

# VIATICAL SETTLEMENTS: AN EXPLANATION OF THE PROCESS, AN ANALYSIS OF STATE REGULATIONS, AND AN EXAMINATION OF VIATICAL SETTLEMENTS AS SECURITIES

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## I. INTRODUCTION

Viatical<sup>1</sup> settlements consist of the buying and selling of life insurance policies of terminally ill policyholders.<sup>2</sup> Viatical insurance agreements arose from the need of terminally ill persons to obtain funds to pay exorbitant medical

1. The word “viatical” is derived from the Latin word “viaticum” meaning “provision [in the form of food, money, necessities] for a journey.” OXFORD LATIN DICTIONARY 2054 (P.G.W. Glare ed., 1982). “Viaticum” is also used in a religious context as “the Eucharist given to one in danger of death as the food for his journey into the next world.” 14 NEW CATHOLIC ENCYCLOPEDIA 637 (Catholic Univ. of Am. ed., 1967). In the viatical settlement context, the term “viaticate the policy” is used to describe the transaction on which this Note will focus. See Carol C. Lamson, *Legal Introduction to Living Benefits in Life Insurance: New Perspectives and Developments*, N.Y. ST. B.J., Nov. 1993, at 16.

2. See Lee Ann Dean, Note, *Acquired Immune Deficiency Syndrome, Viatical Settlement, and the Health Care Crisis: AIDS Patients Reach into the Future to Make Ends Meet*, 25 RUTGERS L.J. 117, 121 (1993).

expenses caused by the rising costs of health care in this country.<sup>3</sup> In general, the transaction is comprised of a third-party viatical settlement company paying money to a terminally ill person for the rights to receive death benefits from his or her life insurance policy.<sup>4</sup> The individual is paid a lump sum of money and the viatical settlement company obtains the right to receive the death benefits of the policy when the individual dies.<sup>5</sup>

The viatical settlement business emerged in 1988 with only a few companies engaging in this type of transaction.<sup>6</sup> By 1991, the industry grew to about twenty companies.<sup>7</sup> Today, approximately sixty viatical settlement companies exist in the United States<sup>8</sup>—most of which are located in New York, California, Florida, and Texas.<sup>9</sup> The industry has recently been subjected to scrutiny because of the high profits earned by many viatical settlement companies.<sup>10</sup>

This Note examines the viatical settlement industry both as the practice of insurance regulated by the state insurance commissioner and as a security transaction, which is regulated by the Securities and Exchange Commission (SEC). First, this Note provides an in-depth examination of the operation of viatical settlement companies. It discusses the process by which an individual and a viatical settlement company enter into a viatical settlement, including purchase criteria, risks assumed by the viatical company, and criticisms of the industry. In addition, this Note investigates the conduct of the viatical settlement companies, which earned the "bad guy" reputation. Second, this Note analyzes current state regulations under which viatical settlements are controlled by the state insurance commissioner. This examination begins by delving into the goals and purposes of the regulations. It also compares and contrasts statutes enacted by twenty-one states that regulate the viatical settlement industry. Further, this Note examines the Model Act and Model Regulation proposed by the National Association of Insurance Commissioners (NAIC). Third, this Note explores the theory of viatical settlements as security transactions regulated by the SEC.

## II. VIATICAL SETTLEMENT COMPANIES

Viatical settlement companies responded to the terminally ill person's cry for money needed to pay medical bills, medical equipment, medications, and living expenses.<sup>11</sup> Viatical settlement companies became the light at the end of the tunnel for persons that could no longer afford necessities to live their last

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3. See Malcolm E. Osborn, *Rapidly Developing Law on Viatical Settlements*, 31 WAKE FOREST L. REV. 471, 471 (1996).

4. *Id.* at 472.

5. *Id.*

6. Russell J. Herron, *Regulating Viatical Settlements: Is the Invisible Hand Picking the Pockets of the Terminally Ill?*, 28 U. MICH. J.L. REFORM 931, 934 (1995).

7. David Weidner, *Viatical Contracts Hit Stride*, WINSTON-SALEM J., July 23, 1995, at A21.

8. Osborn, *supra* note 3, at 472 n.9.

9. Herron, *supra* note 6, at 934 & n.21.

10. *Id.* at 935.

11. *Id.* at 931-32.

months or years in peace.<sup>12</sup> These terminally ill people had no credit and no where to turn—their only asset was a valuable life insurance policy that could not easily be liquidated.<sup>13</sup>

### A. The Viatical Settlement Transaction Process

When a terminally ill person enters into a viatical settlement with a third-party corporation, the process is fairly simple for the viator.<sup>14</sup> The policyholder contacts a viatical settlement company and requests an application "consisting of a questionnaire, an authorization to release medical records, and an authorization to release insurance policy information."<sup>15</sup> After the applicant provides the viatical company with the requested information, doctors evaluate the applicant's records and formulate a prognosis.<sup>16</sup> If the applicant's insurance policy is a stable investment and he or she has *less than two years to live*, the viatical company may make an offer to pay the applicant a lump sum in exchange for the right to receive the individual's death benefits from the insurance policy.<sup>17</sup> The policyholder is generally paid fifty to eighty percent of the death benefits from the

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12. *Id.* at 935. Once the Acquired Immune Deficiency Syndrome (AIDS) epidemic exploded, the most common group of persons that utilize viatical settlements were "persons with AIDS" (PWAs) who desire financial stability and security in their final months or years. Jennifer Berner, Note, *Beating the Grim Reaper, or Just Confusing Him? Examining the Harmful Effects of Viatical Settlement Regulation*, 27 J. MARSHALL L. REV. 581, 584 (1994).

13. Herron, *supra* note 6, at 936-37. It is important to note that viatical settlements are only available to those that have life insurance policies to sell. *Id.* This leaves PWAs in the most financial need—"America's urban poor and the great majority of intravenous drug users"—virtually nowhere to turn for financial support. *Id.* at 937.

14. *Id.* at 933. A "viator" is the terminally ill individual owning a life insurance policy who enters into a viatical agreement with a viatical company. VIATICAL SETTLEMENTS MODEL ACT (National Ass'n of Ins. Comm'rs 1994), reprinted in 4 MODEL LAWS, REGULATIONS AND GUIDELINES §§ 697-1 to 697-9 (National Ass'n of Ins. Comm'rs 1995) [hereinafter MODEL ACT]. Perhaps this transaction is so easy for the viator because it makes the blow less harsh when these people realize that they have just received an amount equal to about half of the value of the death benefits in the policy, and the company has just made a huge profit. See Amey Stone, *Easing the Economic Burdens of Terminal Illness*, BUS. WK., May 3, 1993, at 160.

15. Herron, *supra* note 6, at 933-34 (footnotes omitted). A questionnaire may ask the applicant's current employment, receipt of any government-based financial assistance, family, medical history—including the applicant's CD-4 cell count, the names of treating hospitals, and information on treatments received for the applicant's condition—and life insurance policy information. *Id.* at 933 n.12 (citing Life Benefactors, L.P., Questionnaire 1-4).

16. *Id.* at 934.

17. *Id.* Viatical settlement companies generally refuse to offer settlements to those terminally ill persons that have more than two years to live. *Id.* In other words, the applicant is *too healthy* yet terminally ill at the same time. *Id.* at 936-37. Critics of this transaction claim the process is dehumanizing and petty because the viatical settlement companies profit more when an applicant is taking his or her last few breaths. *Id.*

policy, depending on the remaining life expectancy of the individual.<sup>18</sup> The viatical company continues to pay the policyholder's premiums throughout his or her life which prevents a lapse in the policy, relieving the policyholder from the obligation to pay the premiums, and in return, receives the death benefits upon the policyholder's death.<sup>19</sup>

If the applicant accepts the offer, the two parties sign the purchase documents, which include "a purchase agreement for the policy, a change of ownership form, and a change of beneficiary form."<sup>20</sup> Completion of the transaction can take a mere three to six weeks.<sup>21</sup> If the applicant's contractual capacity is in doubt, the viatical settlement company will likely order a psychological evaluation to determine whether a settlement will be legally binding.<sup>22</sup>

### 1. *Purchase Criteria*

Before a viatical settlement company offers a settlement amount, the applicant must meet certain criteria.<sup>23</sup> First, the applicant must submit all relevant medical records for review by the company's physicians.<sup>24</sup> Second, the applicant's insurance policy must have a high rating and a good history of paying out death claims.<sup>25</sup> Third, the applicant must be willing to not only make the viatical

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18. Lamson, *supra* note 1, at 16; Stone, *supra* note 14, at 160; *see If AIDS Is Tamed, Brokers Will Suffer*, DES MOINES REG., July 20, 1996, at 12S.

