondary market” which pertained to viatical purchases made from persons other than the viatical settlement provider.²⁰

Requiring Viatical Investments to be Regulated as Securities - Proposed 2003 Legislation

This past session, SB 1904 was introduced which provided that viatical settlement investments were securities for the purposes of Florida’s securities law.²¹ Under the proposal, viatical settlement investments would be registered as securities, persons selling such investments would be required to register, and full and fair disclosures would be provided to all investors. The legislation had the support of the Department of Financial Services (DFS), the Office of Insurance Regulation (OIR), and the Office of Financial Institutions and Securities Regulation (OFR), but died in committee.

METHODOLOGY

Staff reviewed the legislative history of the Viatical Settlement Act, relevant case law, as well as civil, administrative, and criminal actions involving licensed viatical settlement providers, brokers, and agents. Viatical and life settlement regulatory provisions in other states were examined, as were the model laws adopted by national securities and insurance associations, and the Commissioners on Uniform State laws. Information was obtained from various stakeholders in the viatical settlement industry in addition to representatives with the Department of Financial Services, the Office of Insurance Regulation and the Office of Financial Institutions and Securities Regulation.

FINDINGS

Regulating Viatical Settlement Transactions

¹⁹ Ch. 2001-247, L.O.F.; ch. 2001-207, L.O.F.

²⁰ These viatical settlement purchase transactions must be completed only through an independent third-party trustee or escrow agent.

²¹ SB 1904 (Sen. Atwater) died in the Committee on Banking and Insurance and HB 487 (Rep. Hasner) died in the Committee on Insurance Regulation. Ch. 517, (Florida Securities and Investor Protection Act).

The viatical settlement industry is a billion dollar business in Florida as is illustrated in Table 1, below. According to information from the Office of Insurance Regulation, from 1997 through 2002, licensed viatical settlement providers in Florida have purchased a total of 15,540 insurance policies from viators having a face value of over \$3 billion for which viators were paid approximately \$951 million. The percent paid to the viator has declined over this six year period because it reflects the decline in traditional viatical settlement transactions and the growth of life settlement agreements.²²

	#PP*	Face Value	Amount Paid	% Paid***
1997	4,672	\$434.3**	\$226.1	52.06%
1998	4,685	\$556.1	\$231.6	41.65%
1999	2,191	\$257.7	\$102.6	39.81%
2000	2,450	\$244.8	\$115.2	47.08%
2001	695	\$431.6	\$89.7	20.80%
2002	847	\$1,106.8	\$185.4	16.75%
Total:	15,540	\$3,031.5	\$950.8	31.36%

* #PP refers to the number of policies purchased for that year.
** In millions of dollars; *** % of the face value paid to viators.

Two agencies are responsible for regulating viatical settlement transactions in Florida: the Office of Insurance Regulation (OIR) and the Department of Financial Services (DFS). The OIR oversees the eight licensed viatical settlement providers in Florida.²³ Of

²² Under a traditional viatical settlement, where the insured has a terminal or chronic illness, the viator is paid a greater percentage of the face value of the policy because the insured’s life expectancy is short (24 months or less) and there is some assurance the insured will die “on time.” Typically, life settlement’s involve a healthy insured, albeit usually an elderly person, whose life expectancy can be up to 6-12 years. The return on investment may be greater with viatical settlements than with life settlements because viatical settlements “mature” faster. The longer the insured stays alive, the longer the investors wait to get their money out, and the lower their annual rate of return. Source: DFS and OIR staff.

²³ (1) *Coventry First, LLC* – Fort Washington, PA – date licensed 4/26/01; (2) *Life Settlements International, LLC* – Boca Raton, FL – date licensed 6/9/00; (3) *Life Equity, LLC* – Hudson, Ohio - date licensed 12/21/01; (4) *Life Settlements Corporation d/b/a Peachtree Life Settlements* – Norcross, GA – date licensed 6/14/01; (5) *Living Benefits Financial Services* – Minnetonka, MN – date licensed 5/6/02; (6) *Mutual Benefits Corporation* – Ft. Lauderdale, FL – date licensed 5/13/97; (7) *Stone Street*

the eight providers, five (Coventry, Life Equity, Peachtree Life Settlements, Living Benefits, and Stone Street) of the companies represent themselves as being institutionally funded which means that they have entered into an agreement with a financing company to purchase and hold viaticated policies until such policies have matured. Coventry is the largest of the five, with 47 percent market share in Florida. Three viatical settlement providers (Life Settlements International, Mutual Benefits, and Lifeline) market policies to individual investors. Mutual Benefits is the largest of the three, with 27 percent market share in this state.²⁴

