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SELLING DEATH SHORT: THE REGULATORY AND POLICY IMPLICATIONS OF VIATICAL SETTLEMENTS

Miriam R. Albert*

INTRODUCTION

In recent years, the escalation of AIDS into a national crisis has devastated its victims' health as well as their finances.¹ This crisis

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¹ According to the Centers for Disease Control and Prevention [hereinafter CDC], AIDS is now the leading cause of death among all Americans between the ages 25 to 44. See THE WHITE HOUSE, THE NATIONAL AIDS STRATEGY 8 (1997) (noting that "[s]ince 1987, AIDS has risen from being the 15th leading cause of death among all Americans to the 8th"); see also *Update on HIV Mortality in Persons Aged 25 to 44*, 53 AM. FAM. PHYSICIAN 2769, 2769 (1996) (analyzing updated data from 1993 and 1994 in a 1996 report available from CDC). From the first recognition of the disease through June 30, 1997, a cumulative total of 612,078 cases have been reported, and more than 379,000 persons have died of AIDS or related causes in the United States alone. See CENTERS FOR DISEASE CONTROL & PREVENTION, U.S. DEP'T OF HEALTH & HUMAN SERVS., HIV/AIDS SURVEILLANCE REPORT 3, 14 (midyear ed. 1997) [hereinafter CDC 1997 MIDYEAR SURVEILLANCE REPORT] (noting that of these, 84% were men, 15% were women, and 1% were children). Over 86,000 persons have been reported with HIV infection without full-blown AIDS. See *id.* at 26.

Through 1996, an estimated 239,000 persons were living with AIDS in the United States. See *id.* at 25. According to the CDC, a figure such as this underrepresents the number of persons with HIV because most HIV-infected persons have not yet progressed to full-blown AIDS, and many persons infected with HIV have never been tested for AIDS. See CENTERS FOR DISEASE CONTROL & PREVENTION, U.S. DEP'T OF HEALTH & HUMAN SERVS., HIV/AIDS SURVEILLANCE REPORT 5 (year-end ed. 1996) [hereinafter CDC 1996 YEAR-END SURVEILLANCE REPORT].

In 1989, one projection was that by the year 2020, without a cure or vaccine, AIDS might be the leading cause of all U.S. deaths, and that within 25 to 30 years, AIDS deaths per year could exceed 1,000,000, or 25% of all U.S. deaths. See Kennes C. Huntley et al., *Life Insurance, Imminent Death and Accelerated Benefits*, J. AM. SOC'Y C.L.U. & CHFC, May 1994, at 84 (arguing that the notion that AIDS might be readily controllable had been dispelled). However, recent changes in AIDS treatment may temper that projection considerably. See *infra* notes 167-71 and accompanying text.

AIDS is a financially devastating diagnosis. A 1992 study by the National Association of People with AIDS found that over 50% of the AIDS patients surveyed live on less than \$12,000 annually. See NATIONAL ASS'N OF PEOPLE WITH AIDS, HIV IN AMERICA: A PROFILE

has generated the need for innovations both in medical approaches to the treatment of AIDS and HIV, and in financial options available to help patients finance their medical and other living expenses. One response of the financial community has been the creation of vehicles to provide terminally-ill policyholders with early access to the death benefits under their life insurance policies, which would otherwise be unavailable to them during their lives.²

As these new financial vehicles became more established, questions about the need for regulation arose. The most popular of these new vehicles is an asset-backed security known as a viatical settlement.³ Viatical settlements are a specialized form of receivable financing under which viatical settlement companies buy from the policyholder, at a discounted rate, the right to receive death benefits under life insurance policies.⁴ The viatical settlement company may then hold the policy, sell the policy to an individual investor, or pool the policy with others and sell fractions of the pool to investors.⁵ The return to investors is the difference between the discounted value paid to the policyholder and the full value paid by the issuing insurance company upon the policyholder's death.⁶

OF THE CHALLENGES FACING AMERICANS LIVING WITH HIV 10 (1992). Over half of the survey respondents reported significant difficulties in providing for basic personal needs such as rent, food, and medicines. *See id.* at 12.

AIDS treatment historically has been very expensive. A 1992 study by the American Medical Association found that HIV patients incur an average of \$119,000 in medical expenses from the time of infection with HIV until death from AIDS-related illnesses. *See* Clifford Carlsen, *AIDS Life Policy Purchaser Seeks New Life from IPO*, S.F. BUS. TIMES, Nov. 10, 1995, § 1, at 3. It is worthy to note that the cost figure reported by the American Medical Association's study pre-dates the advent of new and costly drug therapies such as protease inhibitors. *See infra* note 168.

² *See* Carole C. Lamson, *Legal Introduction in Living Benefits in Life Insurance: New Perspectives and Developments*, N.Y. ST. B.J., Nov. 1993, at 16.

³ The term "viatical" comes from the Latin word "viaticum" which is the Eucharist or communion given to Christians who are dying or are in danger of death. THE AMERICAN HERITAGE DICTIONARY OF THE ENGLISH LANGUAGE 1988 (3d ed. 1992). To the Romans, it meant money or provisions for a journey, but the term came to refer to the last rites—something to sustain the deceased person on his or her "last journey." *Id.*

⁴ *See* Lamson, *supra* note 2, at 16. Typically, the policyholder is a terminally-ill patient who is paid some portion of the face value of his or her life insurance policies while he or she is still alive. *See id.* The policyholder sells, exchanges, or assigns some or all of his or her rights under the transferable policy to the viatical settlement company, as sole beneficiary. *See id.*

⁵ *See id.* at 17; *see also* Katherine DePeri, *Securities Law—Brokered Viatical Settlement Contracts Are Not Securities—Securities & Exchange Commission v. Life Partners, Inc.*, 87 F.3d 536 (D.C. Cir. 1996), 70 TEMP. L. REV. 857, 857 (1997).

⁶ *See* Lamson, *supra* note 2, at 16.

Though the concept of viatication may sound ghoulish, the business of viatical settlements is generally legal and provides a service to terminally-ill patients.⁷ The purchase price for the policies enables the policyholders to realize some estimation of the policies' present value, to use for their living and medical expenses.

Viatical settlements raise regulatory concerns under the insurance laws.⁸ The initial sale of life insurance policies by terminally-

⁷ For a discussion of opposition to the viatical industry in general, see Denise M. Schultz, Comment, *Angels of Mercy or Greedy Capitalists? Buying Life Insurance Policies from the Terminally Ill*, 24 PEPP. L. REV. 99, 103-06 (1996).

⁸ Companies purchasing policies from sellers in one of the 23 regulated states must be licensed to viaticate policies in such states. If the seller lives in a state that is not regulated, then the purchasing company must abide by the National Association of Insurance Commissioners' Model Regulation. See *infra* Part III for an examination of existing regulation within the viatical settlement industry.

Viatical settlements also raise tax law concerns that are beyond the scope of this Article. The recent enactment of the Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-191, 110 Stat. 1936, has essentially equalized the tax treatment of viatical settlements and accelerated death benefit options now available under some traditional life insurance policies by characterizing the income received under both as non-taxable to taxpayers who have life expectancies of 24 months or less, or, under special conditions, to taxpayers who are chronically ill. See Malcolm E. Osborn, *Rapidly Developing Law on Viatical Settlements*, 31 WAKE FOREST L. REV. 471, 492-95 (1996); see also Schultz, *supra* note 7, at 114-20 (discussing the tax issues arising in connection with viatical settlements). See *infra* note 16 for a discussion of accelerated death benefit provisions.

Viatical settlements also raise securities law concerns that are beyond the scope of this Article. The resale of life insurance policies to investors should, under certain circumstances, be subject to regulation under federal and state securities laws. Specifically, the question of whether the resale of fractional interests in pools of purchased policies constitutes an offer and sale of a "security" requiring registration under federal securities laws has been the subject of recent litigation. In *SEC v. Life Partners, Inc.*, 87 F.3d 536, 538 (D.C. Cir. 1996), the Securities and Exchange Commission argued unsuccessfully that such resales constitute the sale of unregistered securities, in violation of section 5 of the Securities Act of 1933. See *Life Partners*, 87 F.3d at 538; Elizabeth L. Deeley, Note, *Viatical Settlements Are Not Securities: Is it Law or Sympathy?*, 66 GEO. WASH. L. REV. 382, 385 (1998) (discussing the *Life Partners* case and suggesting that the SEC exempt viatical settlements from the registration requirements of section 5 of the Securities Act of 1933 to reduce the burden on viators while still providing them the anti-fraud protections of the securities laws); see also Michael R. Davis, Note, *Unregulated Investment in Certain Death: SEC v. Life Partners, Inc.*, 42 VILL. L. REV. 925 (1997) (discussing the *Life Partners* decision).

Although the District of Columbia Court of Appeals was not persuaded in the *Life Partners* case, viatical transactions clearly fall within the definition of securities under federal securities laws and should be subject to registration, absent some exemption. See DePeri, *supra* note 5, at 875 (arguing that the court, in reaching its decision, ignored the remedial purposes of the Securities Act, "and missed an opportunity to require necessary disclosure of the investment's risks"). But see Timothy P. Davis, *Should Viatical Settlements Be Considered "Securities" Under the 1933 Securities Act?*, 6 KAN. J.L. & PUB. POL'Y 75, 85 (1997) (concluding, primarily on public policy grounds, that viatical settlements should not be considered securities); 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)

ill policyholders, known as viators,⁹ to viatical settlement companies is subject to varying amounts of regulation at the state level, typically by a state's insurance department.¹⁰ As a result of the differences in the states' regulations, the sale of otherwise identical policies in different states may lead to different financial outcomes for viators living in different states. While this is not necessarily problematic, these differing results may lead to financial inequities for otherwise similarly-situated viators.