19. Herron, *supra* note 6, at 934.

20. *Id.*

21. *Id.* But *see* Lamson, *supra* note 1, at 16 (estimating the length of time at three to four months "from inception until the viator receives a check").

22. Lamson, *supra* note 1, at 16.

23. *Id.*

24. *Id.* The viator's prior medical history factors into the determination of what percentage of the face value of the policy the company will offer. *See supra* notes 19-21 and accompanying text.

25. Lamson, *supra* note 1, at 16. Three common rating systems exist for insurance policies—Duff & Phelps, Moody's, and Standard & Poor's. *See* PROFILES: LIFE INSURERS FINANCIAL AND UNDERWRITING PERFORMANCE RESULTS (Deborah A. Miner ed., 1994). The Duff & Phelps analysis of insurance company paying ability (CPA) ranks insurance company policies on a nineteen-level rating scale—from "AAA," which denotes the "highest claims paying ability," to "CCC-," which denotes a "substantial risk that the policyholder . . . obligations will not be paid when due." *Id.* at xi. "The CPA rating is derived from quantitative and qualitative factors" which are common in business and focus on the claim's paying ability. *Id.* Moody's rating system is comprised of nine symbols—"Aaa" as "Exceptional Financial Security" down to "C" which is the lowest security. The ratings "reflect an insurer's ability to discharge senior policyholder claims and obligations" and denote the insurer's financial strength or weakness. *Id.* at xiii. Standard & Poor's CPA ratings are opinions of "an operating insurance company's financial capacity to meet the obligations of its insurance policies" based on extensive qualitative and quantitative information provided by the company, including a meeting with the company's management. *Id.* at xv. This system is divided into two broad groups—the secure ratings rank from AAA to BBB- and the vulnerable ratings rank from BB+ to CCC. *Id.*

company a beneficiary, but must also be willing to actually transfer ownership of the policy—meaning the viatical company must possess an insurable interest<sup>26</sup> in the insured's life.<sup>27</sup> A majority of states, through statutes or case law, no longer require the viatical company to obtain an insurable interest in the insured's life if the assignment was conveyed "in good faith and with no intention that the assignment shall be used as a subterfuge to cover a wagering or gambling transaction."<sup>28</sup> The viatical company is required to possess either an insurable interest or a good faith assignment of the insurance policy because a contract made without this is "against public policy on the theory that the beneficiary would be more interested in the early death of the insured than in the prolongation of his life."<sup>29</sup> Fourth, the viatical company requires written releases and consents from the previous beneficiaries named in the policy.<sup>30</sup> Last, the policy must contain an incontestability clause.<sup>31</sup> Unfortunately, even a strict adherence to each purchase criterion does not eliminate the risks assumed by the viatical company by entering into this transaction.<sup>32</sup>

## 2. Risks of Viatical Settlement Companies

Like any other high-priced purchase, viatical companies face several risks by entering into viatical settlement contracts. Those who criticize the low payout rate of fifty to eighty percent of the face value of the policy do not consider the risks involved.<sup>33</sup> The most important risk is the miscalculation of the life

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26. An insurable interest arises from "a reasonable expectation of advantage in the continuation of another's life." *Lynch v. Bogenrief*, 237 N.W.2d 793, 797 (Iowa 1976). A general statutory definition of an insurable interest states: "In the case of individuals related closely by blood or by law, a substantial interest engendered by love and affection; In the case of other persons, a lawful and substantial economic interest in having the life . . . of the individual insured continue . . ." ARK. CODE ANN. § 23-79-103(c)(1)(A)-(B) (Michie Supp. 1997). The Iowa Code does not define an insurable interest in another person's life.

27. *Lamson*, *supra* note 1, at 16. If transfer of ownership is not possible, however, "as in the case of certain group plans where a company or organization owns the policy, the [applicant] must make an absolute assignment of conversion rights with the viaticating company as irrevocable beneficiary." *Id.*

28. *Dean*, *supra* note 2, at 137 (quoting *Hammers v. Prudential Life Ins. Co.*, 216 S.W.2d 703, 704 (Tenn. 1948)).

29. *Id.* (quoting 3 GEORGE J. COUCH, CYCLOPEDIA OF INSURANCE LAW § 24:117, at 197-98 (2d ed. 1984)). The purpose of this requirement is "to prevent wagering contracts on the life of another by one having no insurable interest therein." *Id.*

30. *Id.*

31. *Id.* at 17. An incontestability clause is defined as "[a] clause in a life or health insurance policy providing that after the policy has been in force for a given length of time (e.g. two or three years) the insurer shall not be able to contest it as to statements contained in the application." BLACK'S LAW DICTIONARY 766 (6th ed. 1990).

32. *Dean*, *supra* note 2, at 142.

33. *Id.*

expectancy of the policyholder.<sup>34</sup> Miscalculations occur because "no actuarial tables of life expectancies by morbidity patterns for various diseases exist as yet, purchase prices must be determined by a painstaking and somewhat ad hoc process."<sup>35</sup> Additionally, viatical settlement companies face the risk that technology will find a cure for diseases or allow the terminally ill individual to go into remission.<sup>36</sup> Treatments or cures may prolong the premium payments that viatical companies must make on the policy.<sup>37</sup> Another risk is that interest rates will rise or other variables affecting the value of the policy will change.<sup>38</sup> In addition, viatical companies risk ex-beneficiaries' attempts to enforce previously released rights.<sup>39</sup> When an ex-beneficiary claims the rights to a policy, he or she files a lawsuit and resolves the issue in the court, which results in expensive litigation costs.<sup>41</sup>

*B. Criticisms of the Process—Are Viatical Settlement Companies Really the "Bad Guys"?*

The idea of placing a price on a dying person's life insurance policy based on the fatality of the illness and the life expectancy of the individual continuously faces criticism.<sup>42</sup> The industry has been termed "death futures"<sup>43</sup> and a "ghoulish"<sup>44</sup> business for its shady business deals and unethical conduct.

Do viatical settlement companies deserve the "bad guy" image? Criticisms of viatical companies include conflicts of interest, unfair prices offered to purchase insurance policies, lack of disclosure, and steering.<sup>45</sup> For instance, brokers that claim to place the individual's interest first may be working for the viatical companies that buy the policies, creating a conflict of interest.<sup>46</sup> Many brokers receive flat commissions—usually four to six percent—of the death

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34. Lamson, *supra* note 1, at 17. Especially with the uncertainty and unpredictability of the AIDS virus, an error in calculation of life expectancy could very easily be made. *Id.*

35. *Id.*

36. *Id.*

37. Dean, *supra* note 2, at 142.

38. Lamson, *supra* note 1, at 17.

39. An "ex-beneficiary" is a person that was, at one time, named as the person or persons entitled to the insurance proceeds upon the viator's death, but was replaced by the viatical company. See BLACK'S LAW DICTIONARY, *supra* note 31, at 157.

40. Dean, *supra* note 2, at 142.

41. *Id.* But see Herron, *supra* note 6, at 956 (stating that the risks associated with litigation by ex-beneficiaries is virtually nonexistent because ex-beneficiaries have "no legal right to enforce [the policy], and thus no claim to bring, when the viator replaces them with the viatical company as beneficiary").

42. Stone, *supra* note 14, at 160.

43. Pamela Sherrid, *Enriching the Final Days*, U.S. NEWS & WORLD REP., Aug. 21, 1995, at 56, 56.

44. Lamson, *supra* note 1, at 18.

45. Sherrid, *supra* note 43, at 57-60. Sherrid notes, however, that "some shady practices are actually becoming more rare." *Id.* at 58.

