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Viatical Settlements: The Need for Regulation to Preserve the Benefits While Protecting the Ill and the Elderly from Fraud

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Viatical Settlements: The Need For Regulation to Preserve the Benefits While Protecting the Ill and the Elderly From Fraud*

I. INTRODUCTION

The doctor looked solemn as he scanned Bob’s chart. The chemotherapy is not working as well as everyone had hoped . . . the cancer is spreading . . . nothing else to try. His words came through in a haze. Six months . . . maybe a year or a little more. You are going to need care . . . twenty-four hours a day. How can you arrange that when you cannot work and your savings have already been spent? The only thing left is that life insurance policy, but that is no help now . . . or is it?

Across town, Sue sits in her corner office and reviews the latest financial reports. Her business is finally doing well . . . the hard work is paying off at last. Finally, she is able to think about some other investments, but where? Stocks are down . . . bonds aren't doing well either. Besides, wouldn't it be great to invest in something that might help someone else? Maybe pay back a little for her good fortune.

In a perfect world, Bob and Sue would meet. She would purchase his life insurance policy to provide the money he so desperately needs. He would be able to pay for caregivers and cover general expenses in his remaining months. In return, Sue becomes the owner and beneficiary of the policy. When Bob dies, Sue gets a return on her investment when the insurance company pays her the death benefit. She also gets a sense of satisfaction from helping someone who is so obviously in need.

Of course, this is not a perfect world. This scenario illustrates the basic workings of a viatical settlement in its pure form. An individual who is in need of cash sells an asset that carries value but that is not of immediate use to the individual otherwise. Another person, who has money to invest, buys the asset at a dis-

counted rate for the promise of a higher return later. This seemingly simple concept has led to the growth of a billion dollar industry in the buying and selling of viatical contracts.

This comment will explore the basic workings of a viatical settlement, along with its benefits and disadvantages for both the insured and the investor. The problem of fraud which has permeated the viatical market will be reviewed with the developing case law related to the viatical industry. Finally, the potential for regulation of the industry will be addressed.

II. THE MEANING OF A VIATICAL SETTLEMENT

A viatical settlement is a process by which a terminally-ill individual can sell his life insurance policy to an investor who pays the insured a discounted face value and then collects the policy benefit upon the insured's death.¹ The term "viatical" comes from the Latin word "viaticum" which in Roman times was a purse containing money and provisions for a journey.² More recently, the term refers to the communion given to the dying in the last rites of the Catholic church.³ In its purest form, a viatical settlement is a way in which a dying person can acquire access to resources to aid his last days of life. This noble-sounding purpose, however, has been complicated and often corrupted by the actions of over-zealous entrepreneurs who are willing to take advantage of the most vulnerable in society in order to increase profit. In recent years, viatical settlements have been marketed to the chronically ill, as well as the terminal. As a result, the elderly have become targeted as a major market for this financial vehicle.⁴

The key parties in a viatical settlement are the insured, known as the viator, the insurance company who issued the policy, and the viatical settlement provider who purchases the policy from the insured. In some cases, the viatical settlement provider is actually a broker who merely matches the viator with an investor who will actually purchase the policy. As the investment market in viaticals has grown, the roles of provider and broker have become blurred. Many providers purchase policies in order to resell them to investors or merge them into large investment pools, which are

² Id. at 325.
³ Id.
then sold in shares.\textsuperscript{5} These mutual funds of viaticated policies or 
"death futures" have become popular investment vehicles but also 
the subject of numerous fraudulent schemes.\textsuperscript{6}

The first step in the viatication process is a meeting between the 
terminally-ill insured and the viatical provider. The provider will 
typically require access to the insured's medical records and will 
often contact the insured's physician directly. In addition, the 
provider will review the insurance policy to determine that change 
of beneficiary is permitted and that no unusual restrictions apply. 
He will also ascertain that the insurer is a reputable company 
with a strong record of paying beneficiaries promptly. Essentially, 
the provider is investigating the factors which will determine the 
degree of risk in his investment. From this determination, he will 
calculate an offer price for the viator.

If the viator accepts the offer, the policy is sold to the provider 
who then lists himself as the beneficiary on the policy. The pro-
vider is now responsible for paying any remaining premiums. 
Typically, the provider will stay in touch with the viator and upon 
the viator's death will collect the entire face value of the policy. 
The provider's profit is the face value minus the amount paid to 
the viator, minus any premiums or other administrative ex-

In this simplified version, the viator and provider work with one 
another directly. In reality, there are likely to be many interven-
ing parties involved in the transaction. As noted, a broker often 
makes the initial contact with the viator, who may not even be 
aware of the true purchaser of his policy. Often the funds are not 
passed directly but are held in escrow until the beneficiary change 
is finalized. Afterward, there may be others involved in adminis-
tering the policy by paying the premiums, checking on the viator, 
obtaining a death certificate, and applying to the insurer for the 
death benefit.

The complexity of this process is significant and poses some 
dangers for the viator, who may not realize initially that he is 
dealing with a conglomerate of businesses rather than with an 
individual.\textsuperscript{8} The major power imbalance between the viator and

\textsuperscript{5} Miriam R. Albert, The Future of Death Futures: Why Viatical Settlements Must be 

\textsuperscript{6} Id. at 350-51.