Part I of this Article provides an overview of the creation and growth of the viatical industry as a response to the increasing medical costs and decreasing income streams facing AIDS- and HIV-infected patients.¹¹ Part II sets out the problem of whether and how to regulate the viatical industry, examining the risks and theoretical justifications for regulating the purchase side of the viatical industry.¹² Part III details the existing regulation of the viatical industry.¹³ And Part IV is an evaluation of existing regulations in the viatical industry, in light of the various theoretical rationales for government intervention, concluding that, on balance, some regulation is needed to protect this vulnerable population.¹⁴

(arguing that viatical settlements are not securities and therefore not subject to the regulatory control of the Securities Act of 1933).

⁹ Although this Article is an examination of the economic justifications for regulating the viatical industry, the author is mindful that underlying each viatical transaction is a terminally-ill person diagnosed with essentially a death sentence. And, though this Article follows what is industry custom by using terminology such as "viator" to reflect the terminally-ill policyholder and refers to a policy as "maturing" to reflect the status of the policy upon the policyholder's death, such terminology should not serve to dehumanize this process. To the contrary, the Article argues that regulation is necessary to protect these individuals, in part, due to their medical situation and resultant vulnerability.

¹⁰ See *infra* note 59 and accompanying text. The focus of this regulation is on the initial sale and not on the subsequent resales where the parties are likely to be able to deal at arm's length and may be subject to additional regulation governing the subsequent resale of the policies, perhaps through state securities regulation.

¹¹ See *infra* notes 15-43 and accompanying text. Although AIDS- and HIV-infected patients make up the overwhelming majority of the viatical industry as currently constituted, other terminally-ill patients can, and increasingly are, viaticating policies. See *infra* notes 173-75 and accompanying text.

¹² See *infra* notes 44-58 and accompanying text. The "purchase side" of the viatical industry refers to the viatication or purchase of the insurance policy from the policyholder. The resale side of the viatical transaction involves the disposition of the policy by the buyer, either by resale as a single policy or as part of a pool of policies, or by holding the policy until it matures, and such resale is beyond the scope of this Article. See *supra* note 8 and accompanying text.

¹³ See *infra* notes 59-109 and accompanying text.

¹⁴ See *infra* notes 110-63 and accompanying text.

I. OVERVIEW OF THE VIATICAL INDUSTRY

The first viatical settlement companies emerged in the late 1980s, and primarily acted as brokers, matching up terminally-ill policyholders with investors.¹⁵ The initial growth of the viatical industry was primarily a function of the lack of any significant alternative available from the life insurance industry. Recently, however, more domestic insurance companies have begun offering accelerated benefits to their policyholders, typically in the form of accelerated death benefits provisions in traditional life insurance policies,¹⁶ and, less frequently, in the form of loans on insurance policies¹⁷ and long-term care insurance.¹⁸ The recent increase in

¹⁵ See John Freeman Blake, *Life Insurance Proceeds Can Be Received Tax Free Prior to Death Under New Prop. Regs.*, 79 J. TAX'N 156, 156 (1993).

¹⁶ Under traditional life insurance policies, the insurer guarantees the payment of the policy face value upon the death of the insured, as long as the policy is then in effect. The insurer is under no legal obligation to "accelerate" the payment of the death benefits to the insured, absent an accelerated death benefit [hereinafter ADB] provision. See Abbie Crites-Leoni & Angellee S. Chen, *Money for Life: Regulating the Viatical Settlement Industry*, 18 J. LEGAL MED. 63, 73 (1997).

ADB provisions can be included as an initial policy provision, or can be added as riders or attachments to new or existing policies. See *id.* Unlike viatical settlements, ADB provisions typically provide that a portion of the face value benefit be retained as a death benefit for the traditional beneficiary. See *id.*

Insurers fund ADB provisions either by charging additional premiums or by retaining part of the ADB payments paid to the insured when the provision is exercised or paid to the insured's beneficiary upon the death of the insured; the issuing company reduces the payout to cover its administrative costs, and to compensate it for the interest lost as a result of the early payout. See Lamson, *supra* note 2, at 19. As a result, the insured typically gets only a portion of the face value of the policy under an ADB provision. See *id.* at 16.

An ADB provision typically pays a smaller percentage of the face value of the policy than a viatical settlement and is subject to more stringent requirements on availability in terms of triggering conditions. See Wesley S. Caldwell, III et al., *Innovation and Controversy: Viatical Arrangements and Accelerated Death Benefits*, N.J. LAW., Oct./Nov. 1995, at 39. ADBs typically are available only to insureds with life expectancies of less than one year, whereas viatical settlements can be made with viators with much longer life expectancies. See *id.* The viator would simply be paid a smaller percentage of the face value of the policy to compensate the viatical settlement company for the increased risk of investment (i.e., that the policyholder would outlive his life expectancy), if such percentage complied with any mandated minimum payout provision. See *infra* notes 99-109 and accompanying text for a discussion of the mandated minimum provisions in the NAIC Model Act and Model Regulation.

Additional differences between ADB provisions and viatical settlements include: ADB payouts can be slow, while viatical settlements typically are paid within a few weeks; ADB provisions typically are limited to universal and whole life policies, while viatical settlements can be made on a much wider range of policy types; and insureds must deal exclusively with the issuing insurance company with ADBs, while insureds can shop their policies to various viatical firms. See Caldwell et al., *supra*.

¹⁷ Holders of whole or universal life insurance policies may be able to borrow against the cash value at terms negotiated with the issuing company. The death benefit will be restored if

the options available under life insurance policies does not mean that the increasing numbers of policyholders seeking early access to their death benefits is a short-term phenomenon. The size of the viatical industry has grown from an estimated five million dollars in 1989 to approximately four hundred million dollars in 1995, with projected volumes for 1996 and beyond estimated in excess of five hundred million dollars.¹⁹

There are two basic roles for viatical settlement companies: providers, who buy the policies themselves and hold them as the named beneficiary thereunder, and brokers, who act as intermediaries between viatical settlement providers and viators by performing underwriting functions, and negotiating a fee to be paid by the viatical settlement provider.²⁰

The mechanics of viatical settlements are fairly straightforward. Viatical settlement companies buy almost any type of life insurance, including term, whole, universal and group life policies, as

the loan and interest are repaid prior to the policyholder's death. See Laura Castaneda, *How To Tap Life Insurance Policy Before You Die*, S.F. CHRON., Mar. 10, 1997, at E3.

¹⁸ Critical illness insurance policies and long-term care insurance policies are basically riders to a traditional life insurance policy that pays benefits when a policyholder contracts a specified critical illness, or is unable to perform two out of five specified activities of daily living, or contracts a cognitive impairment, like Alzheimer's disease. See Lore Postman, *New Life Insurance Doesn't Require Death; Holders Need Not Die To Cash in on Benefits*, INDIANAPOLIS BUS. J., Jan. 20, 1997, at 17 for a discussion of critical-illness policies. See Albert L. Gray, Jr., *An Asset-Based Alternative to Long-Term Care*, LIFE ASS'N NEWS, Feb. 1997, at 106-08, for a discussion of long-term care policies.

¹⁹ Because mandatory reporting requirements in the viatical industry are relatively new and are not universal, there is a wide disparity in the estimates of the dollar volume of the viatical industry, and a lengthy time lag in the dissemination of even the disparate dollar estimates. For example, the *Washington Post* puts the 1995 dollar volume at approximately \$200 million, see Albert B. Crenshaw, *Tackling an Issue of Agony; Ruling Ultimately May Aid the Business of Buying Death Benefits*, WASH. POST, Sept. 1, 1995, at C1, while the National Viatical Association [hereinafter NVA], a Washington, D.C. based industry group, estimates the 1995 volume at \$400 million and projects the 1996 volume at \$500 million. See *Viatical Association Drafts Its Own Model Law*, BESTWIRE, Nov. 5, 1996, available in LEXIS, News Library, Txtnews File. See *infra* notes 45-47 and accompanying text for a discussion of the current composition of the viatical industry.

²⁰ See Viatical Association of America, *About the Viatical Industry: Supporting the Viatical Settlement Industry and the People it Serves* (last modified Jan. 9, 1998) <<http://www.cais.com/viatical/about.html>> (noting that the term "funder" is sometimes used instead of "provider").

The NAIC Model Act and Model Regulation differentiate between "viatical settlement providers" and "viatical settlement brokers," recognizing the differences in these two roles by requiring both to be licensed, but requiring providers to post a bond, while brokers must simply maintain errors and omissions coverage. This Article uses the term viatical settlement company to include firms that act as viatical settlement providers but may also engage in some brokering. See *infra* Part III for a discussion of the existing regulation in the viatical settlement industry.

long as the policy is in good standing, contains no prohibition against assignment for value,²¹ and has been in force for at least two years so that the customary two-year period of contestability has expired.²² In most cases, the insured must produce a medical certificate attesting to the fact that death is certain to occur within some set time period, typically from six months to a year.²³ The viatical settlement company then makes an offer to pay the insured a percentage of the face value of the policy; payment is typically made in a lump sum within a few weeks.²⁴

Although viatical settlements may serve an altruistic purpose, both parties to the transaction make money. The viator receives some estimate of the present value of his policy, and the viatical settlement company takes part of the purchase price the investor

²¹ Prohibitions on assignment for value make viatication impossible. For example, the standard group life insurance policy written by Prudential Insurance Co. of America for the University of California prohibits "assignment for value," so those policyholders are unable to enter into viatical settlements. See Ilana DeBare, *UC Employees Can't Sell Their Life Insurance Policies*, SACRAMENTO BEE, Nov. 7, 1996, at C6. The University of California policyholders are not without any options; their policies do permit accelerated death benefits, but the life expectancy of the policyholder must be less than six months. See *id.* Some state laws have remedied this problem by enacting statutes that guarantee consumers the right to assign their policies. See *id.*

²² An "incontestability clause" is an agreement by the issuing insurance company to refrain from challenging claims because of misstatements on the application by the insured, after some period of time, usually two years, has passed. See Eric Mills Holmes, *Solving the Insurance/Genetic Fair/Unfair Discrimination Dilemma in Light of the Human Genome Project*, 85 KY. L.J. 503, 547 (1996-1997).