46. *Id.* at 56.

benefit, not the settlement amount.<sup>47</sup> This means that the broker is not likely to look for the company with the highest settlement, but instead, the one who pays the highest commission.<sup>48</sup> Another conflict arises between physicians that diagnose the applicants and the viatical companies.<sup>49</sup> Viatical companies pay the physicians that analyze and diagnose individuals, which determines the amount the viatical company will offer as a settlement.<sup>50</sup>

Are policyholders steered to settle with a particular viatical company?<sup>51</sup> In June of 1995, the Whitman-Walker Clinic, "the leading facility in Washington, D.C., for AIDS treatment," entered into an agreement with Life Entitlements, a viatical settlement company, in which the Clinic would receive three percent of the face value of all life insurance policies purchased by Life Entitlements from residents of the D.C. area.<sup>52</sup> Representatives of the clinic stressed that this agreement did not constitute steering because the clinic received the funds regardless of whether the viator was a patient of the Whitman-Walker Clinic.<sup>53</sup> The Life Entitlements logo, however, is conveniently displayed on the clinic's informational brochure.<sup>54</sup> Some employers steer workers toward a specific viatical company by naming the viatical company the "preferred provider" of viatical settlements.<sup>55</sup>

Do viatical companies act unconscionably? Another common criticism is overreaching by the viatical company in dealing with the terminally ill policyholder.<sup>56</sup>

Overreaching occurs when an unscrupulous viatical firm takes advantage of a [terminally ill person's] compromised emotional state and desperate financial situation to gain a more favorable settlement for itself than it

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47. *Id.* at 60.

48. *Id.*

49. *Id.* at 58.

50. *Id.*

51. "Steering" is defined as "guid[ing] in a particular direction or manner." THE RANDOM HOUSE DICTIONARY OF THE ENGLISH LANGUAGE 1392 (1967). This practice constitutes unlawful discrimination in the real estate context under the Federal Fair Housing Act of 1988, 42 U.S.C. §§ 3601-3631 (1994). See Elizabeth C. Yen, *Mortgage Lenders and Residential Landlords May Be Liable for Unlawful Discriminatory "Steering" Acts of Loan Brokers and Real Estate Brokers Acting on Behalf of the Lenders or Landlords, Even if the Lenders or Landlords Neither Directed nor Sanctioned the Unlawful Discriminatory Acts of the Broker*, 112 BANKING L.J. 291, 291 (1995) (examining a recent Supreme Court decision in which a real estate broker's referral of only Caucasian applicants to a landlord constituted "steering" in violation of the Fair Housing Act).

52. Sherrid, *supra* note 43, at 58.

53. *Id.* A financial advisor stated, "I need a new dictionary if that does not qualify as steering." *Id.*

54. *Id.*

55. *Id.* at 59.

56. Herron, *supra* note 6, at 967.

otherwise could obtain from a fully informed and rational decision maker, for whom obtaining money is not a matter of life or death.<sup>57</sup>

Viatical companies, fully aware of the desperate circumstances, may act unconscionably by undervaluing the viator's policy.<sup>58</sup> In addition, the demand for viatical settlements is higher than the supply; therefore, the viatical company can be very selective.<sup>59</sup> Inequality in bargaining power and financial despair may lead an individual to accept an amount that is objectively unreasonable.<sup>60</sup> It is these practices that initiated regulating viatical settlement companies in many states.

### III. VIATICAL SETTLEMENTS REGULATED BY STATE LAW

#### A. Purpose and Goals of Current State Regulations

Many state legislators felt, because of the importance of the human element in the viatical settlement industry, regulation was necessary to prevent large corporations from exploiting terminally-ill individuals with their bargaining power, money, and expertise.<sup>61</sup> Profits of twenty to forty percent of the face value of the policy on most settlements raised eyebrows in state legislatures and caused concern about whether viatical settlement companies were taking advantage of vulnerable individuals that have no where to turn.<sup>62</sup>

One goal of state regulations is to provide potential viators with sufficient information to make an informed decision whether or not to enter into a viatical agreement.<sup>63</sup> Common regulations require viatical companies to receive a license from the state insurance commissioner authorizing the commissioner to investigate the character, reputation, training, and competence of a viatical company's

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57. *Id.*

58. *Id.* at 969. To prevent undervaluation of the policy, policyholders must change their way of thinking when it comes to insurance policies. *Id.* at 970. Most people think of insurance as an asset purchased for the benefit of others, not themselves. *Id.* Instead, policyholders should view the policy as an asset accessible for use during their lives. *Id.* By doing so, policyholders may discover that they can receive a substantial settlement from the policy. *Id.* Until then, viatical companies will continue their unethical practices. *Id.* 970-71.

59. *Id.* at 969.

60. *Id.*

61. Berner, *supra* note 12, at 585-86.

62. *Id.* This number has decreased to approximately 12% to 18% because of the use of several medications for treating the AIDS virus that were distributed more prevalently in 1995. *Playing Field in "Death Futures" Can Be Slippery*, PLAIN DEALER (Cleveland), May 5, 1997, at 4D.

63. Herron, *supra* note 6, at 937. Various problems of disclosure exist: viatical companies provide potential clients with misleading or incorrect information; potential viators fail to receive information about alternatives to viatical agreements; and existing restraints on disclosure of information prevent information from reaching potential clients. *Id.* at 939-46.

shareholders, partners, officers, and employees.<sup>64</sup> California's insurance commissioner, John Garamendi, announced that the goal of their regulations was "vital to ensure that the terminally ill are fully protected and get a good value for their policies."<sup>65</sup>

Twenty-one states enacted statutes requiring regulation by the state insurance commissioner of the conduct of viatical settlement industry, including Arkansas, California, Florida, Illinois, Indiana, Kansas, Louisiana, Maine, Michigan, Minnesota, New Mexico, New York, North Carolina, North Dakota, Oregon, Texas,<sup>66</sup> Utah, Vermont, Virginia, Washington, and Wisconsin.<sup>67</sup> Twelve states currently have pending legislation.<sup>68</sup> In addition to state statutes, the NAIC adopted the Viatical Settlements Model Act (Model Act)<sup>69</sup> in 1993 and the Viatical Settlements Model Regulation (Model Regulation)<sup>70</sup> in 1994 on which many states have based their insurance laws.<sup>71</sup> States adopted different approaches in regulating viatical companies. Some states enacted strict legislation, which restricts specific conduct of viatical companies, while other states enacted general regulations allowing viatical companies flexibility in

64. *Id.* at 943-44. Investigations often involve uncovering any past fraudulent or dishonest behavior, "a pattern of unreasonable payments to viators, conviction of a crime involving fraud or moral turpitude, or violation of any provision of the state's viatical settlement act." *Id.*

65. Alfred G. Haggerty, *California Licenses First 3 Viatical Settlement Firms*, NAT'L UNDERWRITER: LIFE & HEALTH INS. EDITION, Apr. 26, 1993, at 13, 13.

66. In 1995, the Attorney General for the state of Texas opined that Texas Insurance Code article 3.50-6A regulating viatical settlements violated the Separation of Powers because it provided "neither standards nor a discernible objective in its delegation of regulatory authority to the Department of Insurance." 1 Tex. Op. Att'y Gen. 314 (1995).

67. ARK. CODE ANN. § 23-81-503 (Michie Supp. 1997); CAL. INS. CODE § 101132 (West Supp. 1998); FLA. STAT. ANN. § 626.9911 (West Supp. 1998); 215 ILL. COMP. STAT. ANN. 158/10 (West Supp. 1997); IND. CODE ANN. § 27-8-19.8-10 (Michie 1994); KAN. STAT. ANN. § 40-2,140-152 (1994); LA. REV. STAT. ANN. § 22:203 (West Supp. 1998); ME. REV. STAT. ANN. tit. 24-A, § 6803 (West Supp. 1997); MICH. COMP. LAWS ANN. § 550.522 (West Supp. 1998); MINN. STAT. ANN. § 60A.962 (West 1996); N.M. STAT. ANN. § 59A-11A-1 (Michie 1997); N.Y. INS. LAW § 7802 (McKinney Supp. 1998); N.C. GEN. STAT. § 58-58-42 (Supp. 1997); N.D. CENT. CODE § 26.1-33.1-02 (1995); OR. REV. STAT. § 744.001 (1997); TEX. INS. CODE ANN. § 3.50-6A (West Supp. 1998); UTAH CODE ANN. § 31A-21-104 (1994); VT. STAT. ANN. tit. 8, § 3827 (Supp. 1997); VA. CODE ANN. § 38.2-5701 (Michie Supp. 1997); WASH. REV. CODE ANN. § 48.102.005 (West Supp. 1998); WIS. STAT. ANN. § 632.68(2) (West Supp. 1997).