\textsuperscript{7} Id. at 349.

\textsuperscript{8} Joy D. Kosiewicz, Death for Sale: A Call to Regulate the Viatical Settlement Indus-
try, 48 CASE W. RES. 701 (1998). "On one side of the transaction is a large company with
the viatical settlement provider and his associates creates a strong potential for abuse.\footnote{9} Because of his illness, the viator may not have the energy or motivation to “comparison shop” for the best payment.\footnote{10} Nor may he realize that he is giving up all rights to the policy for himself and his former beneficiaries.\footnote{11} Time is precious to the viator, so issues may arise if the payment is delayed or some other problem occurs, and he is unable to contact the viatical provider. Finally, there are the major issues of confidentiality and privacy, since each additional party to the viatical transaction may gain access to the viator’s medical records and may even intrude upon the viator’s privacy directly by phoning or visiting him at home, ostensibly to see how he is doing but actually to determine that he is still alive.

\section*{III. GROWTH OF THE VIATICAL INDUSTRY}

The viatical industry was born in the 1980’s in response to the AIDS crisis.\footnote{12} In the early years of the pandemic, AIDS was a rapidly fatal disease whose victims usually died within a few months of their diagnosis. Many AIDS sufferers were single gay men who had little need to leave their insurance proceeds to beneficiaries and great need for an infusion of income to pay for their care after they became debilitated by the disease. Their life expectancies were short and relatively predictable, and so they became attractive subjects for viatication.

The industry grew dramatically from the sale of approximately five million dollars in policy values in 1989 to well over one billion dollars by 2000.\footnote{13} Along the way, the essential characteristics of the viator population changed. Advances in medicine made AIDS

\begin{footnotes}
\footnote{9}{Id. at 704.}
\footnote{10}{Miriam R. Albert, Selling Death Short: The Regulatory and Policy Implications of Viatical Settlements, 61 ALB. L. REV. 1013 (1998). The viatical provider may essentially have a monopoly in a local area: Each geographic area has a small number of firms providing a service with no close substitutes, some barriers to entry, and the potential for excess profits . . . . Thus viatical settlement companies may have functional monopolies which allow them, in effect, to hold potential viators who may be too sick to travel, or even to investigate other alternatives, essentially as geographic hostages. Id. at 1023.}
\footnote{11}{Kosiewicz, supra note 8, at 705.}
\footnote{12}{Id. at 704.}
\footnote{13}{Albert, supra note 5, at 353.}
\end{footnotes}
a treatable, if not curable, disease.\textsuperscript{14} Instead of dying within a few months, AIDS patients could be maintained on a regimen of antiviral “cocktails” for years.\textsuperscript{15} They no longer were the sure bet for rapid demise that had been so attractive to the early viatical settlement companies.\textsuperscript{16} Nevertheless, the viatical providers found new markets for their product in the growing population of chronically ill and elderly.\textsuperscript{17} People suffering from cancer, Alzheimer’s disease, and other progressive illnesses, as well as the frail elderly in need of funds for assisted living, found viatical settlements to provide a new source of income.\textsuperscript{18} In addition, a rather surprising new viator was the affluent older person who had purchased life insurance when his children were young, but who no longer felt the need to provide for them and wanted to enjoy, at least, a partial return from his policy.\textsuperscript{19}

A major impetus to the growth of the viatical settlement industry occurred with the passage of the Health Insurance Portability and Accountability Act (hereinafter “HIPAA”) in 1996.\textsuperscript{20} Under the IRS regulations in existence prior to HIPAA, payments received under a life insurance contract by reason of the death of the insured were excluded only from the taxable income of the beneficiary.\textsuperscript{21} In contrast, payment received by the insured for the sale of his policy was considered ordinary taxable income.\textsuperscript{22} HIPAA expanded the exclusion to benefit the terminally ill by providing that viatical settlements and accelerated death benefits would not be taxable.\textsuperscript{23} The Act also provided a relatively flexible definition of terminal illness as an illness or physical condition of the indi-
vidual such that death can "reasonably be expected" to occur within 24 months, as estimated by the individual's physician.  

In addition, HIPAA extended tax benefits to the chronically ill, as well as the terminal, if the proceeds of the viatical settlement were used to pay for long-term care services.  

A chronically ill individual was defined as someone who is unable to perform at least two activities of daily living without assistance for a period of at least 90 days or who requires substantial supervision to protect his health and safety because of severe cognitive impairment.  

By the late 1990's, viatical marketers focused heavily on these new target populations of terminally and chronically ill elderly, and AIDS sufferers comprised only a small percentage of viators.  

IV. FRAUD IN THE VIATICAL INDUSTRY  

The elderly are particularly susceptible to becoming victims of fraudulent investment schemes.  

Diminished acuity in sight and hearing causes difficulty in reading the fine print of contracts or listening to an oral explanation of risks and benefits.  

Poor health and lack of energy may prevent the individual from conducting a thorough investigation before signing an agreement.  

Cognitive deficits such as mild dementia or simple short-term memory loss may interfere with understanding the transaction.  

Even social isolation can contribute to the elderly person's vulnerability when approached by a seemingly friendly salesperson.  