The OIR screens prospective provider applicants prior to licensure; approves provider contract and other related forms; reviews provider plans of operation; investigates complaints; takes administrative action against providers when sufficient cause is present; and conducts market conduct examinations of providers to assure required compliance with the Viatical Settlement Act.

Representatives with the OIR state that they have received almost 1,000 viatical settlement complaints since the inception of the Act in 1996, with the vast majority coming from viatical settlement purchasers (investors).²⁵ These complaints have resulted in the opening of many investigative cases which typically involve misrepresentations to investors (including misrepresentations as to the life expectancy of the insured), lack of full and fair disclosures, and fraud committed by providers, agents and brokers. Confusion as to the life expectancy of the insured is of major concern to investors because, as agency representatives point out, the state does not license the individual providing estimates of life expectancies. Furthermore, the person providing these estimates is not required to be a licensed medical professional or to have experience in diagnosing diseases or estimating life expectancies.

Hundreds of investor complaints also have been made to the receivers who are appointed to viatical settlement entities which have gone into bankruptcy,²⁶ had their

Financial, Inc. – Bethesda, MD – date licensed 4/26/01; and, (8) *Wm. Page & Associates d/b/a/ The Lifeline Program* – Ft. Lauderdale, FL – date licensed 3/31/97. Source: OIR.

²⁴ Based on 2002 annual reports.

²⁵ The OIR has received 972 complaints since the passage of the Viatical Settlement Act (effective date Oct. 1, 1996, to the present time).

²⁶ Dedicated Resources, Inc., and Reliance Financial Group/Paragon Capital.

licenses revoked,²⁷ or been criminally prosecuted.²⁸ Agency staff states that the complainants are primarily elderly investors whose average age is 70 years old, with the average amount invested by each investor being \$44,733. Many of these elderly investors have lost millions of dollars (the total estimated by the OIR is \$498 million) to fraudulent viatical settlement providers as shown below in Table 2. Officials note that officers with three of the five companies listed in Table 2 (Future First Financial Group, American Benefit Services and Financial Federated Title & Trust, and Justus Viatical Group) have been or are currently being criminally prosecuted. These officials underscore that they have been working closely with the Federal Viatical Task Force involving the FBI and U.S. Postal Inspection Service, as well as having ongoing partnerships with the Securities and Exchange Commission and other state law enforcement agencies involved in viatical investigations.²⁹

Table 2 Estimated Provider Losses to Investors

<u>Company Name/Location</u>	<u>Estimated Losses To Investors</u>
1. Future First Fin. Group/ Ponte Vedra, Fl.	\$203 million
2. American Benefits Ser. Lake Worth, Fl. (and Finl. Fed. Title & Trust)	\$117 million
3. Accelerated Benefits/ Orlando, Fl.	\$114 million
4. Resource Funding/ Atlanta, Ga.	\$61 million
5. Justus Viat. Grp./ Juno Beach, Fl.	\$3 million
Total:	\$498 million

²⁷ Accelerated Benefits Corp., Future First Financial Group and Kelco, Inc.

²⁸ Future First Financial Group (four officers and one trustee were prosecuted); Justus Viatical Group (two officers were prosecuted); Life Benefit Services and Findco, Inc. (five officers were prosecuted); Kelco (three officers were prosecuted); Financial Federated Title and Trust and American Benefit Services/Financial Title & Trust (officers prosecuted) . Source: DFS, OIR, and the Office of the U.S. Attorney (Southern District).

²⁹ Testimony of Florida Chief Financial Officer Tom Gallagher, before the U.S. House of Rep., Committee on Financial Services, Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises (May 15, 2003).