68. S.B. 93, Reg. Sess. (Ala. 1997); S.B. 407, Reg. Sess. (Conn. 1998); S.B. 39, 138th Leg., Reg. Sess. (Del. 1997); H.B. 347, 19th Leg., Reg. Sess. (Haw. 1997); H.B. 52, 181st Leg., Reg. Sess. (Mass. 1997); H.B. 1383, 89th Leg., 2d Reg. Sess. (Mo. 1998); S.B. 112, 55th Leg., Reg. Sess. (Mont. 1997); H.B. 263, Reg. Sess. (N.H. 1997); H.B. 12, 122nd Leg., Reg. Sess. (Ohio 1997); H.B. 2373, 46th Leg., 2d Sess. (Okla. 1997); H.B. 526, 181st Leg., 1st Reg. Sess. (Pa. 1997); H.B. 3542, 112th Leg., Reg. Sess. (S.C. 1997).

69. MODEL ACT, *supra* note 14, §§ 697-1 to 697-12.

70. Viatical Settlements Model Regulation (National Ass'n of Ins. Comm'rs 1994), reprinted in 4 MODEL LAWS, REGULATIONS AND GUIDELINES §§ 698-1 to 698-7 (National Ass'n of Ins. Comm'rs 1995) [hereinafter Model Regulation].

71. Osborn, *supra* note 3, at 473-74.

conducting business with little state intervention.<sup>72</sup> Iowa, on the other hand, has not adopted any regulation of the viatical settlement industry.

### B. Analysis of Current State Regulations

In general, enacted state regulations can be analyzed in six different categories: licensing requirements, disclosure requirements, general contract provisions, minimum price regulations or minimum discount rates, penalties for violating the statute, and miscellaneous provisions.<sup>73</sup>

#### 1. Licensing Requirements

Each state's statute, except Michigan, contains licensing or registration requirements. The substance of the requirements is essentially the same in that the company applying for the license must complete an application and pay a licensing fee.<sup>74</sup> Although the general requirement is the same, the fee varies significantly from state to state. California and New York set high licensing fees at \$2833 and \$2500, respectively.<sup>75</sup> On the other side of the spectrum, Vermont has the lowest fee of \$50.<sup>76</sup> Other states charge various amounts in between: Arkansas, \$100;<sup>77</sup> Florida, \$500;<sup>78</sup> Illinois, \$1500;<sup>79</sup> Kansas and Louisiana, \$1000;<sup>80</sup> Maine, \$400;<sup>81</sup> and Minnesota and North Dakota, \$250.<sup>82</sup> Virginia established a range between \$500 and \$1500.<sup>83</sup>

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72. See, e.g., FLA. STAT. ANN. § 626.9912 (exemplifying strict regulations); MINN. STAT. ANN. § 60A.962 (same); N.C. GEN. STAT. § 58-58-42 (exemplifying more liberal regulations); VT. STAT. ANN. tit. 8, § 3827 (same).

73. Osborn, *supra* note 3, at 475-79.

74. ARK. CODE ANN. § 23-81-503(b) (Michie Supp. 1997); CAL. INS. CODE § 10113.2(b)(1) (West Supp. 1998); FLA. STAT. ANN. § 626.9912(2); 215 ILL. COMP. STAT. ANN. 158/10 (West Supp. 1997); IND. CODE ANN. § 27-8-19.8-10 (Michie 1994); KAN. STAT. ANN. § 40-2,141 (1994); LA. REV. STAT. ANN. § 22:203(B)-(C) (West Supp. 1998); ME. REV. STAT. ANN. tit. 24-A, § 6803(2) (West Supp. 1997); MINN. STAT. ANN. § 60A.962(1)-(2); N.M. STAT. ANN. § 59A-11A-3(A) (Michie 1997); N.Y. INS. LAW § 7802 (a)-(c) (McKinney Supp. 1998); N.C. GEN. STAT. § 58-58-42(b); N.D. CENT. CODE § 26.1-33.1-02(1)-(3) (1995); OR. REV. STAT. § 744.326 (1997); TEX. INS. CODE ANN. § 3.50-6A(2)(1)(c) (West Supp. 1998); VT. STAT. ANN. tit. 8, § 3827(a)-(e); VA. CODE ANN. § 38.2-5701(A)(1) (Michie Supp. 1997); WASH. REV. CODE ANN. § 48.102.010(1)-(3) (West Supp. 1998); WIS. STAT. ANN. § 632.68(2) (West Supp. 1997).

75. CAL. INS. CODE § 10113.2(b)(1); N.Y. INS. LAW § 7802(b).

76. VT. STAT. ANN. tit. 8, § 3827(b).

77. ARK. CODE ANN. § 23-81-503(b).

78. FLA. STAT. ANN. § 626.9912(2).

79. 215 ILL. COMP. STAT. ANN. 158/10(b).

80. KAN. STAT. ANN. § 40-2,141 (1994); LA. REV. STAT. ANN. § 22:203(b) (West Supp. 1998).

81. ME. REV. STAT. ANN. tit. 24-A, § 6803(2) (West Supp. 1997).

82. MINN. STAT. ANN. § 60A.964 (West 1996); N.D. CENT. CODE § 26.1-33.1-02 (1995).

83. VA. CODE ANN. § 38.2-5701(A)(1) (Michie Supp. 1997). The Insurance Commission is responsible for prescribing the exact amount for the application fee. *Id.*

Accompanying the application, the Florida, Washington, and Wisconsin licensing requirements demand extensive information regarding the business and individuals that are employed or have an interest in the company.<sup>84</sup> Arkansas and Virginia require the Commissioner to investigate each applicant extensively to determine whether the application should be accepted.<sup>85</sup> The majority of states, however, merely require the viatical company to disclose, upon request of the insurance commissioner, information regarding the identity of the directors, officers, stockholders, and any other individual with an interest in the business.<sup>86</sup>

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84. See FLA. STAT. ANN. § 626.9912(3)(c)-(e) (West Supp. 1998); WASH. REV. CODE ANN. § 48.102.010(4)(a) (West Supp. 1998); WIS. STAT. ANN. § 632.68(2)(b)(3)-(4) (West Supp. 1997). Florida requires the viatical company to provide:

- (c) Copies of all bylaws, rules, [and] regulations . . . regulating the conduct of the applicant's internal affairs.
- (d) A list showing the name, business and residence addresses, and official position of each individual who is responsible for conduct of the applicant's affairs, including but not limited to, any member of the applicant's board of directors, board of trustees, executive committee, . . . and any other person or entity owning . . . 10 percent or more of the voting securities of the applicant.
- (e) With respect to *each* individual named in paragraph (d):
  - (1) A sworn biographical statement on forms provided by the department.
  - (2) A set of *fingerprints* . . . .
  - (3) Authority for release of information relating to the investigation of the individual's background.

FLA. STAT. ANN. § 626.9912(3)(c)-(e) (emphasis added). Florida is the only state that requires fingerprint cards of officers, directors, and stockholders of viatical companies. Christine Jordan Sexton, *Florida Moves Closer to Licensing Viatical Industry*, NAT'L UNDERWRITER: LIFE & HEALTH, FIN. SERV. EDITION, Sept. 9, 1996, at 58, 58. Washington requires disclosure of the "identity of all stockholders, partners, and corporate officers; its parent entities and affiliates, and their stockholders, partners, and officers." WASH. REV. CODE ANN. § 48.102.010(4)(a). Wisconsin requires "a detailed plan of operation" and disclosure of all stockholders, partners, officers, and employees. WIS. STAT. ANN. § 632.68(2)(b)(3)-(4).