The prospect of selling a policy to a viatical settlement company may seem like an easy method to acquire extra funds for a chronically ill elderly person living on a fixed income. However, the extra money may do no more than interfere with the person's eligibility for means-tested benefits, such as Medicaid and Supplemental Security Income (SSI).  

Nursing homes may even encourage

24. Id. at 816.  
25. Spurrier, supra note 21, at 818.  
26. Id.  
29. Id.  
30. Id.  
31. Id.  
32. Id. See also Frolik, supra note 4.  
elderly residents to become viators because the resulting self-payment from the resident would be higher than the home’s reimbursement from Medicaid. At the other end of the economic spectrum, the affluent elderly person who has funds to invest may be drawn by promises of high returns and low risk or may even view the viatical market as a humanitarian endeavor.

Unfortunately, the viatical industry has been plagued with many forms of fraud and unethical practices. Because of the complex relationships among the viator, the insurance company, the viatical provider, the investor, and various agents and brokers, the possibilities for deception are numerous.

In general, fraudulent practices in the viatical industry can be classified into four major types: (1) insurance agents defrauding insurance companies by hiding the viator’s health status; (2) viators defrauding insurance companies on their own; (3) viators defrauding viatical settlement companies; and (4) viatical settlement companies defrauding viators and investors alike.

An example of the first type of fraud is seen in a recent case, *Davis v. Texas*, in which an insurance agent worked with a viatical provider to induce viators to apply for additional policies. The insurance agent and viatical provider conspired in an elaborate scheme to acquire new policies by hiding the medical conditions of the applicants, and then selling the policies to unsuspecting investors. The viatical provider first solicited viators at resource centers for AIDS patients and even by contacting social workers in hospitals. Soon after they sold their existing policies to the viatical company, the AIDS sufferers were contacted by the insurance agent who assisted them in applying for several new policies. The agent filled out the insurance applications with false information about the applicant’s health status, a process known as “clean sheeting.”

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34. Albert, supra note 5, at 364.
35. See Treaster, supra note 19.
36. Albert, supra note 5, at 368.
38. *Davis*, 68 S.W.3d at 277.
39. Id. at 278.
40. Id.
41. Id. at 279.
and were paid directly for each new policy issued. The new policies were then sold by the viatical provider to various investors.

The second type of fraud, viator fraud on the insurance company, is illustrated in *Amex Life Insurance v. Superior Court of Los Angeles County.* An applicant for an insurance policy, who knew he was HIV positive, sent an imposter to take the physical exam required for the policy. Although the impostor was a different height and weight and his signature did not match that on the application, the policy was issued anyway. Later, the insured individual sold the policy to a viatical company. After the viator's death and the discovery of the deception, the insurance company attempted to withhold payment to the viatical provider. The court ruled against the insurer, however, because the two-year contestability period on the policy had expired. The court noted that it is the insurance company's responsibility to determine that information provided by applicants is accurate. Even if a policy is initially obtained through fraud, after the contestability period ends, the policy can only be cancelled for failure to pay the premiums.

The third type of fraud potentially could occur if the viator presented his health status as worse than it actually was, thus deceiving the viatical provider into offering a higher payment for his policy. Typically, the sooner the viator's death is expected, the greater the portion of the face value of the policy which is paid out in the viatical settlement. The risk for the viatical provider is less in a short term investment because of the likelihood of a faster return from the death benefit and the reduced need for payout of premiums and administrative expenses. Therefore, it is financially advantageous for the potential viator to appear to be closer

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42. *Id.*
43. *Davis,* 68 S.W.3d at 282. The case record includes over 12,000 pages of documentary evidence of multiple interacting companies, including offshore entities in the Bahamas. *Id.* The appellant Davis also objected unsuccessfully to introduction of testimony concerning his three convictions for murder of a husband, wife, and infant child for insurance and inheritance benefits. *Id.* at 283. The court ruled the testimony was “extremely instructive concerning appellant's character.” *Id.* at 283-84.
44. 930 P.2d 1264 (Cal. 1997).
45. *Amex,* 930 P.2d at 1266.
46. *Id.*
47. *Id.*
48. *Id.* at 1271.
49. *Id.* at 1273.
to death than he actually may be.\textsuperscript{51} For example, an AIDS patient could postpone starting a course of treatment until after the viatical settlement was complete.\textsuperscript{52} If he then underwent a successful course of treatment that had the effect of prolonging his life, the profit margin of the viatical provider would be reduced.\textsuperscript{53} Another potentially fraudulent activity perpetrated by the viator could occur if an insured person sells his policy to more than one viatical company, although this type of fraud has become less likely because viatical providers have increased in sophistication and have required direct confirmation from the insurance company of any policy changes undertaken by the insured.\textsuperscript{54} Nevertheless, in a similar situation, a viator may attempt to sell a policy over which he has no legal control. In \textit{Gander v. Gander}, a father was required as part of a divorce settlement to maintain a life insurance policy on himself as the insured and name his ex-wife as beneficiary, with all proceeds of the policy to be held in trust for the couple's two children.\textsuperscript{55} He sold the policy to a viatical settlement company.\textsuperscript{56} The children sued the viatical provider and were found by the court to be the legal beneficiaries of the policy.\textsuperscript{57} Although the viatical company argued unsuccessfully that it was a bona fide purchaser of the policy, the court held that the company had notice of the conflicting claim.\textsuperscript{58} Although the father was the owner of the policy, he was required by the divorce decree to maintain the policy for the benefit of the children and was not legally able to transfer it otherwise.\textsuperscript{59} The court held that the viatical company should have understood the risk it assumed by purchasing a policy that was subject to these restrictions.\textsuperscript{60}