One result of the growth in the viatical industry is the increased incidence of fraud, specifically in the area of incontestability clauses. See *id.* (arguing that these clauses "not only foster a moral hazard of fraud but also unfairly require insurers to pay claims that should not be paid"). Applicants for life insurance simply lie about their HIV-status on the application, or send an impostor in to take any required physical exam. See *Amex Life Assurance Co. v. Superior Court*, 930 P.2d 1264, 1265, 1273 (Cal. 1997) (holding that "after the contestability period has expired, an insurer may not assert the defense that an imposter [sic] took the medical examination if, as here, the named insured personally applied for insurance"). But see *Protective Life Insurance Co. v. Sullivan*, 682 N.E.2d 624, 626-27 (Mass. 1997), where the Supreme Judicial Court of Massachusetts held that insurers must pay benefits on policies in effect for more than two years, even when the insureds intentionally lied about their health in applying for the policies. This decision could have a chilling effect on the willingness of insurance companies to write policies, and thus, could cause a possible spillover effect into the viatical industry. But see *infra* note 176 and accompanying text for a discussion of insurance companies seeking to sell life insurance policies to AIDS patients.

²³ See Russell J. Herron, Note, *Regulating Viatical Settlements: Is the Invisible Hand Picking the Pockets of the Terminally Ill?*, 28 U. MICH. J.L. REFORM 931, 934 (1995). Viatication is available for policyholders with longer life expectancies as well; the amount paid for the policy is simply decreased to take into account the longer life expectancy. See *infra* notes 26-37 and accompanying text.

²⁴ See Herron, *supra* note 23, at 934.

pays, and also may take part of the insurance proceeds when paid out.²⁵

The amount paid to the viator for a policy is an estimation of its present value.²⁶ This present value is calculated in light of factors such as the projected life expectancy of the policyholder, the prevailing economic climate (particularly current interest rates), the face value of the policy, and the cost of at least two years of future premiums, which, under the viatical settlement agreement, become the responsibility of the purchaser, absent a disability waiver of premiums.²⁷ Additional factors for calculating present value include the financial strength of the issuing life insurance company, the viatical settlement company's cost of funding the policy acquisition, and any miscellaneous expenses.²⁸

The most uncertain of these factors is the projected life expectancy of the policyholder; the timing of and effect on individuals afflicted with AIDS varies greatly.²⁹ Because AIDS is a relatively new terminal illness, there are as yet no established life expectancy tables for patients afflicted with HIV or AIDS.³⁰ Accordingly, viatical settlement companies tend to estimate life expectancies of AIDS-afflicted policyholders in a conservative manner.³¹ This translates into a lower price paid to insureds.³²

²⁵ See *id.* at 933 (explaining the financial workings of the viatical industry).

²⁶ See Glick, *supra* note 8, at 964-65; Michael Todd Scott, *An Illinois Lawyer's Guide to Viatical Settlements*, 85 ILL. B.J. 276, 276 (1997) (discussing the factors affecting the amount of settlement).

²⁷ Under a disability waiver, an employer pays the policy premiums on behalf of its employees who have become disabled and thus unable to pay the premium themselves. See Herron, *supra* note 23, at 957-58. A disability waiver eliminates the need to pay premiums on the policy and typically is renewable as long as the disability exists. See *id.*; see also Jonathan G. Blattmachr, *Selected Aspects of Taxation Relating to Life Insurance and Deferred Compensation*, 155 PRAC. L. INST. 237, 245 (1985). For a discussion of the effect of an absolute assignment of a policy on a waiver of premium clause in connection with a viatical settlement, see Osborn, *supra* note 8, at 489-90.

²⁸ See Scott, *supra* note 26, at 276.

²⁹ See Herron, *supra* note 23, at 951.

³⁰ See Lamson, *supra* note 2, at 17.

³¹ See Sharon Crockett & Lynn Homa, *Viatical Settlement Firms Look To Securitize*, MORTGAGE-BACKED SECURITIES LETTER, Apr. 10, 1995.

³² According to Sharon Crockett and Lynn Homa:

Although there are a number of elements, including clinical factors, disease progression, and types of treatment, that are considered when estimating life expectancy, these considerations have only prognostic associations with survival after diagnosis and offer no actuarial basis for life expectancy estimation. As a result, policies are conservatively discounted.

Id.

While viatical settlements undoubtedly provide a service to the policyholders, the transactions are not without financial, legal, and collateral risks. The primary financial risk for both viators and viatical settlement companies flows out of the uncertainty in estimating life expectancies.³³ Some estimate of life expectancy must be used to calculate the payout.³⁴ The insured's life expectancy is the most significant factor in ascertaining the present value of a given policy; the shorter the life expectancy of the policyholder, the greater the percentage of the policy value paid to him.³⁵ Likewise, and this is the troublesome part for the squeamish investor, the shorter the actual life of the policyholder, the greater the return to the investors.³⁶ If the viator dies earlier than or outlives the projected life expectancy used to calculate the viatical settlement payment, the return to the investor is affected.³⁷

Viatical settlements also pose legal risks to both sides. Viators run the risk of losing other benefits, such as welfare or Medicare, as a result of the sale of their policy; viatical settlement companies risk the possibility of a determination that the viator lacked the necessary mental capacity to enter into the settlement, or that the decision was made under duress.³⁸ Additional legal risks include the possibility that a court will hold the policy to be non-assignable or cancelable, or that not all the prior beneficiaries have waived their rights, if irrevocable, under the policy.³⁹ Finally, because of the nature of the viatical settlement transaction, the insurance company that issued the original policy ultimately provides credit for the deal, exposing both the viator and the viatical settlement

³³ Viatical settlement companies that borrow funds to finance the purchase of policies at a floating rate are also vulnerable to rises in the interest rate on these funds after the viatical settlement contract has been signed. See Lamson, *supra* note 2, at 17.

³⁴ See Scott, *supra* note 26, at 276.

³⁵ See *id.*

³⁶ See *id.*

³⁷ See David W. Sommer et al., *Viatical Settlements: Perspectives of Investors, Regulators and Insureds*, J. AM. SOC'Y C.L.U. & CHFC, Mar. 1997, at 54-60 and table 1 for a tabular illustration of the range of expected returns for varying lengths of time and initial investment, exclusive of taxes and transaction costs. For example, a \$100,000 policy with a 70% settlement yields at least a 19% compounded return if the viator dies within two years, a 13% compounded return if the viators dies at 36 months, and a little more than 9% compounded return at four years. See *id.*

³⁸ See Patricia B. Rumore, *Elder Law: Pitfalls for the Unwary*, 58 ALA. LAW. 160, 161-62 (1997) (examining the viatication process with an elder client); see also Lamson, *supra* note 2, at 16 (noting that the viatical settlement company may request a psychiatric evaluation).

³⁹ See Herron, *supra* note 23, at 956.

company to the risk that this insurance company will default on its payment obligations.⁴⁰

Viatical settlements also pose collateral risks for viators, who run the risk that their private medical history furnished to the viatical settlement company will somehow become more publicly disseminated.⁴¹

Because of the underlying emotional issues and risks involved with viatical transactions, the issue of whether to regulate the viatical industry in order to minimize, or at least better manage, some of these risks has been extensively debated by various interested parties almost since the first viatical settlement.⁴² Such parties include viatical settlement companies and industry groups, AIDS lobbyists, state insurance departments, and the Securities and Exchange Commission.⁴³

II. DESCRIPTION OF THE PROBLEM

Recognized deviations from the economic model of perfect competition, with its goal of economic efficiency, provide traditional rationales for government intervention.⁴⁴ The viatical industry reflects evidence of two such deviations: local monopolies and information asymmetries. This section analyzes each of these market failures as a basis for regulation in the viatical industry.

⁴⁰ Because viatical settlements are such a new transaction, no court has yet ruled on issues common in traditional insurance litigation, such as lack of capacity, or duress. Further, there presently are no reported cases of an issuing insurance company defaulting in a viatical transaction. But, in the absence of appropriate regulation, as more policies are viated, the likelihood of such occurrences increases.

⁴¹ See *infra* Part IV for a discussion of how the potential confidentiality problems are addressed in the NAIC Model. See also *infra* note 58 and accompanying text for a discussion of these collateral risks.

⁴² See 1992 Winter National Meeting, 1993 PROC. NAT'L ASS'N INS. COMMISSIONERS 779, 782 [hereinafter 1993-1 NAIC PROC.].

⁴³ See *id.*

⁴⁴ While efficiency must be considered as a part of any policy decision, it should not be the sole consideration. There are other concurrent, valid social considerations, such as the respect for human dignity (by protecting the infirm or otherwise vulnerable members of society), and general fairness considerations (by preventing discrimination). That these goals are not documented in traditional economic theory should not invalidate them as additional rationales for regulation. Arguably, the evaluation of the necessity and appropriateness of regulation should reflect both non-efficiency considerations and efficiency considerations. See DAVID L. WEIMER & AIDAN R. VINING, POLICY ANALYSIS: CONCEPTS AND PRACTICES, RATIONALES FOR PUBLIC POLICY: DISTRIBUTIONAL AND OTHER GOALS 94-102 (2d ed. 1992).