85. ARK. CODE ANN. § 23-81-503(f) (Michie Supp. 1997); VA. CODE ANN. § 38.2-5701(E). Both states require a finding by the Commissioner that the applicant: (1) "has provided a detailed plan of operation"; (2) "is competent and trustworthy"; (3) expresses an intention to act in good faith; (4) has a "good business reputation"; (5) if an individual, "has had experience, training or education" which qualifies him or her for the license; and (6) if the applicant is a corporation or partnership, is in good standing pursuant to law and has proper authority to engage in viatical settlement transactions. VA. CODE ANN. § 38.2-5701(E); accord ARK. CODE ANN. § 23-81-503(f).

86. 215 ILL. COMP. STAT. ANN. § 158/10(d) (West Supp. 1997); KAN. STAT. ANN. § 40-2,151 (1994); LA. REV. STAT. ANN. § 22:203(D) (West Supp. 1998); ME. REV. STAT. ANN. tit. 24-A, § 6803(4); MICH. COMP. LAWS ANN. § 550.522(1) (West Supp. 1997); MINN. STAT. ANN. § 60A.962(3); N.Y. INS. LAW ANN. § 7802(d) (McKinney Supp. 1998); OR. REV. STAT. § 744.001(2) (1997); VT. STAT. ANN. tit. 8, § 3827(d) (Supp. 1997).

## 2. Disclosure Requirements

Disclosure requirements refer to the information that the viatical company must disclose to the viator prior to signing the agreement.<sup>87</sup> Disclosure of information to viators not only aids viators in making an informed decision, but it also allows one viatical company to distinguish itself from another.<sup>88</sup> The goal is not perfect information, but rather adequate or sufficient information.<sup>89</sup> Most states base disclosure requirements on section 8 of the Model Act which requires disclosure of six items no later than the date the viatical settlement agreement is signed.<sup>90</sup> These statutes require the disclosure of:

- (a) Possible alternatives to viatical settlement contracts for persons with Terminal or Chronic illnesses, including, but not limited to, accelerated benefits offered by the issuer of the life insurance policy;
- (b) The fact that some or all of the proceeds of the viatical settlement may be taxable, and that assistance should be sought from a personal tax advisor;
- (c) The fact that the viatical settlement could be subject to the claims of creditors;
- (d) The fact that the receipt of a viatical settlement may adversely affect the recipient's eligibility for Medicaid or other government benefits or entitlements, and that advice should be obtained from the appropriate agencies;
- (e) The policyowner's right to rescind a viatical settlement contract within<sup>[91]</sup> thirty (30) days<sup>[92]</sup> of the date it is executed by all parties or fifteen (15) days of the receipt of the viatical settlement proceeds by the viator, . . . ; and
- (f) The date by which the funds will be available to the viator and the source of the funds.<sup>93</sup>

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87. Osborn, *supra* note 3, at 476.

88. Herron, *supra* note 6, at 938. For example, viatical companies may "attempt to gain a competitive advantage by agreeing to uphold a certain 'Code of Ethics' and list of 'Standard Business Practices' which require [viatical companies to] provide certain information to potential viators." *Id.*

89. *Id.* at 939.

90. See MODEL ACT, *supra* note 14, § 697-8.

91. *Id.*; accord ARK. CODE ANN. § 23-81-508 (Michie Supp. 1997); FLA. STAT. ANN. § 626.9923 (West Supp. 1998); MICH. COMP. LAWS ANN. § 550.523(f); MINN. STAT. ANN. § 60A.969(6); N.C. GEN. STAT. § 58-58-42(g)(6) (Supp. 1997); N.D. CENT. CODE § 26.1-33.1-07(6) (1995); OR. REV. STAT. § 744.348; VA. CODE ANN. § 38.2-5705(a) (Michie Supp. 1997); WASH. REV. CODE ANN. § 48.102.035 (West Supp. 1998).

92. The number of days allowed for rescission of the viatical settlements contract varies among states.

93. ARK. CODE ANN. § 23-81-508(f); accord FLA. STAT. ANN. § 626.9923(6); MICH. COMP. LAWS ANN. § 550.523(f); MINN. STAT. ANN. § 60A.969(6); N.C. GEN. STAT. § 58-58-42(g)(6); N.D. CENT. CODE § 26.1-33.1-07(6); OR. REV. STAT. § 744.348(6); VA. CODE ANN. §

Illinois, Maine, New York, Vermont, and Wisconsin require more disclosure than the Model Act.<sup>94</sup> In addition to the six items listed above, which must be disclosed no later than the time the agreement is signed, Illinois requires disclosure of any affiliation "between the viatical settlement [company] and the issuer of an insurance policy to be viaticated."<sup>95</sup> Maine requires the viatical company to disclose "that a consequence of the viatical settlement will be the loss of some or all of the death benefit payable under the life insurance policy."<sup>96</sup> A viatical company conducting business in New York must include a notice stating that a viatical settlement may affect the viator's eligibility for Medicaid, AFDC, SSI, and AIDS drug assistance programs on the viatical settlement *application* completed by the potential viator.<sup>97</sup> Vermont added an additional provision that the viatical company must, prior to the execution of the contract, disclose that the viatical settlement contract is null and void if the viatical company fails to pay the viator as provided in the agreement.<sup>98</sup> Wisconsin requires disclosure of the "frequency and procedure for contacts" by the viatical company regarding the health status of the viator after performance of the contract and the name of the new policyholder under the viatical settlement contract.<sup>99</sup>

California and New Mexico require less disclosure than the majority of states.<sup>100</sup> California only requires the viatical company to disclose the possible alternatives to a viatical settlement agreement, the tax consequences that may result from a viatical settlement, and that receiving proceeds from a viatical settlement may interrupt the viator's public assistance.<sup>101</sup> New Mexico does not regulate disclosure of information to viators.<sup>102</sup>

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38.2-5705(A)(6); WASH. REV. CODE ANN. § 48.102.035(6). Louisiana requires only five of the six items listed—it excludes disclosure that viatical settlement proceeds may be subject to creditors. See LA. REV. STAT. ANN. § 22:208 (West Supp. 1998). Indiana and Kansas require only four of the six items—they exclude disclosure that viatical settlement proceeds may be subject to creditors; and disclosure of the date the funds will be available to the viator and the source of those funds. See IND. CODE ANN. § 27-8-19.8-23 (Michie 1994); KAN. STAT. ANN. § 40-2,145 (1994).

94. Compare MODEL ACT *supra* note 14, § 697-8 with 215 ILL. COMP. STAT. ANN. 158/35 (West Supp. 1997); N.Y. INS. LAW § 7807 (McKinney Supp. 1998); VT. STAT. ANN. tit. 8, § 3831 (Supp. 1997); WIS. STAT. ANN. § 632.68(9)(b) (West Supp. 1997).

95. 215 ILL. COMP. STAT. ANN. 158/35(a).

96. ME. REV. STAT. ANN. tit. 24-A, § 6808(7) (West Supp. 1997).

97. N.Y. INS. LAW § 7807(a). This is different from the similar disclosure addressed in *supra* note 93, in that it must be included on the application.

98. VT. STAT. ANN. tit. 8, § 3831(7).

99. WIS. STAT. ANN. § 632.68(9)(b)(7), (10).

100. See MODEL ACT *supra* note 14, § 697-8; CAL. INS. CODE § 10113.2(d) (West Supp. 1998); N.M. STAT. ANN. § 59A-11A (Michie 1997).