Representatives with the OIR assert that state regulatory and administrative actions have been taken against viatical settlement providers which involve providers not making full and fair disclosures to investors, making misrepresentations as to the viator's life expectancy, or fraud (cleansheeting) in the life insurance application. The OIR has also referred criminal investigations against providers to state and federal authorities.

The DFS licenses viatical settlement brokers³⁰ and life agents³¹ (who carry out similar responsibilities as brokers under the viatical settlement law). That agency screens prospective licensees, conducts investigations, and carries out market conduct examinations to assure compliance with the law. The DFS has opened 184 investigations against brokers and agents in the past four years involving cleansheeting, misrepresentations of the benefits of viatical investments, fraud and deceptive practices, advertising violations, and misrepresentations (or misunderstandings on the part of the investor) as to the viator's life expectancy.³² Viatical fraud cases involving brokers and agents have also been referred to the Division of Insurance Fraud by the DFS.

Regulating Viatical Investments as Securities

Although the Office of Financial Institutions and Securities Regulation (OFR)³³ regulates security transactions under Florida's Securities law (ch. 517, F.S.), that office also investigates investor complaints as to viatical settlement transactions if the viatical investment in such a transaction meets the criteria of a "security." Under ch. 517, F.S., the definition of a "security" includes an "investment contract."³⁴ As an investment contract is not defined in statute, Florida has adopted the U. S. Supreme Court's test in *Securities and Exchange Commission v. W.J. Howe Co.*³⁵ which contains the standards which are used to

determine whether a viatical investment is an investment contract, and therefore a security. The criteria are: 1) investment of money; 2) in a common enterprise; 3) with an expectation of profits to be earned through the efforts of others. If a viatical investment meets these elements, Florida law requires the registering of such investments as nonexempt securities, the registration of the individual selling the investments with the OFR, and full and fair disclosure of all material terms and conditions of the transaction. For example, the sale of an interest in a pool of viaticated insurance policies would constitute the sale of a security, and compliance with the securities law would be required, according to OFR staff.

Representatives with the OFR assert that a viatical settlement transaction is a hybrid transaction that implicates both insurance law and securities law.³⁶ The "insurance law component" of the transaction arises when the viatical settlement provider transacts with the viator. The "securities component" of the transaction arises when a viatical settlement provider solicits investors to raise money to fund the pay-out to the insured. Investors are induced to invest with the promise that they will receive a death benefit, or fraction thereof, in an amount that will exceed their original investment. This type of arrangement constitutes an "investment contract," which is a type of security.

Over the past five years, the OFR has received 70 complaints from viatical settlement investors which resulted in the opening of 158 investigations against viatical providers, brokers, and agents ranging from misrepresentation as to the risk and return of the viatical investment to loss of economic value in the investment. Many of these complaints resulted in the OFR filing over a hundred administrative actions in the past three years against viatical life agents and brokers for not registering viatical investments as securities and for not registering as security dealers.³⁷ The OFR is currently in litigation against three life insurance agents

³⁰ There are 181 individuals licensed as viatical settlement brokers in Florida.

³¹ There are 101,466 licensed resident life agents in Florida who are licensed under s. 626.015, F.S.

³² Complaints received from 1999 to present.

³³ The OFR is the successor agency to the Dept. of Banking and Finance.

³⁴ s. 517.021(19)(q), F.S.

³⁵ 328 U.S. 293 (1946). See *Brown v. Rarigh*, 363 So.2d 590 (Fla. 4th DCA 1978). The U.S. Court of Appeals for the District of Columbia in *SEC v. Life Partners, Inc.* 87 F.3d 536 (D.C. Cir. 1996), held that certain viatical investments were not securities. The OFR takes the position that *Life Partners* is not controlling with respect to Florida's application of the *Howey* test to viatical settlements investments under Florida Law.

³⁶ This position is taken in 47 of the 50 states. See, testimony of Thomas E. Geyer, Ohio Dept. of Commerce, before the U.S. House of Rep., Committee on Financial Services, Subcommittee on Oversight and Investigations (Feb. 26, 2002).