A. Local Monopoly Problems

The existence of the first market failure, local monopoly, is evident by examining the demand and supply sides of the viatical industry, and the relationship between the prevalence of AIDS and the availability of viatication. While the viatical market taken as a whole consists of a relatively large number of firms, the industry is composed of smaller markets relating to specific geographic regions.⁴⁵ Because of the lack of regulation in the viatical industry, determining the actual number of firms viaticating policies with any degree of certainty is difficult. Estimates range from 75 to 100 firms that participate to some degree in viatication as providers and/or brokers, some as a full-time effort and others for just a few policies.⁴⁶ As of January 24, 1998 at least twenty-eight firms have joined the two principal viatical industry associations, the Viatical Association of America and the National Viatical Association, both located in Washington, DC.⁴⁷

In some geographic areas, the viatical industry constitutes a local monopoly. Each geographical area has a small number of firms providing a service with no close substitutes, some barriers to entry,⁴⁸ and the potential for excess profits. State laws concerning vi-

⁴⁵ See Herron, *supra* note 23, at 960-64 (explaining that because "of this concentration of companies, the competitiveness of the market for viaticals varies naturally and substantially from state to state").

⁴⁶ During the course of the drafting of the NAIC Viatical Settlement Model Act and Model Regulation in the early 1990s, the NAIC working group was advised by industry participants that there were approximately 54 viatical companies. See *Spring 1994 National Meeting*, 1994 PROC. NAT'L ASS'N INS. COMMISSIONERS 352, 360 [hereinafter 1994-1 NAIC PROC.] (noting that there was a "great deal of competition" in view of the number of industry participants).

An unofficial compilation by the author, with the assistance of the National Association of People With AIDS, put the number of firms as of April 1, 1997 at 94. This number has increased since then.

⁴⁷ According to these two organizations, the current member firms are geographically distributed as follows:

NVA membership, as of January 29, 1998, totaled 8 members with 3 located in Florida, 1 each in Kentucky, Missouri, New Jersey, Ohio, and California. See NATIONAL VIATICAL ASS'N, MEMBERSHIP AS OF JANUARY 1998 (1998).

Viatical Association of America membership, as of January 24, 1998, totaled 20 members (12 providers or funders and 8 brokers), with 23 offices, consisting of: 1 located in California, 5 in Florida, 3 in Georgia, 3 in Illinois, 1 in Kentucky, 1 in Michigan, 1 in Minnesota, 1 in Missouri, 2 in New York, 1 in Nevada, 1 in North Carolina, 1 in Pennsylvania, 1 in Utah, and 1 in Canada. See Viatical Association of America, *Member Companies* (visited Feb. 1, 1998) <<http://www.caais.net/viatical/memlist.html>>.

⁴⁸ Barriers to entry in the viatical industry include the need to understand and fully comply with the various licensing requirements in the different states, as well as the need to un-

atical settlements vary,⁴⁹ and the geographical distribution of AIDS- and HIV-infected policyholders is uneven, with high concentrations in certain cities such as New York and San Francisco.⁵⁰ 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.

The local monopoly problem evident in some segments of the viatical industry results from the uneven distribution of AIDS and HIV cases among the states, and the resulting availability of viatication in such states.⁵¹ The number of AIDS cases reported varies dramatically by state.⁵² Five states (California, Florida, New York, Texas and New Jersey) account for over half of the cumulative new AIDS case reports through June 1997.⁵³ Some of the highest rates of reported cases are found in large metropolitan areas with populations in excess of 500,000.⁵⁴ It is not surprising, then, that in 1994, there were an estimated fifty-eight viatical companies, over half of which were located in California, Florida, New York and Texas,

derstand how to price viatical settlements. See Herron, *supra* note 23, at 943-45 (discussing possible mitigating measures to these barriers of entry). However, as the industry expands, these barriers may decrease over time.

In the fall of 1997, the Florida-based viatical firm Page & Associates began offering the first free viatical settlement representative certification course in the United States. See *Ft. Lauderdale Company Offers New Income Opportunity in the Viatical Industry*, BUS. WIRE, Aug. 13, 1997, available in LEXIS, News Library, Bwire File (noting that the "course was designed to educate people wanting to become representatives in the ever growing viatical settlement industry"). No data is available yet on the enrollment of the course. See *id.*

⁴⁹ See *infra* Part III for an examination of existing regulation within the viatical settlement industry.

⁵⁰ See '96 AIDS Rates Show Dramatic Ups, Downs, ARIZ. REPUBLIC, Apr. 18, 1997, at A12.

⁵¹ See CDC 1997 MIDYEAR SURVEILLANCE REPORT, *supra* note 1, at 6-7; *supra* note 47 and accompanying text.

⁵² See CDC 1997 MIDYEAR SURVEILLANCE REPORT, *supra* note 1, at 5 (noting that the cumulative total of AIDS cases through June 1997 was 85 in North Dakota as compared to 113,549 in New York).

⁵³ See *id.*

⁵⁴ A breakdown of AIDS cases by state, through June 1997, is as follows: Alabama-4504; Alaska-385; Arizona-5258; Arkansas-2270; California-101,569; Colorado-5962; Connecticut-9174; Delaware-1922; District of Columbia-9946; Florida-62,200; Georgia-17,985; Hawaii-2028; Idaho-394; Illinois-19,319; Indiana-4779; Iowa-1028; Kansas-1919; Kentucky-2401; Louisiana-9660; Maine-783; Maryland-16,223; Massachusetts-12,523; Michigan-8770; Minnesota-3095; Mississippi-3050; Missouri-7487; Montana-249; Nebraska-843; Nevada-3300; New Hampshire-729; New Jersey-34,871; New Mexico-1522; New York-113,549; North Carolina-7742; North Dakota-85; Ohio-9109; Oklahoma-2886; Oregon-4021; Pennsylvania-18,338; Rhode Island-1668; South Carolina-6661; South Dakota-122; Tennessee-5947; Texas-42,185; Utah-1449; Vermont-316; Virginia-9699; Washington-7930; West Virginia-801; Wisconsin-2916; Wyoming-153. See *id.*

four of the five states with over half of the newly-reported cases of AIDS.⁵⁵

Obviously, there is some connection between the incidence of AIDS and the existence of viatication opportunities. For the 385 residents of Alaska with AIDS, the 249 residents of Montana with AIDS, the 316 residents of Vermont with AIDS, what options are available to them?⁵⁶ What financial incentive does a viatical settlement company have to reach out to these small pockets of potential viators? Viatical settlement companies can cross state lines through advertisements on the internet, on television and in magazines geared towards AIDS- and HIV-infected readers. But viators, a vulnerable segment of society, arguably have no way, in the absence of appropriate regulation, to know even what questions to ask about this new and strange process of viatication.

B. Information Asymmetry Problems

The second market failure apparent in the viatical industry, information asymmetry, may lead to pricing that, in the absence of full information, does not reflect the true value of viatical settlements; potential viators may be unable to understand and evaluate their choices. Those in the best position to produce and to disseminate information may decide that the cost of disclosure is too high. They may engage in strategic behavior, perhaps deliberately seeking to mislead, by lying or concealing key facts such as the effects of viatication on other benefits or the existence of any alternatives to viatical settlements, in an effort to close the deal and get their fee. As a result of this inequality of information, viators may make inappropriate choices with respect to the disposition of their policies,⁵⁷ and the viatical market itself may be unable to function properly in the absence of full information.⁵⁸

⁵⁵ See Herron, *supra* note 23, at 934-35.

⁵⁶ See CDC 1997 MIDYEAR SURVEILLANCE REPORT, *supra* note 1, at 5.

⁵⁷ Viators may sell their policies for less than the true market price, or may sell their policies to disreputable firms.

⁵⁸ In addition to the two market failures, the viatical industry poses collateral risks with respect to income-determined benefits such as welfare. Thus a viator could wind up in a worse net position after selling the policy; the government would be the unintended beneficiary of the viatication, because it would not have to pay benefits to that viator, leading to possible distributional inequities. These tertiary risks also support some non-efficiency related rationales for regulation in the viatical industry. The population involved is terminally ill, and its members may have lost their jobs, their health insurance, and perhaps even their hope. Viatication gives them funds to dispose of as they see fit, perhaps to cover expensive

III. EXISTING REGULATION OF THE VIATICAL SETTLEMENT INDUSTRY

The initial purchase of the policy by a viatical firm is subject to varying amounts of regulation at the state level, typically by a state's insurance department.⁵⁹ As a result of differences in the states' regulations, the viatication of otherwise identical policies can result in two different settlements in two different states, both in terms of dollars paid and the rights and remedies provided in each viatical settlement contract.⁶⁰ As of August 15, 1997, twenty-three states have adopted some form of regulation of the viatical settlement industry.⁶¹

experimental treatments that may prolong their lives. Arguably, society has an obligation to take care of its vulnerable and infirmed members. And, if not done for purely altruistic reasons, from a practical point of view, any money these viators gain access to is money that does not have to come from the tax-payer funded government coffers. See *supra* note 44 and accompanying text for a discussion of valid social considerations.

⁵⁹ The National Association of Insurance Commissioners has promulgated a Viatical Settlements Model Act and Model Regulation. Currently, 23 states regulate some aspect of viatical settlements, typically through statutes and regulations based, to varying degrees, on the NAIC Models. See *infra* note 61 and accompanying text for a listing of the state statutes. An industry trade group, the NVA, has prepared its own draft model act and regulation. See *infra* Part IV.