101. CAL. INS. CODE § 10113.2(d).

102. See N.M. STAT. ANN. § 59A-11A.

### 3. *General Contract Provisions*

The general contract provisions are vital to protecting the viator's interests.<sup>103</sup> When entering into a contract with a terminally ill person, a viatical settlement contract is valid only if the viatical company obtains a written statement from a physician that the person is "of sound mind and under no constraint or undue influence."<sup>104</sup> The viatical company must also procure a document witnessed by one or two witnesses, depending upon the state, in which the "person consents to the viatical settlement contract, acknowledges the catastrophic or life-threatening illness, represents that [he or she] has . . . complete understanding of the . . . contract, releases [his or her] medical records; and acknowledges that [he or she] has entered into the viatical settlement contract freely and voluntarily."<sup>105</sup> In addition, some states explicitly require the viatical company to make the payment in lump sum except under very specific circumstances.<sup>106</sup> The majority of states either require all proceeds to be transferred to escrow immediately upon execution of the contract or do not specify the type of payment required.<sup>107</sup>

### 4. *Minimum Price Regulation*

Minimum price regulations, also called minimum discount rates, are minimum payout rates established by the state to force the viatical settlement company to pay a certain minimum percentage of the face value of the viator's

103. Osborn, *supra* note 3, at 477.

104. MODEL ACT, *supra* 14, § 697-9(1); accord ARK. CODE ANN. § 23-81-509(a)(1) (Michie Supp. 1997); CAL. INS. CODE § 10113.1(c)(1); 215 ILL. COMP. STAT. ANN. 158/45(a)(1) (West Supp. 1997); IND. CODE ANN. § 27-8-19.8-24(1) (Michie 1994); LA. REV. STAT. ANN. § 22:209(A)(1) (West Supp. 1998); ME. REV. STAT. ANN. tit. 24-A, § 6809(1)(A) (West Supp. 1997); MICH. COMP. LAWS ANN. § 550.524(1)(a) (West Supp. 1998); MINN. STAT. ANN. § 60A.970(1)(1) (West 1996); N.C. GEN. STAT. § 58-58-42(h)(1) (Supp. 1997); N.D. CENT. CODE § 26.1-33.1-08(1)(a) (1995); OR. REV. STAT. § 744(15)(a) (1997); VA. CODE ANN. § 38.2-5705(B)(I) (Michie Supp. 1997); WASH. REV. CODE ANN. § 48.102.040(1)(a) (West Supp. 1998); WIS. STAT. ANN. § 632.68(9)(a)(1).

105. MODEL ACT, *supra* 14, § 697-9(2); accord ARK. CODE ANN. § 23-81-509(a)(2); CAL. INS. CODE § 10113.1(c)(2); FLA. STAT. ANN. § 626.9924 (West Supp. 1998); 215 ILL. COMP. STAT. ANN. 158/45(a)(2); IND. CODE ANN. § 27-8-19.8-24(2); LA. REV. STAT. ANN. § 22:209(A)(2); ME. REV. STAT. ANN. tit. 24-A, § 6809(1)(B); MICH. COMP. LAWS § 550.524(a)(2); MINN. STAT. ANN. § 60A.970(1)(2); N.Y. INS. LAW § 7808(a) (McKinney Supp. 1998); N.C. GEN. STAT. § 58-58-42(h)(2); N.D. CENT. CODE § 26.1-33.1-08(1)(b); OR. REV. STAT. § 744(15)(b); VA. CODE ANN. § 38.2-5705(B)(ii); VT. STAT. ANN. tit. 8 § 3832(a) (Supp. 1997); WASH. REV. CODE ANN. § 48.102.040(1)(b); WIS. STAT. ANN. § 632.68(9)(a)(2).

106. MINN. STAT. ANN. § 60A.970(5); N.Y. INS. LAW § 7808(c)(3); OR. REV. STAT. § 744(15); WIS. STAT. § 632.68(9)(f).

107. CAL. INS. CODE § 10113.1; FLA. STAT. ANN. § 626.9924(5); 215 ILL. COMP. STAT. ANN. 158/45(d); IND. CODE ANN. § 27-8-19.8-1; KAN. STAT. ANN. § 40-2,140 (1994); N.M. STAT. ANN. § 59A-11A-1; N.C. GEN. STAT. § 58-58-42; N.D. CENT. CODE § 26.1-33.1-01; TEX. INS. CODE ANN. § 3.50-6A (West Supp. 1998); UTAH CODE ANN. § 31A-21-104 (1994); VT. STAT. ANN. tit. 8, § 3826; WASH. REV. CODE ANN. § 48.102.005.

policy based on the viator's life expectancy.<sup>108</sup> Minimum price regulation is one of the most controversial issues surrounding viatical settlements.<sup>109</sup> The Model Regulation established minimum payment regulations,<sup>110</sup> pursuant to authority from the Model Act, empowering the commissioner to "establish standards for evaluating reasonableness of payments under viatical settlements contracts. This includes . . . regulation of discount rates."<sup>111</sup> Under the Model Regulations, the minimum percentage of face value of the viator's insurance policy that the viatical company must pay is eighty percent for life expectancy less than six months; seventy percent for life expectancy more than six months, but less than twelve months; sixty-five percent for life expectancy of more than twelve months, but less than eighteen months; sixty percent for life expectancy more than eighteen months, but less than twenty-four months; and fifty percent for life expectancy of twenty-four months or more.<sup>112</sup> "In order to assure that viators receive a reasonable return for viaticating an insurance policy,"<sup>113</sup> three states adopted minimum payment regulations. Louisiana and Minnesota implemented minimum payment regulations exactly like the Model Regulation.<sup>114</sup> Wisconsin enacted minimum payment regulations with different percentage payouts and life expectancy categories.<sup>115</sup> Many states authorize the insurance commissioner to promulgate rules and regulations to ensure the reasonableness of viatical settlement contracts, including establishing minimum payment regulations; however, none have done so thus far.<sup>116</sup> Florida, on the other hand, does not explicitly authorize the insur-

108. Herron, *supra* note 6, at 946-47.

109. *Id.* at 947.

110. Model Regulation, *supra* note 70, § 698-4.

111. MODEL ACT, *supra* note 14, § 697-10(b).

112. Model Regulation, *supra* note 70, § 698-4. The Regulation allows for a reduction of five percent for an insurance policy "written by an insurer rated less than the highest four categories by A.M. Best, or a comparable rating by another rating agency." *Id.* See *supra* note 25 for an explanation of common rating systems of insurance policies.

113. Model Regulation, *supra* note 70, § 698-4.

114. LA. REV. STAT. ANN. § 209(C)(1) (West Supp. 1998); MINN. STAT. ANN. § 60A.971 (West 1996).

115. WIS. STAT. ANN. § 632.68(9)(c)(1) (West Supp. 1997). Wisconsin's minimum discount rates are eighty percent for life expectancy less than six months; seventy-five percent for life expectancy more than six months, but less than twelve months; sixty-five percent for life expectancy more than twelve months, but less than twenty-four months; fifty-five percent for life expectancy more than twenty-four months, but less than thirty-six months; forty-five percent for life expectancy more than thirty-six months, but less than forty-eight months; and thirty percent for life expectancy more than forty-eight months. *Id.*

116. ARK. CODE ANN. § 23-81-510(b) (Michie Supp. 1997); CAL. INS. CODE § 10113.2(f) (West Supp. 1998); 215 ILL. COMP. STAT. ANN. 158/50(2) (West Supp. 1997); IND. CODE ANN. § 27-8-19.8-25 (Michie 1994); KAN. STAT. ANN. § 40-2,151 (1994); ME. REV. STAT. ANN. tit. 24-A, § 6810 (West Supp. 1997); N.C. GEN. STAT. § 58-58-42(j)(2) (Supp. 1997); OR. REV. STAT. § 744.018(1) (1997); VT. STAT. ANN. tit. 8, § 3833(2) (Supp. 1997); VA. CODE ANN. § 38.2-5706(1) (Michie Supp. 1997); WASH. REV. CODE ANN. § 48.102.050 (West Supp. 1998). Michigan, New Mexico, North Dakota, and Utah statutes do not contain this provision. See MICH. COMP. LAWS

ance commissioner from "directly or indirectly regulat[ing] the amount paid as consideration for entry into a viatical settlement contract."<sup>117</sup>