By far, the most prevalent form of fraud is the fourth type, in which unscrupulous providers and brokers deceive unsuspecting viators and investors. The chief method by which a viator is defrauded is by receiving payment that is far below the present value of his policy. The National Association of Insurance Commissioners (NAIC) has issued guidelines for payments based on

\begin{footnotes}
\item[51] Id.
\item[52] Id.
\item[53] Id.
\item[54] Id. at 378.
\item[55] 250 F.3d 606 (8th Cir. 2001).
\item[56] \textit{Gander}, 250 F.3d at 608.
\item[57] Id. at 613.
\item[58] Id.
\item[59] Id.
\item[60] Id.
\end{footnotes}
the life expectancy of the insured, but these have not been adopted in all states.61

Many schemes have been perpetrated by viatical providers to solicit investors fraudulently, often from the vulnerable elderly population. In Securities and Exchange Commission v. Tyler,62 the defendant was accused of enticing more than 480 elderly investors into purchasing viatical shares with false guarantees of liquidity, high interest rates, and fixed maturity dates. In reality, viaticals are generally not liquid, do not have fixed maturity dates (since the date of the insured's death is uncertain), and their rate of return is a variable dependent upon how long the insured survives after his policy is sold.63 Tyler lured investors through an elaborate campaign of newspaper ads, investment seminars, telemarketing calls, and mass mailings.64 Problems arose when the investments reached their promised maturity dates, and the viators were still alive.65 Tyler attempted to create a liquid market by purchasing large numbers of viatical contracts in his own name and then selling shares to investors.66 If an investor wanted to sell his share, Tyler would buy it back or transfer it to another investor.67 This artificial liquidity failed to hold up when Tyler did not have sufficient resources to meet the demands of the investors, and he had to file for bankruptcy.68

In a Pennsylvania case, Srein v. Frankford Trust Company,69 a broker actually sold the same viatical policies to two investors.70 Although both investors had accounts with Frankford Trust, and the same trust officer administered both accounts, the viaticals were not registered investments so no one at the trust company noticed the duplication.71 The viatical agreements were assigned random numbers and locked in the bank's vault, but were not ana-

64. Id.
65. Id. at *4.
66. Id. at *6.
67. Id.
69. Srein, 323 F.3d 214 (3d Cir. 2003).
70. Srein, 323 F.3d at 219. Srein initially sued the broker and won a judgment of two million dollars, but by then the broker was insolvent and the judgment could not be collected. Id.
71. Id. at 219.
lyzed or cross-referenced in any way. After several years, the plaintiff began to investigate why his viatical investments were not paying off and discovered that the policy benefits had been paid out to the other investor. At the district court level, his suit against the trust company was unsuccessful because of his contributory negligence in failing to monitor his investments more closely.

On appeal, the decision in favor of the trust company was reversed and remanded for a new trial. The Court of Appeals recognized that the trust company had a fiduciary duty to the plaintiff, which was established when Frankford solicited his business and charged him fees for trust management. In failing to establish an efficient tracking system which would have identified the duplications, Frankford neglected to notice that the proceeds of Srein's investments were being paid into another account. However, even the Court of Appeals criticized Srein for failing to monitor his investments more closely and only reversed the lower court because it had failed to properly instruct the jury on the Pennsylvania Comparative Negligence Act. “Let the buyer beware” continues to be the appropriate motto for the investor in viatical plans.

V. VIATICAL SETTLEMENTS AND SECURITIES REGULATION

Courts have struggled with the question of whether viatical arrangements should be considered "securities" and thus subject to the control of the Securities and Exchange Commission (SEC). If viaticals are found to be securities, the purveyors of these arrangements would be required to reveal certain information regarding risks and performance of the investments, so that potential buyers would have the capability of making informed decisions. Although it has been monitoring the viatical industry closely, thus far the SEC has not been successful in obtaining a clear ruling at the federal level that viaticals must meet the legal requirements of securities.

72. Id. at 218.
73. Id. at 219.
74. Srein, 323 F.3d at 219.
75. Id. at 225.
76. Id. at 222-23.
77. Id. at 223.
78. Id. at 224.
The highest federal court to consider the question has been the U.S. Court of Appeals for the District of Columbia Circuit in *Securities and Exchange Commission v. Life Partners, Inc.* Life Partners marketed fractions of viatical contracts which allowed small investors to pay as little as a few hundred dollars for a share in a policy. Working through financial planners as its agents, Life Partners grew to dominate the viatical market, and therefore, it attracted the attention of the SEC. Although Life Partners modified its business practices several times, essentially the company operated by identifying potential viators, evaluating their medical records to determine degree of risk, purchasing the insurance policies and naming the company as beneficiary, and then reselling fractions or shares of the policies to investors. When it came under scrutiny by the SEC, Life Partners changed its practice to either list the investors or an escrow agent as the policy owner, instead of itself. Under either plan, Life Partners made its profit through fees charged to the investors before the proceeds of the policies were paid out.