On the resale side, the viatical industry is subject to no specific regulation, as the SEC has been unsuccessful to date in convincing a court that the resale of fractionalized interests in pools of viaticated policies constitutes securities for purposes of the Securities Act of 1933. See *supra* note 8 (discussing SEC v. Life Partners, Inc., 87 F.3d 536 (D.C. Cir. 1996)).

⁶⁰ These potential disparities exacerbate the potential information asymmetries and the resulting need for consistent and full disclosure.

⁶¹ See Arkansas (1997 Ark. Acts 490); California (CAL. INS. CODE §§ 10113.1-5 (Deering Supp. 1996)); Connecticut (1997 Conn. Legis. Serv. 202 (West)); Florida (FLA. STAT. ANN. §§ 626.991-993 (West Supp. 1998)); Illinois (ILL. COMP. STAT. ANN. 158/5-99 (West Supp. 1997)); Indiana (IND. CODE ANN. §§ 27-8-19.8-1 to 19.8-26 (Michie 1994)); Louisiana (LA. REV. STAT. ANN. §§ 201-210.1 (West Supp. 1997)); Maine (ME. REV. STAT. ANN. tit. 24-A, §§ 6801-6816 (West Supp. 1997)); Michigan (MICH. STAT. ANN. § 24.569 (Law. Co-op. Supp. 1997)); Minnesota (MINN. STAT. ANN. §§ 60A.961-973 (West 1996)); Montana (MONT. CODE ANN. §§ 33-20-1301 to 1315 (Supp. 1997)); New York (N.Y. INS. LAW §§ 7801-7809 (McKinney Supp. 1997)); North Carolina (N.C. GEN. STAT. § 58-58-42 (Supp. 1996)); North Dakota (N.D. CENT. CODE §§ 26.1-33.1-01 to 33.1-07 (1995)); Oregon (OR. REV. STAT. § 744.342 (1995)); Texas (TEX. REV. CIV. STAT. ANN. art. 3.50-6A (West Supp. 1998)); Utah (UTAH CODE ANN. § 31A-21-104 (Supp. 1997)); Vermont (VT. STAT. ANN. tit. 8, §§ 3826-3834 (Supp. 1997)); Virginia (VA. CODE ANN. §§ 38.2-5700 to 5707 (Michie Supp. 1997)); Washington (WASH. REV. CODE ANN. §§ 48.102.005-.901 (West 1997)); Wisconsin (WIS. STAT. ANN. § 632.68 (West Supp. 1997)).

In addition, as of March 1998, eight states are considering some form of regulation for the viatical industry. See Arizona (S.B. 1137, 43d Leg., 2d Reg. Sess. (Ariz. 1998)); Delaware (S.B. 39, 139th Gen. A. (Del. 1997)); Kentucky (H.B. 414, Reg. Sess. (Ky. 1998)); Massachusetts (H.B. 5346, 182d Gen. Ct., Reg. Sess. (Mass. 1997)); Missouri (H.B. 1383, 89th Gen. A., 2d Reg. Sess. (Mo. 1998)); New Hampshire (H.B. 263, Reg. Sess. (N.H. 1997)); Oklahoma (S.B. 791, 46th Leg., 2d Sess. (Okla. 1997)); (H.B. 2373, 46th Leg., 2d Sess., (Okla. 1997)); Pennsylvania (H.B. 526, Gen. A., H.B. Sess. (Pa. 1997)); South Carolina (H.B. 3542, Gen. A., 112th Sess. (S.C. 1997)).

Most of the state regulations are based on a model promulgated by the National Association of Insurance Commissioners (NAIC).⁶² In December 1993, the NAIC adopted the "Viatical Settlement Model Act"⁶³ and in September 1994, the NAIC adopted the "Viatical Settlement Model Regulation"⁶⁴ (collectively, the NAIC Models), designed to protect viators when dealing with viatical settlement companies.⁶⁵ The three primary areas of regulation in the NAIC Models are enforcement provisions,⁶⁶ mandatory disclosure to viators,⁶⁷ and mandated minimum payouts.⁶⁸ Although many industry participants have resisted portions of the NAIC Models, specifically the mandated minimum payouts,⁶⁹ the viatical industry

⁶² The NAIC is a voluntary association made up of the chief insurance regulatory commissioners and staff from all 50 states, the District of Columbia, American Samoa, Guam, Puerto Rico, and the U.S. Virgin Islands. *See 1980 Regular Meeting*, 1980 PROC. NAT'L ASS'N INS. COMMISSIONERS 960, 960.

⁶³ In May, 1993, the working group changed the title of the Model Act from "Living Benefits Model Act" to "Viatical Settlements Model Act" to reflect the universally accepted term for the industry. *June 1993 National Meeting*, 1993 PROC. NAT'L ASS'N INS. COMMISSIONERS 714, 728 [hereinafter 1993-2 NAIC PROC.]; *see also Fall 1994 National Meeting*, 1994 PROC. NAT'L ASS'N INS. COMMISSIONERS 515, 515 [hereinafter 1994-3 NAIC PROC.] (reporting on "plans to introduce the Viatical Settlements Model Act in the legislature during the next session"); *1993 National Meeting*, 1993 PROC. NAT'L ASS'N INS. COMMISSIONERS 642, 642 (noting that the Plenary Sessions had adopted the Viatical Settlement Model Act).

⁶⁴ 1994-3 NAIC PROC., *supra* note 63, at 515. Commissioner Pomeroy "reported that the full NAIC membership had adopted the Viatical Settlement Model Regulation on Sept. 18." *Id.*

⁶⁵ According to David J. Walsh, president of the NAIC:

[t]he issue surrounding viatical settlements couldn't be clearer. This is, plain and simple, a matter of consumer protection. We needed to act to make sure consumers get adequate and truthful information as well as some basic protections when dealing with viatical companies. Our mission has been made all the more urgent given that this affects the terminally ill and their loved ones. We are confident that this model regulation and the model act we adopted last year will serve those who are often in great need of our assistance.

Insurance News Network, *State Regulators Approve Further Controls on Viaticals* (visited Feb. 7, 1998) <<http://www.insure.com/life/viatical/vnaicpr.html>>.

⁶⁶ Enforcement provisions enable state insurance commissioners to police the viatical settlement companies to make sure they fully comply with applicable regulations. *See infra* notes 83-87, 112-25 and accompanying text.

⁶⁷ Mandatory disclosure provisions require dissemination of information to potential viators regarding their rights in the viatication process, before any viatical contract is executed. *See infra* notes 88-98, 126-38 and accompanying text.

⁶⁸ Minimum payout provisions are an attempt to make sure that viatical settlement companies uniformly provide "reasonable" payments for policies. *See infra* notes 99-109, 139-63 and accompanying text.

⁶⁹ *See* 1994-1 NAIC PROC., *supra* note 46, at 360 (discussing the link between minimum payouts and price fixing).

and regulators were in basic agreement with respect to the issues of disclosure and enforcement.⁷⁰

The debate over whether and how to regulate the viatical industry can be best understood by an analysis of the existing regulations, put into their context. This is achieved through an examination of how the NAIC devised its Models, including an understanding of the comments made by both NAIC members and viatical industry participants during the process. Many of the issues raised during the drafting of the NAIC Models and not reflected therein remain at the heart of the current debate.

When putting the NAIC Models in their context, one should note that the mandate of the NAIC working group set up to consider the issue was to determine *how*, and not *whether*, to regulate the viatical industry.⁷¹ And because all NAIC members are insurance commissioners, opponents of regulating the viatical industry argue that the NAIC has a bias towards limiting the availability of viatical settlements.⁷² Arguably, the availability of viatical settlements decreases the market for accelerated death benefits available under traditional insurance policies. Further, once the policy has been viaticated, the viatical settlement companies pay the premiums, re-

⁷⁰ See *id.* at 362.

⁷¹ "[T]he working group was not focusing on the philosophical issues of whether viatical companies should be regulated or allowed to operate, but rather on the specifics of the model that it had been charged to develop." 1993-2 NAIC PROC., *supra* note 63, at 723.

⁷² Some view the NAIC as the "lobbying arm of the insurance industry." *Fairer, Sensible, Broadly Beneficial Regulation of Living Benefits Industry Drafted by the National Viatical Association*, BUS. WIRE, Oct. 31, 1996, available in LEXIS, News Library, Bwire File [hereinafter *Beneficial Regulation*].

According to Mark Leeds, a consultant to the NVA, the NAIC:

is funded by the insurance industry and is loyal to the latter's priorities. The NAIC, by all rights, should not be expected to reflect the interests of taxpayers or consumers, nor places those interests on the same plane as the interests of the insurance industry. . . . The insurance industry's ADB 'innovation' was evolved *after the initial success of the viatical industry occurred [sic] and loomed as a continuing threat to the higher margins enjoyed by insurers due to cancellation.*

Mark B. Leeds, *National Viatical Association (NVA) Statement for NCOIL Seminar "Regulation of Living Benefits—A Marketplace Viewpoint," NAT'L VIATICAL ASS'N: COMM. & LEGIS. COMMITTEE*, Mar. 1996, at 7; see also Marilyn Askin, *Viatical Settlements: Creative Tool for Planning*, N.J. LAW., Mar./Apr. 1997, at 49.