The reason for the controversy surrounding this type of regulation hinges on whether a minimum payment regulation or minimum discount rate restrains a viator's right to freely alienate his or her property.<sup>118</sup> According to the drafters of the Model Act and Model Regulation, section 4—the minimum payment regulation—is essential to consumer protection in that it assures viators receive reasonable payment for the sale of their insurance policy.<sup>119</sup> Those who oppose minimum discount rates claim that the other regulations sufficiently protect viators from overreaching, overbearing, money-hungry viatical companies.<sup>120</sup> Accordingly, commentators believe that minimum discount rates fail to fit any of the situations in which courts have, historically, allowed restraints on alienation.<sup>121</sup> First, opponents contend that these regulations prevent goods from "going to those who value them most."<sup>122</sup> That is, minimum payments prevent viators from receiving as much of a viatical company's capital as possible because minimum rates become the maximum price a purchaser will pay.<sup>123</sup> Second, minimum discount rates violate the "natural working of the market and pricing system" by interfering with economic principles of supply and demand.<sup>124</sup> Third, minimum payment regulations preclude viators from accepting a price lower than the minimum rate or bargaining for the highest price available, thus inhibiting their ability to sell the policy at a price that fits their life quality.<sup>125</sup> Whether more minimum payment regulations will be adopted may depend upon how various states resolve the issues on both sides.<sup>126</sup>

## 5. *Miscellaneous Provisions*

A few states enacted regulations restricting specific conduct of viatical companies and viators distinct from any category discussed above. In Florida, a viatical settlement company must ascertain whether the viator has any dependent children.<sup>127</sup> If so, the viator "may not [sell] more than [fifty] percent of the face

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ANN. § 550.521 (West Supp. 1998); N.M. STAT. ANN. § 59A-11A-1 (Michie 1997); N.D. CENT. CODE § 26.1-33.1-01 (1995); UTAH CODE ANN. § 31A-21-104 (1994).

117. FLA. STAT. ANN. § 626.9926 (West Supp. 1998).

118. Berner, *supra* note 12, at 598-99.

119. Osborn, *supra* note 3, at 480-81.

120. Berner, *supra* note 12, at 611-13.

121. *Id.* at 599. Historically, courts have restricted free alienation in three situations: when free alienation created (1) "economic inefficiencies in the form of . . . costs to third parties"; (2) resulted in "undesirable external consequences"; or (3) for the protection of individuals from "yielding to harmful monetary temptations." *Id.* at 595-97.

122. *Id.*

123. *Id.* at 600.

124. *Id.* at 602.

125. *Id.* at 604.

126. Osborn, *supra* note 3, at 495.

127. FLA. STAT. ANN. § 626.993 (West Supp. 1998).

value of the policy."<sup>128</sup> In Minnesota, after the viatical settlement has occurred, a viatical settlement company or broker cannot contact the viator to determine his or her health status more than once every three months if the viator's life expectancy is more than one year or once every month if the viator's life expectancy is less than one year.<sup>129</sup> Viatical companies licensed in North Dakota must comply with stringent annual reporting requirements regarding detailed information about each policy viaticated, the viator's death information, if applicable, and a breakdown by disease category of viatical applications received, accepted, or rejected.<sup>130</sup>

#### 6. *Penalties for Violating State Regulations*

Virtually every state assesses penalties for violating the viatical settlement statutes. States differ, however, in classifying the violation a civil or criminal penalty. The Model Act provides that a violation constitutes unfair trade practice, thus subject to the state's penalties contained in the Unfair Trade Practice Act, which varies from state to state.<sup>131</sup> Arkansas, Maine, North Carolina, North Dakota, Virginia, Vermont, and Washington adopted the Model Act's approach to penalties by making a violation of that state's viatical settlement statutes an unfair trade practice.<sup>132</sup> Illinois, Louisiana, Minnesota, and Oregon will merely revoke the viatical company's license for business in the state.<sup>133</sup> Florida, Indiana, Michigan, and New York impose sizable civil fines in lieu of or in addition to license revocation. Florida provides for a fine not to exceed \$2500 for each nonwillful violation and \$10,000 for each willful violation by the viatical company.<sup>134</sup> Indiana imposes a civil penalty of not less than \$25,000, but not more than \$100,000.<sup>135</sup> Michigan authorizes either a fine not exceeding \$500; or, if the person knew or reasonably should have known of the violation, the Commissioner may "order the payment of all death benefits and other proceeds paid by the viator . . . and a civil fine of not more than \$2500.00"; or a cease and desist order.<sup>136</sup> New York penalizes a viatical company \$5000 for each violation of its statute.<sup>137</sup>

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128. *Id.*

129. MINN. STAT. ANN. § 60A.970(9) (West 1996).

130. N.D. CENT. CODE § 26.1-33.1-05 (1995).

131. MODEL ACT, *supra* note 14, § 697-11.

132. ARK. CODE ANN. § 23-81-511 (Michie Supp. 1997); ME. REV. STAT. ANN. tit. 24-A, § 6814 (West Supp. 1997); N.C. GEN. STAT. § 58-58-42(k) (Supp. 1997); N.D. CENT. CODE § 26.1-33.1-09; VT. STAT. ANN. tit. 8, §3834 (Supp. 1997); VA. CODE ANN. § 38.2-5707 (Michie Supp. 1997); WASH. REV. CODE ANN. § 48.102.055 (West Supp. 1998).

133. 215 ILL. COMP. STAT. ANN. 158/15(a)(5) (West Supp. 1997); LA. REV. STAT. ANN. § 22:204 (West Supp. 1998); MINN. STAT. ANN. § 60A.965(1)(5); OR. REV. STAT. § 744(10)(k) (1997).

134. FLA. STAT. ANN. § 626.9914 (West Supp. 1998).

135. IND. CODE ANN. § 27-8-19.8-20 (Michie 1994).

136. MICH. COMP. LAWS ANN. § 550.528(2)(b) (West Supp. 1998).

137. N.Y. INS. LAW § 7803 (McKinney Supp. 1998).

California and New Mexico classify a violation of their viatical settlement statutes as a misdemeanor.<sup>138</sup> California also authorizes the insurance commissioner, after notice and hearing, to assess a civil penalty up to \$10,000 for a violation of the statute.<sup>139</sup> A willful violation of the North Dakota Viatical Settlement Contract statutes constitutes a class C felony.<sup>140</sup>

#### IV. VIATICAL SETTLEMENTS AS SECURITIES REGULATED BY THE SECURITIES ACT OF 1933<sup>141</sup>

Two types of companies engage in transactions within the viatical settlement industry. The first type is the viatical settlement companies, which this Note has addressed thus far, that purchase life insurance policies directly from viators.<sup>142</sup> These companies hold the rights to the insurance policy through assignment or ownership and are named the beneficiaries after the transaction occurs.<sup>143</sup> The second type of companies, called brokered viatical settlement companies, "act as brokers or middlemen by matching a potential buyer or group of buyers with a particular policy currently 'on the market.'"<sup>144</sup> The buyer purchases ownership rights and is named the beneficiary of the insurance policy.<sup>145</sup> The brokered viatical settlement company never acquires the ownership rights of the policy; instead, it receives payment for services rendered.<sup>146</sup>

##### A. *Introduction to the Securities Act of 1933*

Controversy recently arose over whether or not either type of transaction should be considered the sale of a security under the Securities Act of 1933 (1933 Act).<sup>147</sup> To make that determination, two questions must be answered: "Is the instrument a security? [and] Is the instrument expressly exempt from the regulatory control of the '33 Act?'"<sup>148</sup> The controversy stems from a provision in the 1933 Act which exempts from regulatory control of the 1933 Act "[a]ny insurance or endowment policy . . . issued by a corporation subject to the supervision of the insurance commissioner."<sup>149</sup> If viatical settlements are "contracts of insurance" under the 1933 Act, then they are exempt from regulatory control under that act.<sup>150</sup> If viatical settlements are not considered

138. CAL. INS. CODE § 10113.2(o) (West Supp. 1998); N.M. STAT. ANN. § 59A-11A-8 (Michie 1997).

139. CAL. INS. CODE § 10113.2(j).

140. N.D. CENT. CODE § 26.1-33.1-02 (1995).

141. Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1994).

142. Shanah D. Glick, Comment, *Are Viatical Settlements Securities Within the Regulatory Control of the Securities Act of 1933?*, 60 U. CHI. L. REV. 957, 957 (1993).