³⁷ s. 517.07(1), F.S., requires securities to be registered with the OFR, and s. 517.12(1), F.S., requires the broker dealer and sales agent to be registered with the OFR. A viatical company may register itself (as an issuer dealer) and its employees (associated persons) to sell viaticated products, or employ the services of a dealer to sell the viaticated policies.

before two Florida courts of appeal concerning the issues involving viatical investments and securities law.³⁸ The primary issue pertains to whether the viatical insurance regulations under Part X, of ch. 626, F.S., preempt OFR from regulating viatical investments as securities under ch. 517, F.S.³⁹

Regulating Viatical Settlement Transactions in Other States

According to the National Association of Insurance Commissioners, 46 states regulate investments in viatical or life settlements as securities. Such regulation is either specifically codified in statute, by executive decree, or by court ruling. The regulation by each state varies greatly, with some states exempting investments in single viaticated policies or viatical investments involving institutional investors.⁴⁰ The four states which do not regulate such investments as securities are Florida, Connecticut, Nevada, and Wyoming.

How the Commissioners on Uniform State Laws, and Security and Insurance Model Acts Treat Viatical and Life Settlement Transactions

Both the National Conference of Commissioners on Uniform State Law in its Uniform Securities Act (USA) of 2002,⁴¹ and the North American Securities Administrators Association. (NASAA)⁴² in its recently

adopted Model Guidelines, have stated that investments in viatical settlements (including senior and life settlement investments) are securities and should be regulated under state securities laws. Also, persons selling such investments should be registered under securities laws and full and fair disclosure of viatical investments be made to prospective investors. The USA is supported by the 50 state securities commissioners, the Securities Administrators Association, and the American Bar Association.

In 1993, the National Association of Insurance Commissioners (NAIC)⁴³ adopted its Viatical Settlement Model Act to bring viatical companies under the authority of state insurance departments. The current act, adopted in March 2000, covers all sales of life insurance policies for less than the expected death benefit.⁴⁴ The NAIC model includes “optional” investor provisions if state insurance departments regulate the investor side of the transaction, including disclosures to investors and advertising standards. The National Conference of Insurance Legislators⁴⁵ (NCOIL) adopted its Life Settlement Model Act in 2000 which is currently undergoing revision.⁴⁶

³⁸ The three cases are: Dept of Banking and Finance v. Donald J. Denton, DOAH Case No. 02-1284 (appeal before the 5th DCA); OFR v. David. H. Kligfeld, DOAH Case No. 02-2668 (appeal before the 4th DCA); and, OFR v. James Torchia, DOAH Case No. 02-3583, (appeal before the 4th DCA). The Kligfeld and Torchia cases have been consolidated.

³⁹ In these cases, the OFR has argued that ch. 517, F.S., is not preempted by the Viatical Settlement Act and that the life insurance agents were selling securities in accordance with the *Howey* definition of investment contracts. The insurance agents argue that that each viatical transaction was pursuant to the Viatical Settlement Act, and thus not a security under the Securities law.

⁴⁰ Viatical and Life Settlement Assn. of America.

⁴¹ The USA is the work product of the Commissioners on Uniform State Law and that organization comprises more than 300 lawyers, judges and law professors, appointed by the 50 states, to draft proposals for uniform model laws and work toward their enactment in their legislatures. Since its inception in 1892, the group has promulgated more than 200 acts, among them the Uniform Commercial Code, Uniform Probate Code, and the Uniform Partnership Act.

⁴² The North American Securities Administrators Assn. (NASAA) is an association of security administrators in the 50 states, plus the Dist. of Columbia, Puerto Rico, Canada, and Mexico. Founded in 1919, it is the oldest

international organization devoted to investor protection. In its model guidelines, NASAA relied on the *Howey* case, but rejected both the rationale and the outcome of the *Life Partners* case by stating that “state regulators are not bound by the interpretation of federal statutes by federal courts, particularly where the rationale does not serve the prophylactic and remedial purposes of the state securities laws.

⁴³ NAIC is composed of the insurance regulators in the 50 states.

⁴⁴ The NAIC Model requires licensing of providers and brokers (optional licensing for life insurance agents); protections for insurance consumers, including disclosures such as the fact that there are alternatives to viatical settlements, that the proceeds may be taxable or subject to claims of creditors, or that there is a possibility of loss of Medicaid benefits. Most of the NAIC provisions have been adopted in Florida’s law (except Florida mandates licensure of life agents).