The NAIC denies that its Viatical Settlement Model Act and Regulation were prepared "by the insurance industry to benefit the insurance industry." *Summer 1994 National Meeting*, 1994 PROC. NAT'L ASS'N INS. COMMISSIONERS 549, 550 [hereinafter 1994-2 NAIC PROC.]. Instead, the drafts had been prepared by the NAIC "with consumers in mind." *Id.*

sulting in fewer lapsed policies and more claims for the insurance companies to pay out.⁷³

*The NAIC Models*⁷⁴

By 1992, the NAIC had begun considering regulation of the viatical industry.⁷⁵ The resulting draft was based on the California Insurance Code's viatical settlement provisions, without any input from the viatical industry.⁷⁶ Industry participants wanted a voice in the process, in the form of an advisory committee to assist the NAIC working group.⁷⁷ Nonetheless, the Viatical Settlement Working Group was established in 1993, with no advisory committee in place,⁷⁸ to "solicit information in an informal manner from knowledgeable resources and in a formal manner by way of public hearings before making any final decisions."⁷⁹

⁷³ One insurance company's response to the increase in viatical settlements has been to raise the bar on its group term life accelerated benefit provision from a maximum benefit of 50% up to 75%. See Linda Koco, *Group Term Plan Ups Bar on Accelerated Benefit*, NAT'L UNDERWRITER, July 14, 1997, at 7. To "increase employee consciousness about the feature" the company, Standard Insurance Company of Portland, Oregon, instituted an education campaign to alert its employees of the availability of the ADB option, so the employees would not automatically seek viatication. *Id.*

⁷⁴ For a more detailed discussion of the provisions of the NAIC Models, see Osborn, *supra* note 8.

⁷⁵ The Insurable Interest Working Group of the NAIC's Life Insurance (A) Committee prepared a discussion draft of the "Living Benefits Model Act," the term initially used by the NAIC to refer to viatical settlements. See 1993-1 NAIC PROC., *supra* note 42, at 782. The draft was dated July 21, 1992 and corrected September 29, 1992. See *id.*

⁷⁶ See 1993-2 NAIC PROC., *supra* note 63, at 730.

⁷⁷ See 1993-1 NAIC PROC., *supra* note 42, at 780-83 (providing excerpts from statements from various parties indicating their desire to participate in the process).

⁷⁸ See March 1993 Southeastern Zone Meeting, 1993 PROC. NAT'L ASS'N INS. COMMISSIONERS 249, 249 [hereinafter MARCH 1993-1 NAIC PROC.]. According to the Commissioner Yancey, as noted in 1992 before the formation of the Viatical Settlement Working Group, there was no intent to preclude anyone from participating in the process. See 1993-1 NAIC PROC., *supra* note 42, at 781-82. The NAIC wanted to make the option to viaticate policies as accessible as possible, and Commissioner Yancy encouraged people to participate in an advisory capacity. See *id.*

⁷⁹ MARCH 1993-1 NAIC PROC., *supra* note 78, at 249. Toward this end, the working group solicited comments and questions from industry participants whose enthusiasm for regulation in the viatical industry ranged from complete to virtually non-existent. See 1993-1 NAIC PROC., *supra* note 42, at 781-82. The comments ranged from complaints about the lack of representation of the terminally ill on the working group, to proposals for the establishment of an advisory committee "comprised of a broad spectrum of interested parties [to] be formed to develop a proposal that would have consensual support among all interested parties," to more substantive comments, raising concerns that some the regulation would be overreaching, such as overly-burdensome registration processes, and that mandating minimum payouts would not be an effective way to assure the highest payout. *Id.*

The NAIC Models cover three primary areas: enforcement provisions such as mandatory licensing for viatical settlement providers and brokers, giving state insurance commissioners the power to suspend, revoke, or refuse renewal of licenses;⁸⁰ pre-signing disclosure to viators;⁸¹ and minimum payouts designed to ensure reasonable payments to viators.⁸²

1. Enforcement Provisions

Viatical settlement providers, and anyone else entering into or soliciting viatical settlement contracts, must be licensed by the Commissioner of the state in question.⁸³ As part of the licensing process, the applicant must furnish the Commissioner with a "detailed plan of operation."⁸⁴

The Commissioner may "suspend, revoke or refuse to renew" a license if the licensee makes a misrepresentation on its original application, is guilty of fraudulent or dishonest practice, "demonstrates a pattern of unreasonable payments to policyowners," has been convicted of a felony or misdemeanor of which criminal fraud is an element, or has violated any provisions of the Act.⁸⁵

The form of the viatical settlement contract must be submitted to the Commissioner for approval, which shall be denied if the Commissioner thinks the form is "unreasonable, contrary to the interests of the public, or otherwise misleading or unfair to the policyowner."⁸⁶

In addition to the other remedies contained in the NAIC Models, violations thereunder also trigger the relevant state's Unfair Trade Practices Act.⁸⁷

⁸⁰ See VIATICAL SETTLEMENTS MODEL ACT §§ 3(A), 3(F), 4(A), 5 (National Ass'n of Ins. Comm'rs 1993).

⁸¹ See *id.* §§ 6, 7(B), 8(C), 8(D), 8(E), 9(B).

⁸² See *id.* §§ 4(A)(3), 10(B).

⁸³ See *id.* § 3(A) (listing the requirements for licensing).

⁸⁴ *Id.* § 3(F)(1). This requirement was added so that the Commissioner would be aware of the type of operations being conducted, and presumably to enable the Commissioner to keep unqualified or unscrupulous firms out of his or her state. See 1993-2 NAIC PROC., *supra* note 63, at 724.

⁸⁵ VIATICAL SETTLEMENTS MODEL ACT § 4(A).

⁸⁶ *Id.* § 5. "The working group members thought that it [insurance department review of contract forms] served as a valuable consumer protection, and it was also useful to have this information available to the public." 1993-2 NAIC PROC., *supra* note 63, at 729.

⁸⁷ See VIATICAL SETTLEMENTS MODEL ACT § 11. This section may not be of any real use as written, because typically, Unfair Trade Practices Acts require a pattern of business practices. The intent of the working group was to be able to take action based on one unfair act.

2. Disclosure Provisions

Under the NAIC Models, viatical settlement providers must disclose to the viator, prior to the execution of the viatical settlement contract, the following information: possible alternatives to viatication (including accelerated death benefits under traditional life insurance policies);⁸⁸ the possibility that receipt of the proceeds may trigger adverse tax consequences, along with a recommendation that viators seek tax advice;⁸⁹ that settlement proceeds may be subject to the claims of creditors;⁹⁰ that receipt of the proceeds may affect the viator's eligibility for Medicaid or other government benefits, along with a recommendation that viators seek advice from the appropriate agencies;⁹¹ that the viator has an absolute right to rescind the viatical settlement contract within the lesser of thirty days from the signing or fifteen days from receipt of payment;⁹² and the date by which the funds will be available to the viator⁹³ as well as the source of those funds.⁹⁴

Licensed viatical settlement providers must also make disclosure to the licensing state and they must file annual statements with

See 1994-1 NAIC PROC., *supra* note 46, at 363. The working group agreed to "review further whether an amendment to the Viatical Settlement Model Act would be necessary." *Id.*

⁸⁸ Query who benefits most from this NAIC-mandated disclosure.

⁸⁹ This disclosure has become less critical in light of the Health Insurance Portability and Accountability Act of 1996 [hereinafter HIPPA], but because HIPPA covers only viatical settlements with viators who have life expectancies of less than two years, viatical settlements to viators with longer life expectancies may be taxable. See Kevin D. Millard, *Changes Affecting Life Insurance Enacted by New Laws*, 24 EST. PLAN. 3, 3-4 (1997); see also *supra* note 8 and accompanying text; *infra* note 169 and accompanying text. There also may be additional taxes at the state and local levels.

In crafting the tax implications disclosure, the working group used an approach similar to that used in the NAIC Accelerated Benefits Model Regulation, urging the viator to seek professional advice. See 1993-2 NAIC PROC., *supra* note 63, at 729 (noting that the disclosure was used because a viatical settlement provider "was not necessarily qualified to give advice in these areas"). "The working group considered whether the viator ought to be required to sign a waiver to indicate he had received the disclosures. It was agreed that this would be in a regulation, rather than a statute, so consideration was tabled." *Id.*; see *infra* note 135 and accompanying text.

⁹⁰ See VIATICAL SETTLEMENTS MODEL ACT § 8(C).

⁹¹ See *id.* § 8(D).

⁹² See *id.* § 8(E). This provision mitigates late disclosure, but shifts the burden to the viator, setting up a "bargaining game" that may work against the viator. See *id.*; see also Heron, *supra* note 23, at 943 (arguing that the section 8 provisions which allow for late disclosure provide "a serious flaw in the NAIC's Model Act").

⁹³ See VIATICAL SETTLEMENTS MODEL ACT § 8(F). This provision forecloses the option of a viatical settlement firm trying to lower its costs by delaying payment of the proceeds.

⁹⁴ *Id.*

that state's Insurance Commissioner,⁹⁵ detailing for each policy viaticated: the date the viatical settlement contract was executed; the life expectancy of the viator; the face value of the policy; the amount paid to viaticate the policy; and if the viator has died, the date of death and the total insurance premiums paid by viatical settlement provider to maintain the policy. Further, the licensees must provide a breakdown of applications received, accepted and rejected, by disease category; a breakdown of policies viaticated by issuer and policy type; the number of secondary versus primary market transactions; its portfolio size; and the amount of any outside borrowing.⁹⁶

To address concerns stemming from the sensitive and confidential nature of much of the information provided by viators to viatical settlement companies, which would then be required to disclose such information to the state, the NAIC Models require that "[a]ll medical information solicited or obtained by any licensee" is subject to applicable state laws on confidentiality of medical information.⁹⁷ Names and individual identification data for viators is considered private and confidential, and will only be disclosed by the Commissioner if required by law.⁹⁸

3. Reasonable Payments

The NAIC Models authorize the chief insurance regulatory official (Commissioner) of each state to suspend, revoke or refuse to renew a license if the licensee "demonstrates a pattern of unreasonable payments to policyowners."⁹⁹ Further, the Commissioner is authorized to "[e]stablish standards for evaluating reasonableness of payments" with respect to viatical settlement contracts, including regulating the discount rates used to determine the amount paid for the viatication of a policy.¹⁰⁰ The Model Regulation does just that,

⁹⁵ See *id.* § 6.