The district court which first heard the case agreed with the SEC and ruled that Life Partners was selling securities without a license. However, the Court of Appeals reversed that decision after applying the three-pronged test used by the U.S. Supreme Court in *Securities and Exchange Commission v. W.J. Howey Co.* Under this test, an investment contract is deemed to be a security if the investors (1) expect profits from (2) a common enterprise that (3) depends on the efforts of others. Clearly, the investors in the Life Partners viaticals expected profits, and clearly, theirs was a common enterprise in that their funds were pooled to buy the policies and they shared any profits or losses after the policy benefits were paid out. However, the court ruled that the third prong of the test was not met, because Life Partners performed no essential entrepreneurial services after the purchase of the contracts.

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80. *Life Partners*, 87 F.3d at 539.
81. Id.
82. Id. The medical risk evaluations of policy holders were conducted by a physician who was a part owner of Life Partners. Id. at 539.
83. Id. at 540.
84. Id. at 540.
85. *Life Partners*, 87 F.3d at 538.
86. 328 U.S. 293 (1946).
88. Id. at 544.
89. Id. at 546.
The court reasoned that the profitability of the investment was directly determined by how long a viator lived, not by any actions of Life Partners itself.\(^9\) The court specifically discounted the pre-purchase activities performed by Life Partners, such as identification of potential viators, rating of medical risk, and negotiation of contract price, as not meeting the requirement of the third prong.\(^9\) Thus, the court established a bright-line test: an investment contract would only be considered a security if, post-purchase, the seller continued to perform some substantial activity that affected the profitability of the arrangement.\(^9\)

The *Life Partners* decision has been widely cited and frequently criticized. Several state appellate courts have considered similar viatical investment plans and ruled that they are securities for the purpose of state securities regulation. In *Joseph v. Viatica Management, LLC*, the Court of Appeals of Colorado ruled that the "units" of investment in a viatical fund met the state definition of a security.\(^9\) Viatica Management sold investment units for a minimum price of $25,000.\(^9\) The plan was to pool these monies into multi-million dollar funds which would then purchase large numbers of viaticated policies.\(^9\) When the return on investment proved to be smaller than promised, a disgruntled investor complained to the state securities commission.\(^9\) The court applied the *Howey* test and found that all three prongs were met.\(^9\) In its analysis of the critical third prong, the Colorado court distinguished this case from *Life Partners*, although it also noted that it was not persuaded by the reasoning followed in that case.\(^9\) Essentially the investors in *Life Partners* were sold fractional shares in specific viatical policies.\(^9\) In contrast, Viatica Management sold shares in a fund which then purchased multiple policies.\(^9\) The identification of these policies and the negotiation of the viatical settlements were all done post-investment, or at least were not

\(^9\) Id. at 545.
\(^9\) Id. at 546.
\(^9\) *Life Partners*, 87 F.3d at 548.
\(^9\) *Joseph*, 55 P.3d at 265.
\(^9\) Id.
\(^9\) Id. at 264. When advances in medical treatment led to longer survival times for AIDS patients, the returns on their viatical settlements did not come as quickly as expected. *Id* at 266.
\(^9\) Id. at 267.
\(^9\) Id.
\(^9\) *Joseph*, 55 P.3d at 267.
\(^9\) Id.
identified to the potential investor at the time he was making his decision to buy into the fund. In this way, the bright-line test established in *Life Partners* was met in that profits were determined by activities carried on post-purchase by the plan sponsors.

Several state courts have questioned the reasoning underlying the *Life Partners* decision. In *Siporin v. Carrington*, an Arizona case, the "bright-line" distinction between pre- and post-purchase activities was challenged. Carrington had solicited investors with brochures promising double-digit returns; he also marketed to potential viators through local health service organizations. Carrington did his homework in investigating a number of factors which could affect the outcome of the viatical arrangement. After being given access to medical records, he would contact the viator's physician for an estimate of life expectancy. He also investigated the rating of the life insurance company and determined that the policy allowed assignment of beneficiaries. Finally, he required that former beneficiaries formally waive their rights under the policy.

The court concluded that the profitability of the viatical investment was directly related to Carrington's pre-purchase activities. The success or failure of the investment was largely determined by his skill in selecting appropriate viators who had policies with strong insurers and whose policies contained the particular clauses that permitted viatication. In applying the *Howey* test and concluding that all three prongs were met, the *Siporin* court noted that it was taking a position contrary to that of the *Life Partners* court. Although state courts typically follow the interpretations of federal courts, here the court felt that the rigidity of the *Life Partners* bright-line test undermined the purpose of the

101. *Id.*
102. *Id.*
104. *Siporin*, 23 P.3d at 93. "In the 'Win/Win Investing' brochure, Carrington suggests returns of from 10% to 11% for policies in which the viator had a projected life expectancy of up to 12 months, to as high as 68% to 70% for policies in which the viator's projected life expectancy was up to 48 months." *Id.* at 94.
105. *Id.* at 93.
106. *Id.* at 93-94.
107. *Id.* at 94.
108. *Siporin*, 23 P.3d at 94.
109. *Id.* at 96.
110. *Id.* at 96-97.
111. *Id.* at 99.
securities regulation statutes.\textsuperscript{112} In concluding that Carrington’s plan constituted the sale of securities, the court stated:

What truly determines viatical settlement profitability is the realization . . . of an outcome predicted by the seller through its analysis of the viator’s life expectancy, the soundness of the insurer, the actions needed to keep the policy in effect for the original face amount, and the insurer’s unconditional liability under the policy’s terms.\textsuperscript{113}

Whether the activities occur before or after the investment is immaterial to the determination that the investment is a form of security transaction.\textsuperscript{114}

The \textit{Siporin} decision was followed in a recent Indiana case, \textit{Poyser v. Flora}.\textsuperscript{115} An investor, Flora, charged that the insurance agent, Poyser, violated the Indiana Securities Act because he was not registered as a seller of securities and the viatical contracts themselves were not registered.\textsuperscript{116} The court noted that viatical settlement contracts were not mentioned in the Act itself at the time of Flora’s investment, but could be found to qualify as securities under the general category of “investment contracts”.\textsuperscript{117} Furthermore, this court challenged the rigidity of the \textit{Life Partners} interpretation of the \textit{Howey} test: the \textit{Life Partners} majority felt that \textit{Howey} required “that profits be made solely from the efforts of others,” while many courts have taken the position that the “profits only have to be generated predominantly from the efforts of others.”\textsuperscript{118} Like the \textit{Siporin} court, the \textit{Poyser} court held that the mortality of the viator was but one of several factors which determine the profitability of the viatical arrangement.\textsuperscript{119} Equally important are actions performed by the seller in identifying and maintaining relationships with viators and insurers.\textsuperscript{120} Whether these activities occur pre- or post-investment is immaterial in de-

\textsuperscript{112} \textit{Id.}
\textsuperscript{113} \textit{Siporin}, 23 P.3d at 99.
\textsuperscript{114} \textit{Id.}
\textsuperscript{115} 780 N.E.2d 1191 (Ind. App. 2003).
\textsuperscript{116} \textit{Poyser}, 780 N.E.2d at 1192.
\textsuperscript{117} \textit{Id.} at 1194. Flora’s investment was made in 1997. In March 2000, the Indiana legislature amended the Act to include a “viatical settlement contract [or] any fractional or pooled interest in a viatical settlement contract.” \textit{Id.} at 1197 n.5.
\textsuperscript{118} \textit{Id.} at 1195 n.2.
\textsuperscript{119} \textit{Id.} at 1197.
\textsuperscript{120} \textit{Id.} at 1197.
terminating whether the third prong of the *Howey* test has been met.\textsuperscript{121}

The rigidity of the *Life Partners* approach has also been rejected by other federal courts. In *Securities and Exchange Commission v. Tyler*, the U.S. District Court for the Northern District of Texas reasoned that the defendant performed a post-purchase service when he bought viaticals in his own name and sold fractions to investors.\textsuperscript{122} In this way, he created a form of liquidity which heightened the value of the investment.\textsuperscript{123} If investors wanted to sell their shares, Tyler would either sell them to others or buy them back himself, thus creating an artificial secondary market.\textsuperscript{124} Even though the investors may not have been aware of his actions, the court felt they relied on his description of the investments as being liquid.\textsuperscript{125} This was felt to be sufficient to pass the third prong of the *Howey* test and support the court's finding that the viatical investment met the definition of a security.\textsuperscript{126}

In addition, the *Tyler* court offered an alternative formulation under which viatical arrangements would qualify for regulation as securities because they meet the definition of an investment "note."\textsuperscript{127} As outlined in the Supreme Court's decision in *Reves v. Ernst & Young*,\textsuperscript{128} securities have the following characteristics: (1) the seller's purpose is to raise money and the buyer's purpose is to profit from the investment; (2) the instrument is commonly traded for speculation or investment purposes; (3) public expectation holds the instrument to be a security; and (4) no other regulatory mechanism serves to reduce the risk of the instrument.\textsuperscript{129} The *Tyler* court concluded that these four requirements were met because the viatical arrangements were clearly bought and sold for profit, were widely advertised, and sold in multiple states as investments.\textsuperscript{130} Furthermore, promises made to potential buyers created the expectation that they were dealing in securities that offered a fixed interest rate and pre-determined maturity date and value.\textsuperscript{131}

\begin{itemize}
\item[121.] *Poyser*, 780 N.E.2d at 1198 n.8.
\item[123.] *Tyler*, 2002 U.S. Dist. LEXIS 2970, at *16-17.
\item[124.] Id.
\item[125.] Id. at *18.
\item[126.] Id. at *19.
\item[127.] Id. at *9.
\item[128.] 494 U.S. 56 (1990).
\item[129.] *Reves*, 494 U.S. at 66-67.
\item[131.] Id. at *13.
\end{itemize}
Finally, it was obvious to the court that no other form of regulation was available to protect investors in these arrangements.\textsuperscript{132}

In spite of this group of decisions contrary to \textit{Life Partners}, state courts continue to adopt inconsistent positions on whether viatical settlements should be treated as securities. In a recent Ohio decision, \textit{Glick v. Sokol}, the court reverted to the position that "the only variable that can impact the profitability of the viatical settlements at issue is the timing of the death of the insured."\textsuperscript{133} Although this court did not cite the \textit{Life Partners} decision, their reasoning was essentially the same: the value of the investment is determined by the timing of death, not by any actions taken by the viatical settlement provider or broker.\textsuperscript{134}