⁴⁵ NCOIL is an organization of state legislators who focus on insurance issues. It intends to consider further changes to its Life Settlement Model Act in November 2003.

⁴⁶ The NCOIL Act provides for the licensing and regulation of viatical providers, brokers, or sales agents by the state insurance departments; contains disclosure requirements for owners of life insurance policies; and prohibits certain practices, false representations, and specified unfair trade practices.

Viatical Industry Position

Representatives with viatical settlement providers which market investments primarily to individual investors emphasize that the current insurance regulatory framework provides adequate oversight over viatical transactions which involve both the consumer as a viator or as an investor.⁴⁷ They assert that licensure requirements as well as the myriad disclosure provisions ensure sufficient protection to investors. These industry officials state that if Florida were to amend its securities law to include viatical investments of viaticated policies, that the results would effectively foreclose providers from doing business in the state because the costs of this requirement would be passed directly to the parties in the transaction, substantially effecting the pricing of the transaction for the parties. One provider admitted that its analysis of the size of these transaction costs as applied per viatical settlement sale suggests that these costs would make the transaction “unfeasible.”⁴⁸

Furthermore, viatical settlements provide meaningful alternatives to persons either facing terminal illnesses, or who have life insurance policies they no longer want or can afford. Since the industry now primarily deals with life settlements, as opposed to traditional viatical transactions, industry representatives assert such settlements give policyholders a new option to consider in their financial planning. Oftentimes, when individuals viaticate their policies, they receive more money than they expected to receive in cash surrender benefits.⁴⁹ Ultimately, industry officials believe investor abuses can be sufficiently eradicated through adequate enforcement of the existing viatical settlement laws.

Position of the CFO, OIR and OFR

Florida’s Chief Financial Officer as well as the director’s of both the OIR and OFR⁵⁰ assert that the viatical settlement law does not protect Florida

⁴⁷ Companies which market viatical settlement investments to institutional investors are usually exempt under securities regulations in most states. This is because these investors are more sophisticated and knowledgeable than individual investors, e.g., “Mom and Pop” investors.

⁴⁸ Response from Wm. Page & Ass. d/b/a as The Lifeline Program, in a letter to committee staff on Oct. 10, 2003. Currently, Lifeline does not solicit purchasers in the United States and all of the purchaser funds it accepts come from non-U.S. sources.

⁴⁹ *Viatical and Life Settlements: The Challenge Facing the Life Insurance Industry*, Jean C. Gora, LOMA.2000.

⁵⁰ Chief Financial Officer Tom Gallagher, OIR Director Kevin McCarty, and OFR Director Don Saxon.

consumers who invest in viatical investments. These officials state that “it is imperative for the legislature to clarify that investments in viatical settlements are subject to the securities regulations...because such legislation would ensure that existing consumer protections, applicable to all other investments, are maintained for viatical settlement investments. Investments in viatical settlements are no different than investments in other securities and, as such, should receive similar regulatory treatment.” These officials also state that viatical settlement investment companies operate in the forty six states which currently regulate such investments as securities.⁵¹

Agency representatives believe that the Viatical Settlement Act does not curtail criminal or civil fraud committed by providers, brokers or agents, or curb abuses as illustrated by the millions of dollars investors have lost as noted previously in this report.

RECOMMENDATIONS

Based on the findings contained in this report, committee staff recommends that in order to protect Florida’s consumers, viatical settlement investments be regulated as securities under the Florida Securities and Investor Protection Act, ch. 517, F.S.⁵² The benefits to consumers would be threefold:

1. All persons that sell viatical settlement investments would be licensed and subject to securities regulation.

2. All viatical settlement investments would be registered as securities.

3. Full and fair disclosure of all material terms and conditions of transactions would be made to the investor so that the investor could make a realistic appraisal of the merits of the securities and exercise informed judgment in determining whether or not to purchase such securities.

⁵¹ See discussion above under Regulating Viatical Transactions in Other States.

⁵² The securities law would only apply *after* the viator has viaticated (sold) the policy to the provider.