⁹⁶ The working group members acknowledged that the viatical settlement industry was a relatively new industry, and that there was not a lot of statistical information available. See 1994-2 NAIC PROC., *supra* note 72, at 571. The working group members thought the information required in this section would serve as a database of information on the viatical industry. See *id.*

⁹⁷ VIATICAL SETTLEMENTS MODEL ACT § 9B.

⁹⁸ See *id.* § 7(B).

⁹⁹ *Id.* § 4(A)(3).

¹⁰⁰ *Id.* § 10(B).

setting out the minimum percent of the face value of a policy that must be paid to a viator to constitute a "reasonable payment."¹⁰¹

The concept of the reasonableness of the payments provision received the most comments of any provision in the discussion draft.¹⁰² Since the NAIC first considered regulating viatical settlements, industry representatives have sought to have the minimum payout provision eliminated.¹⁰³ These critics argue generally that minimum payouts are unnecessary and even harmful to viators and to the viability of the viatical industry, and argue specifically that the proposed percentages are too high.¹⁰⁴ This is especially true, critics claim, in the case of AIDS patients, with the possibility of life-prolonging treatments being introduced *after* viatical settlements that were calculated based upon life expectancies without the new treatments, lowering the return to investors.

In connection with the actual percentages to be included in the Model Regulation, industry participants told the working group that there were "industry standards" already in place, thus obviat-

¹⁰¹ For viators with life expectancies of less than 6 months, the minimum percent of the face value is 80%; for viators with life expectancies of at least 6 months but less than 12 months, it is 70%; for viators with life expectancies of at least 12 months but less than 18 months, it is 65%; for viators with life expectancies of at least 18 months but less than 24 months, it is 60%; and for viators with life expectancies of 24 months or more, it is 50%. See VIACIAL SETTLEMENTS MODEL REGULATION § 4 (National Ass'n of Ins. Comm'rs 1994).

These percentages can be reduced by 5% for viatication of policies written by insurers rated in less than the top four categories by A.M. Best, or a comparable rating by some other rating agency. See *id.*

¹⁰² See 1994-2 NAIC PROC., *supra* note 72, at 575; see also Herron, *supra* note 23, at 946-48 (discussing the impact of a minimum price regulation on viatical company profits).

¹⁰³ See Herron, *supra* note 23, at 945-48 (noting that the Viatical Association of America now embraces all of the provisions in the Model Act except the one concerning minimum payouts).

¹⁰⁴ For example, according to Peggy Wallace of Affirmative Lifestyles, a viatical settlement company, discount limits were not helpful because the viator "was protected by the free market and increased competition." 1993-2 NAIC PROC., *supra* note 63, at 724. The working group minutes continue by noting that "[s]he suggested, as an alternative, disclosure of recent offers" to help insure fair payment. *Id.* Ms. Wallace's comments ignore the local monopoly and information asymmetry problems present in the viatical settlement industry. See *supra* Part II.

According to William Freeman of the National Association of People with AIDS [hereinafter NAPWA], the "natural dynamics of the marketplace force companies to strive for the efficiency that will allow them to offer the largest settlement." 1993-1 NAIC PROC., *supra* note 42, at 787. "As the national association of those with HIV disease, NAPWA maintains a national resource listing of the viatical companies, and we encourage the terminally ill to compare company payouts in order to secure the best settlement for the individual." *Id.*

With respect to the discount on the minimum payments idea, a representative of the NVA claimed that setting discount rates was price fixing, and that he would not participate in such an effort. See 1994-1 NAIC PROC., *supra* note 46, at 360 (comments of Parker Willson).

ing the need for mandatory minimums.¹⁰⁵ The working group requested written copies of such standards several times, but none was ever provided.¹⁰⁶ In the absence of any documentable industry standard, the working group had to set standards that were, admittedly, somewhat arbitrary.¹⁰⁷

The working group considered alternate approaches. In a later version of the Model Regulation, presumably in response to comments from industry participants, the working group lowered the minimum percentages; the working group also considered removing the provision altogether, and instead requiring just the collection of data for the present time, deferring a determination of any required discounts.¹⁰⁸ After considerable discussion, the working group decided to leave the minimum payout provision in the Model Regulation, raising the amounts back to the original version.¹⁰⁹

IV. EVALUATION OF THE EXISTING REGULATORY SCHEME IN THE VIATICAL INDUSTRY

Despite vehement objection by some industry participants and industry trade associations over regulation in the viatical indus-

¹⁰⁵ See 1994-1 NAIC PROC., *supra* note 46, at 360 (comments of Bob Wright).

¹⁰⁶ See *id.* (noting that the request for "industry standards" were made over a year ago).

¹⁰⁷ See *id.* In an attempt to estimate industry standards, the working group relied on an article in the *National Underwriter* that said viators "with a life expectancy of six months generally got about 80% of the face value of their policy and viators with a four-year life expectancy generally received around 40%" of the face value. *Id.*

Several years after the working group drafted the NAIC Models, they continue to evaluate the minimum payout levels contained therein. According to one member, the original working group had very little information on which to base the payout requirements, and so they relied on representations from the industry. See 1996 Spring National Meeting, 1996 PROC. NAT'L ASS'N INS. COMMISSIONERS 591, 618 [hereinafter 1996-1 NAIC PROC.] (adding that "no actuarial study had been done at that time"); see also *infra* note 109 (explaining that the working group ultimately relied on numbers provided by the industry as average payments).

¹⁰⁸ See 1994-2 NAIC PROC., *supra* note 72, at 574 and 1994-1 NAIC PROC., *supra* note 46, at 360 for a discussion of an alternate approach suggested by Florida's Insurance Commissioner Carol Ostapchuk, to include a reporting requirement instead of minimum discount, and after gathering information, to later add a provision with percentage amounts.

¹⁰⁹ See 1994-2 NAIC PROC., *supra* note 72, at 575. With respect to the percentages in section 4, because the working group was uncertain at what levels to set the percentages, it reverted to the earlier numbers which had been provided by the industry as average payments. See *id.* The working group did not intend to limit the availability of viatical settlements. See *id.* at 572. Because data was not available to make clear what the minimum percentages should be, "the working group lowered the minimums so as not to artificially interfere with the market. The working group had taken upon itself the burden of providing a method to collect data so that at some later point it would have correct information and could raise the percentages if appropriate." *Id.*

try,¹¹⁰ twenty-three states have adopted some regulation of the purchase side of the viatical industry.¹¹¹ In large part, these regulations are based on the NAIC Models, sharing its primary emphasis on enforcement, disclosure, and minimum payouts. While arguments can be made in support of both sides of these issues, on balance, these NAIC Model-based regulations are supportable as valid and appropriate responses to the market failures and distributional inequities present in the viatical industry.

A. Enforcement Provisions as a Mechanism To Correct Information Asymmetries

Enforcement provisions such as licensing and reporting requirements give the individual states statutory authority to protect viators within their borders from unscrupulous or incompetent viatical settlement providers and brokers. These provisions benefit viators by providing an objective mechanism for vetting viatical settlement providers and brokers, both local and out of state. This process should ease both the local monopoly problem and information asymmetries, and generate an information database with which to better regulate this evolving industry.

Critics of the enforcement provisions, including the licensing and reporting obligations, argue that these provisions will exacerbate the local monopoly problems and create privacy concerns for via-

¹¹⁰ For example, the NVA opposes, for the most part, the NAIC Models, and any regulation that will:

cripple the viatical option; that needlessly overcomplicate the transaction itself; that limit arbitrarily the number of available brokers or funding sources; that raise the cost of business such that the net to the selling insured party is reduced as a result of the regulations; that hamper competition or which lead to lower and fewer bids for the policies; that are limited to insureds with 12 or fewer months of expected remaining life (as is presently the ADB practice), or which slow up the process at a time when the insured's days are literally numbered and near at hand; that tend to discourage viatical firms from entering or remaining in certain marketplaces; that tend or try to fix prices paid for policies as an alternative to marketplace bid competition; that give a state agency the power to undo a transaction that neither party seeks to dislodge and where there is an absence of even the suggestion of fraud; that give a state undue powers to review advertising and other communications, or the names of businesses, or to review extensively past and present business practices and associations, worker, executive and owner histories are obviously inadvisable, work against the interests of society, and smack of other than democratic government.

Leeds, *supra* note 72, at 6-7.

¹¹¹ See *supra* note 61 and accompanying text.

tors.¹¹² Unduly burdensome registration and reporting processes will create barriers to entry, raising the cost of business.¹¹³ This may discourage viatical settlement companies from entering or staying in certain markets.¹¹⁴

But the driving force behind the growth in the viatical industry is the number of potential viators.¹¹⁵ For the present, with the overwhelming majority of viatications initiated by AIDS- or HIV-infected policyholders, the industry should grow fastest in areas with many potential viators. Since the number of reported cases of AIDS in some states far exceeds the number in others,¹¹⁶ it would not be surprising, or even significant, if the initial response by viatical settlement companies to similar registration requirements was different.

While the criticisms, as posed, may arguably have some theoretical validity, the licensing and reporting provisions as drafted in the NAIC Models are necessary to correct information asymmetries; and the proposed registration and reporting requirements are not unduly burdensome, especially in light of the strong public interest at stake. States must protect viators from unscrupulous or inexperienced firms.