While courts remain divided on the issue of viaticals as securities, some states have taken legislative or regulatory action to resolve the problem. For example, the Pennsylvania Securities Commission (PSC) has issued a notice that viatical settlements are "investment contracts" and as such are considered to be securities and are subject to the regulations of the PSC.\textsuperscript{135} Although it noted the \textit{Life Partners} decision to the contrary, the PSC pointed out that a federal case is not binding on state courts.\textsuperscript{136} Under PSC regulations, sellers of viatical arrangements are required to be registered in the state as brokers and must disclose all information material to the transaction.\textsuperscript{137}

\section*{VI. MODEL ACT AND REGULATION}

The National Association of Insurance Commissioners (NAIC) has developed the Viatical Settlements Model Act\textsuperscript{138} and Viatical Settlements Model Regulation\textsuperscript{139} to guide states in their supervision of the viatical industry. Originally issued in 1993 and 1994 respectively, both models have been extensively amended to re-

\begin{flushleft}
\textsuperscript{132} Id.
\textsuperscript{133} 777 N.E.2d 315, 319 (Ohio Ct. App. 2002).
\textsuperscript{134} \textit{Glick}, 777 N.E.2d at 319. The court reached its decision in spite of its recognition that, by statute, Ohio declared all viatical arrangements to be securities subject to registration under the Ohio Securities Law, effective October 5, 2001. The Glick investment was made in 1998. \textit{Id.}
\textsuperscript{136} \textit{Id.}
\textsuperscript{137} \textit{Id.}
\textsuperscript{138} \textsc{Viatical Settlements Model Act} (Nat'l Ass'n Ins. Comm'rs 1993) (amended 2000).
\textsuperscript{139} \textsc{Viatical Settlements Model Regulation} (Nat'l Ass'n Ins. Comm'rs 1994) (amended 1999).
\end{flushleft}
flect the changing characteristics of the industry. Although similar in many ways to other forms of legislation designed to protect the investor, the Model Act is unique in its emphasis on protection for the viator as well.

The Model Act provides that a viatical settlement provider or broker must be licensed in the state in which the viator resides and gives the state authority to approve the formats of viatical contracts. The content of disclosure statements to the viator is specified in detail and includes warnings that the proceeds of the settlement may be subject to creditor claims and may adversely affect the viator’s eligibility for Medicaid and other government benefits. In addition, the viator must be informed about alternatives to viatical settlements, such as accelerated death benefits and the ability to use the policy as collateral for a loan. Disclosure of these alternate mechanisms is mandated because they may provide the financial assistance the viator is seeking, while allowing him to maintain ownership of his policy and potentially provide a payment to his heirs after his death.

Privacy provisions within the Act assure the viator that his medical, financial or personal information, including his name, will only be disclosed with his consent and only to the degree required to achieve the viatical arrangement. In addition, the Act protects viators from excess intrusiveness by providers, by limiting visits with the insured to once a month if the insured has a life expectancy of less than one year and once in three months if life expectancy is greater than a year.

Perhaps most important to the viator is the requirement that the settlement funds be paid to him within three business days of the date that the insurance company transfers ownership of the policy. The viator is given a 15-day period within which he may rescind the settlement contract after receipt of the payment. If the viator dies within this period, the contract is deemed to be rescinded, the viatical payment must be refunded, and the policy payment must be made to the original beneficiary.

140. **Viatical Settlements Model Act** §§ 3-5.
141. *Id.* at § 8.
142. *Id.* at § 8.A(1).
143. *Id.* at § 6.
144. *Id.* at § 9.G.
145. **Viatical Settlements Model Act** § 9.E.
146. *Id.* at § 9.C.
147. *Id.*
In addition to these protections for the viator, the Act specifies an extensive list of required disclosures to the potential purchaser of viaticals as investments. These disclosures must be part of the purchase contract or a separate document signed by both the purchaser and provider. Specifically, the purchaser must be informed that there will be no return on his investment until the insured person dies and that a guaranteed rate of return cannot be determined since both the length of the investment and the return rate are directly dependent upon the date of the insured's death. Also, it must be clearly stated that the viatical investment should not be considered a liquid purchase because no established secondary market exists for resale of these contracts.

The investor must also be given information about the type of insurance policy he is purchasing and whether he is responsible for paying the premiums or other costs which would reduce the value of his investment. The contract must clearly state whether the investor will be the owner of the policy in addition to being named as the beneficiary and, if not, how his rights and responsibilities could be affected. Any unusual circumstances, such as a policy still within its contestability period, must be described with a specific warning that the investment may be lost if the policy is cancelled.

The qualifications of the physician who determined the viator's life expectancy and the actuary who projected the sale price must be revealed. The investor must be told how often the insured's condition will be monitored and by whom, "how the date of death [will be] determined, and how and when" the investor will receive this information. Like the viator, the investor is given an opportunity to change his mind after entering the agreement, but he must cancel the contract within three days after receiving these disclosures.