143. *Id.*

144. *Id.*

145. *Id.*

146. *Id.*

147. *Id.* at 958.

148. *Id.* at 959.

149. *Id.* (quoting 15 U.S.C. § 77(c)(a)(8) (1988)).

150. *Id.* at 959-60.

"contracts of insurance," however, the viatical companies must comply with the disclosure requirements and other regulations under the 1933 Act.<sup>151</sup> Determining that viatical settlements are not "insurance contracts" exempted from the 1933 Act does not necessarily mean that viatical settlements are "securities."<sup>152</sup> A separate inquiry must be conducted before concluding that viatical settlements are securities under the 1933 Act.<sup>153</sup>

#### B. SEC v. LifePartners, Inc.

In one jurisdiction, this controversial issue came to a head when the SEC sued Life Partners, Inc., one of the largest viatical settlement companies in the United States, for selling unregistered securities in violation of the 1933 Act.<sup>154</sup> The conduct that the SEC felt constituted the sale of securities involved Life Partners purchasing insurance policies from terminally ill individuals and reselling the policies at a discount to investors that received the policy benefits after the insured died.<sup>155</sup> The court quickly dismissed the argument that viatical settlements qualified for the section 3(a) exemption of the 1933 Act, because the court found that viatical settlements simply did not transfer or distribute risk like insurance policies.<sup>156</sup> The court held that viatical settlements fit the definition of a security, thus, Life Partners had engaged in the selling of unregistered securities in violation of the 1933 Act.<sup>157</sup> The court found that the case "rested in the gray area of securities law," however, and was not persuaded by the SEC's argument that a broad preliminary injunction was necessary.<sup>158</sup> Instead, the court issued a limited preliminary injunction, which allowed Life Partners to continue operations as long as it made efforts to work with the SEC and comply with the 1933 Act.<sup>159</sup>

Five months later, the SEC filed a suit to hold Life Partners in contempt for failing to comply with the district court's order by continuing to sell unregistered securities.<sup>160</sup> The SEC, for a second time, requested the court to enjoin Life Partners from continuing to sell viatical settlements to investors.<sup>161</sup> Life Partners claimed to have made a good-faith effort to bring their operations into compli-

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151. *Id.*

152. *Id.* at 960.

153. *Id.*

154. SEC v. Life Partners, Inc., 898 F. Supp. 14, 18 (D.D.C. 1995). No other jurisdiction has faced this issue.

155. *Id.* at 17-18.

156. *Id.* at 18.

157. *Id.* at 22.

158. *Id.* at 23-24. One of the remedies the court issued was a limited preliminary injunction prohibiting Life Partners from "engaging in any act or making any statement which is made with knowledge or reasonable grounds to believe is untrue or misleading." *Id.* at 24.

159. *Id.* at 24.

160. SEC v. Life Partners, Inc., 912 F. Supp. 4, 11 (D.D.C. 1995), *rev'd*, 87 F.3d 536 (D.C. Cir.), *reh'g denied*, 102 F.3d 587 (D.C. Cir. 1996).

161. *Id.* at 7.

ance.<sup>162</sup> The court again held that a viatical settlement fell squarely within the definition of "security" under the 1933 Act.<sup>163</sup> The court concluded that contempt was not warranted because Life Partners had taken steps toward compliance.<sup>164</sup> The court, however, altered its original order by enjoining Life Partners from selling unregistered securities—viatical settlements—"in the form of fractional interests."<sup>165</sup> It also compelled Life Partners to comply with SEC's discovery requests.<sup>166</sup>

This case was heard in the Court of Appeals for the District of Columbia, which determined that viatical settlements were not subject to regulation under the Securities Act of 1933.<sup>167</sup> In making that determination, the court first examined whether viatical settlements constituted insurance contracts or policies, which would exempt them from coverage under the 1933 Act.<sup>168</sup> First, Life Partners argued that viatical settlements redistribute risk in the same manner as insurance contracts. Second, Life Partners argued that a number of states had enacted regulations of viatical settlement companies in the insurance sections of the state codes.<sup>169</sup> The court, however, adopted the SEC's argument that buyers of insurance policies forego "current consumption in order to protect against future risk," whereas purchasers of viatical settlements give up protection of the policy in favor of current consumption.<sup>170</sup>

After determining that viatical settlements did not fit the explicit exemption of the 1933 Act, the court next examined whether viatical settlements are securities within the terms of the 1933 Act.<sup>171</sup> The definition of security is a three-part test established in *SEC v. W.J. Howey*.<sup>172</sup> Under *Howey*, "an investment contract is a security subject to the [1933] Act if investors purchase with (1) an expectation of profits arising from (2) a common enterprise that (3) depends upon the efforts of others."<sup>173</sup> The court concluded that purchasers of viatical settlements reasonably expected a return on their investment.<sup>174</sup> Next, the court concluded that a common enterprise existed because purchasers of viatical settlements engaged in pooling of investment funds, profit sharing, and loss sharing in sufficient amounts to satisfy the second prong of the *Howey* test.<sup>175</sup> Nevertheless, viatical settlements failed to satisfy the final prong of the *Howey*

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162. *Id.* at 5.

163. *Id.* at 10-11.

164. *Id.* at 11.

165. *Id.* at 12.

166. *Id.*

167. *SEC v. Life Partners, Inc.*, 87 F.3d 536, 549 (D.C. Cir.), *reh'g denied*, 102 F.3d 587 (D.C. Cir. 1996).

168. *Id.* at 541.

169. *Id.*

170. *Id.* at 541-42.

171. *Id.* at 542.

172. *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946).

173. *SEC v. Life Partners, Inc.*, 87 F.3d at 542 (citing *SEC v. W.J. Howey Co.*, 328 U.S. at 298-99).

174. *Id.* at 543.

175. *Id.* at 544.

test because the SEC was unable to demonstrate that a viatical company's efforts had "a predominant influence upon investors' profits."<sup>176</sup> The court basically accepted Life Partners' argument that after the transactions occur, investors do not rely on efforts of the viatical company or anyone else because the only variable remaining is the timing of the viator's death, which is not in the viatical company's control.<sup>177</sup> The court remanded the case and ordered the district court to vacate the three injunctions issued against Life Partners.<sup>178</sup>

Subsequently, the SEC's Petition for Rehearing was denied, and the court attached a memorandum opinion to the denial order for the sole purpose of clarifying the D.C. Circuit's decision.<sup>179</sup> In that opinion, the court stated that it did not adopt an "artificial bright-line rule" that viatical settlement agreements were not securities.<sup>180</sup> Second, the court expressly invalidated the SEC's position that the court's decision placed uncertainty about the applicability of securities law to certain asset-backed securities.<sup>181</sup> The court found that the SEC's arguments and contentions lacked any authority or basis.<sup>182</sup> The SEC decided not to appeal the decision of the D.C. Circuit any further.

## V. CONCLUSION

With twenty-one states currently regulating the viatical settlement industry and more states with pending legislation, the industry will likely face many changes in the near future. It is quite possible that the Model Act and Model Regulation will be widely accepted, bringing uniformity to regulations within the industry.

At this point, however, states that have adopted viatical settlement regulations have similar goals, but differ in determining the best way those goals can be achieved. The amount of regulation may affect the viatical company's decisions about what state to do business in because one state may be more cost effective than the other.

The view that viatical settlements are securities under the Security Act of 1933 is the minority view. *SEC v. Life Partners, Inc.*<sup>183</sup> may be an indication of the direction of future litigation. The SEC's decision not to appeal the D.C. Circuit's decision means that battle is over, but many more are likely ahead for the viatical settlement business.

Jennifer A. Lann

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176. *Id.* at 548.

177. *Id.* at 545.

178. *Id.* at 549.

179. *SEC v. Life Partners, Inc.*, 102 F.3d 587, 588 (D.C. Cir. 1996).

180. *Id.*

181. *Id.*

182. *Id.* (declaring the SEC's arguments "totally unsubstantiated").

183. *SEC v. Life Partners, Inc.*, 87 F.3d 536 (D.C. Cir.), *reh'g denied*, 102 F.3d 587 (D.C. Cir. 1996).