The Act also includes an extensive section of guidelines for advertisements of viatical settlements and viatical investment

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148. Id. at § 8.D.
149. Id.
150. VIATICAL SETTLEMENTS MODEL ACT §§ 8.D(1)-(2).
151. Id. at § 8.D(3).
152. Id. at § 8.D(5).
153. Id. at § 8.D(12).
154. Id. at §§ 8.E(5)-(7).
156. Id. at § 8.E(8).
157. Id. at § 8.F.
plans.\textsuperscript{158} Certain terms are assumed to be false or misleading on their face and are prohibited, such as "guaranteed," "no risk," "high yield," or "quick profit."\textsuperscript{159} The viatical settlement provider or broker is also required to develop an "antifraud plan" which must be submitted to the state insurance commissioner.\textsuperscript{160} The plan must provide for the detection and elimination of fraudulent activities by any personnel involved in the viatical settlement process.\textsuperscript{161} Persons convicted of fraudulent activity under the terms of the Act would be subject to imprisonment for up to twenty years, fines up to $100,000, and mandated to pay restitution to any injured parties.\textsuperscript{162}

The NAIC Model Regulation includes sample disclosure statements and consumer warnings.\textsuperscript{163} It also provides standards for determination of reasonable viatical payments.\textsuperscript{164} These standards are based on the life expectancy of the insured and range from 50\% of policy face value when the insured's life expectancy is greater than twenty-four months to 80\% when life expectancy is less than six months.\textsuperscript{165} Among its other protections, the Model Regulation provides the interesting stipulation that "[a] viatical settlement provider shall not knowingly solicit investors who have treated . . . the illness of the insured whose coverage would be the subject of the investment."\textsuperscript{166}

Thirty-seven states have adopted some version of the NAIC models. On July 4, 2002, Pennsylvania passed its Viatical Settlements Act, which became effective in January of 2003.\textsuperscript{167} Although largely drawn from the NAIC Model Act, the Pennsylvania statute omitted a large section of the Model Act which provided guidelines for advertising of viatical settlements and investments. The legislators may have felt that the issue would be adequately covered by the state securities commission in its oversight of viatical investment plans. However, misleading advertising has been at the cen-

\begin{itemize}
\item 158. Id. at § 11.
\item 159. Id. at § 11.D.
\item 160. VIATICAL SETTLEMENTS MODEL ACT § 12.G.
\item 161. Id.
\item 162. Id. at § 13.
\item 163. VIATICAL SETTLEMENTS MODEL REGULATION app. A (1999).
\item 164. VIATICAL SETTLEMENTS MODEL REGULATION § 5.
\item 165. Id.
\item 166. Id. at § 7.F. Apparently, the drafters of the Model Act were concerned that a physician-investor might be tempted to hasten the demise of the insured in order to receive an earlier return on his investment.
\item 167. Viatical Settlements Act, 40 PA. CONS. STAT. §§ 626.1-17 (2002).
\end{itemize}
The high incidence of fraud in the viatical industry lends strong support to the view that these arrangements should be considered securities and should be regulated as such. However, until a case involving viaticals rises to the level of review by the United States Supreme Court, the Life Partners decision will remain the highest federal court holding on the issue. Many state courts and several federal courts have been reluctant to follow Life Partners and have searched for ways to distinguish the facts of their cases in order to arrive at the conclusion that viaticals are securities. Similarly, a majority of states have taken legislative action either to declare viatical arrangements subject to existing securities laws or to adopt specific new statutes drawn on the NAIC model. Unfortunately, neither court decisions nor legislative actions have been consistent, and so the opportunity for fraudulent activity continues.

When considering involvement in a viatical settlement, both the potential viator and the investor must make a cautious appraisal of the benefits and risks. For the viator, the cash received from a previously hidden asset may help pay for medication, assisted living, or that last long vacation. But the viator must be careful that he is receiving reasonable value for his policy and that the viatical "deal" is better than alternatives of tapping an accelerated death benefit or simply borrowing against the policy. Individual circumstances must be considered, such as the desire to provide for beneficiaries, as well as the potential impact on Medicaid eligibility.

For the potential investor, the key word is caution. Viatical plans are not low risk and a positive rate of return is not guaranteed. What looks like a simple way to make money, and maybe even help a fellow human being in need, is really a complex financial transaction designed to enrich many parties before the individual investor gets his return. Before choosing any viatical investment, the investor should carefully investigate all aspects of the offer, including the method of selecting viators, the stability of the insurance companies backing the policies, and the reputation of the viatical settlement provider or broker. In particular, the investor must realize that the timing of the viatical payout can never be guaranteed. As medical science advances, formerly terminal illnesses become chronic conditions which may persist for
years. During this time, the investor will receive no return and may even be forced to pay policy premiums and other expenses. Only those wealthy enough to afford speculating with their funds should even consider viatical investments.

In spite of these limitations, the viatical industry continues to grow and is apparently fulfilling needs among the terminally and chronically ill. In addition, investors appear to be willing to take on these high-risk vehicles. The need is clear for improved scrutiny of the industry for the protection of both viators and investors. All states should adopt legislation which includes the key features of the Model Code, particularly the requirement for a predetermined level of payment to the viator, mandated licensure of brokers, and strict limits on misleading advertising. In short, viatical arrangements should be recognized and treated as securities. In this way, heightened surveillance from state regulatory agencies will reduce the more flagrant abuses which have plagued the industry and allow the ill and the elderly to benefit from the positive features of these arrangements.

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