One objection to the registration and licensing process centers on the difference between viatical settlement companies and traditional insurance firms in general.¹¹⁷ An insurance company has a long-term obligation to stand ready to indemnify.¹¹⁸ Thus, the long-term financial health of an insurance company is important. A viatical settlement company, however, essentially engages in a spot transaction, a one-time exchange of funds with no future obligation

¹¹² See 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, 604-06 (1994) (arguing that minimum price provisions impair a viator's right to sell his or her policy, and interfere with his or her right to freely alienate his property).

¹¹³ See *id.* at 600.

¹¹⁴ But see *supra* note 48 (noting the expansion of the viatical industry that may result in decreased barriers to entry).

¹¹⁵ See Crites-Leoni & Chen, *supra* note 16, at 66-67 (discussing the impact of the AIDS epidemic on the viatical settlement industry).

¹¹⁶ See *supra* note 54 (giving the breakdown, by state, of reported AIDS cases through June 1997).

¹¹⁷ See Crites-Leoni & Chen, *supra* note 16, at 76.

¹¹⁸ See Berner, *supra* note 112, at 582 n.6 (examining the life insurance indemnification process).

to the viator.¹¹⁹ Thus, arguably, regulators should have no further interest in viatical settlement companies.

However, giving the Commissioners power to license viatical settlement companies initially, and, on an ongoing basis through license revocation power, will enable the state to monitor the players in the field, and the disclosure obligations will help to level the playing field. In fact, correcting the information imbalances may encourage viators to go outside of their geographic market, easing the local monopoly problem in the relevant markets. These rules are simply a non-intrusive way to prevent abuses by requiring viatical settlement companies to have some degree of accountability for their actions.

The privacy concerns raised by viatical settlements have been handled in the NAIC Model to the extent possible.¹²⁰ The regulations require viatical licensees to report certain confidential information to the Commissioner, as a condition for license renewal.¹²¹ The Model Act requires that information about viators be kept confidential, and not be disclosed unless required by law.¹²²

Further, there is an inherent confidentiality problem in the viatication of policies: the policies are owned by someone with no insurable interest in the life of the insured.¹²³ Critics fear that viatical settlement companies will hound the viators, seeking medical information in order to monitor their investments.¹²⁴ Again, the NAIC Models address this concern, by limiting the amount and nature of contact between the viatical settlement company and the viators, depending on the life expectancy of the viator.¹²⁵

¹¹⁹ See *id.* at 584-85 (discussing the operational function of a viatical firm in the market).

¹²⁰ See VIATICAL SETTLEMENTS MODEL ACT §§ 7(B), 9(B) (National Ass'n of Ins. Comm'rs 1993).

¹²¹ See VIATICAL SETTLEMENTS MODEL REGULATION § 5 (National Ass'n of Ins. Comm'rs 1994).

¹²² See VIATICAL SETTLEMENTS MODEL ACT § 7(B).

¹²³ See Osborn, *supra* note 8, at 485-89 (discussing the problems associated with the assignment of a life insurance policy).

¹²⁴ See, e.g., Berner, *supra* note 112, at 586 n.29 (providing information on the practices among some viatical firms).

¹²⁵ See VIATICAL SETTLEMENTS MODEL REGULATION § 6(F).

B. Mandatory Disclosures as a Mechanism To Correct Information Asymmetries

Mandated pre-signing disclosures to potential viators will benefit the viators by helping to correct some of the information asymmetries in the viatical industry. Especially in light of the local monopoly problems discussed above, the disclosures will in turn strengthen the industry itself. The purpose of mandating disclosures is to provide potential viators with the information that they need to make an informed decision about the disposition of their policies.¹²⁶ No one could reasonably argue that viators should be kept uninformed about the viatication process. Rather, the debate on disclosure, unlike the debate on mandated minimum payouts, centers more on the degree, and not the overall need, for disclosure, and on the related question of who should provide these disclosures.¹²⁷

Two kinds of disclosure are regulated in the NAIC Models: those made generally, through advertising by the viatical settlement companies, and those made specifically to potential viators by individual firms.¹²⁸ Critics of the NAIC Models and their progeny claim that the additional financial costs associated with such disclosures are not recoverable in terms of compensating benefits to the viators.¹²⁹ The claim is that any such regulation will increase the cost of, and decrease participation in, the viatical industry,¹³⁰ worsening the local monopoly problem and diminishing the net payment to viators.¹³¹ A further question is the appropriateness of requiring viatical firms to serve essentially as the insurer of the viators' understanding of all of the possible ramifications from viatication,

¹²⁶ Of course no regulation can actually force people to absorb the information and to act rationally based on the information provided.

¹²⁷ Because of the newness of the viatical industry, no judicial opinions have dealt yet with the problems of disclosures to people who, because of their medical condition, are (1) not able to understand the disclosures, or (2) do not have much choice in the viatication process. Both of these concerns raise issues addressed by the common defenses to contract formation of mental infirmity and economic duress. As the viatical industry evolves, these issues will need to be addressed, perhaps similarly to the way they are addressed under traditional contract law principles.

¹²⁸ See VIATICAL SETTLEMENTS MODEL ACT § 8 (National Ass'n of Ins. Comm'rs 1993).

¹²⁹ See Crites-Leoni & Chen, *supra* note 16, at 86.

¹³⁰ See *id.* at 87 (noting that state regulations will increase the cost of doing business thereby decreasing the amount viatical companies pay for policies).

¹³¹ See *id.* at 86-87 (discussing generally the negative effect regulations have on the viatical industry).

when, arguably, it would be more cost-efficient to leave this task up to AIDS groups, as "guardians" for the terminally ill.

But these disclosures are necessary to correct information asymmetries in the viatical industry that can lead to inefficient pricing of viatical settlements, exacerbated in some areas by the local monopoly problem. In the absence of timely disclosures, viators may not have a real idea of what they are giving up. In order to make informed decisions, viators need the protection of full disclosure of the ramifications of sale, prior to entering into the viatical settlement contract. These disclosures should include alternatives to viatication as well as the tax consequences of viatication and the possible impact of viatication on need-based assistance programs like Medicaid. Mandating disclosure of viators' absolute right to rescind the contract for some stated period of time removes this critically-important right as a topic for negotiation.¹³² Likewise, requiring viatical settlement companies to disclose the date the proceeds will be paid removes the possibility that a firm will seek to lower its costs by holding up settlement.

The standards for advertising, requiring that it be "truthful and not misleading by fact or implication" are hard to dispute on their face, as is the further requirement that if the advertiser emphasizes the speed with which the viatication will occur, it must also disclose the average time frame on a viatication, from completed application to ultimate payout of proceeds.¹³³ Similarly difficult to dispute is the requirement that, if the viatical settlement company's advertisement emphasizes dollar amounts, the firm must disclose the average settlement percentage paid to viators in the preceding six months.¹³⁴ No viatical settlement company has gone on record to dispute either the goals or results of these regulations. The criticism is aimed at the claim that there is a need for such regulation, and the fear that insurance commissioners may be arbitrary and unreasonable in their evaluation of the viatical industry's advertising efforts.

But if, as the critics claim, these standards are so basic and are already in place in the industry, industry participants should not be

¹³² See Herron, *supra* note 23, at 942-43 (commenting on right to rescind provisions under the Model Act as well as under the New York, California, and Vermont statutes).

¹³³ VIACIAL SETTLEMENTS MODEL REGULATION § 6(H)(1)-(2) (National Ass'n of Ins. Comm'rs 1994).

¹³⁴ See *id.* § 6(H)(3).

concerned with the simple codification of accepted industry practices. As for the cost of compliance with specific disclosures to potential viators, the viatical settlement company simply needs to advise the viator that there are still tax considerations for viators with life expectancies greater than twenty-four months, and that viatication may affect other government benefits. This could be done by having a pre-printed sheet for the viator to sign before the viatical settlement contract is executed.¹³⁵ The cost of this could be passed on to the viator, arguably the ultimate beneficiary of the information.¹³⁶

Such disclosures should also include information designed to make the process of viatication more understandable. Unlike the sale of other assets, such as real property, that sellers may undertake several times in their lives, possibly becoming more sophisticated about the process each time, viators typically go through this process only once, possibly with more than one policy, at arguably the most vulnerable time of their lives.

In the absence of mandatory advertising standards and disclosure obligations, some viatical settlement companies might nonetheless functionally comply with them, providing truthful advertising generally, and providing some disclosure to potential viators, either as a requirement of their membership in an industry association,¹³⁷ or as a marketing tool, in an effort to differentiate their firm from the

¹³⁵ The NAIC working group has drafted a version of the tax disclosure that involves a flow chart showing the steps a viator takes in the viatication process, plus a textual explanation that

[e]ffective January 1, 1997, life insurance payments received as the result of a viatical settlement are not included in taxable income if certain requirements are met. Generally, tax-free treatment is available for proceeds received on the life of an individual who is either "terminally ill" or "chronically ill." This disclosure does not constitute tax advice. You should consult your tax advisor for a determination of the tax ramifications of your own situation.

Conference Call with Viatical Settlements Working Group (Jan. 30, 1997) (on file with author). The draft goes on to define terms like "chronically ill" and "qualified viatical settlement provider" and goes through a check list for terminally and chronically ill potential viators. *See id.*

¹³⁶ Although the cost of the pre-printed sheet proposed may be minimal, for the viator to be truly informed, he or she must then expend costs and resources to determine how the tax and government benefits considerations apply to him or her. Arguably, this shifts the costs to the viators who may be ill-equipped to incur search costs to find appropriate advisors.

¹³⁷ The NVA claims to support disclosure generally. *See* NATIONAL VIATICAL ASSOCIATION, INFORMATION BOOKLET 15-16 (1997). It requires its members to encourage viators to get advice from a financial planner, insurance professional, attorney and/or tax accountant before viaticating any policy, and to inform viators of the possibility of a reduction in government benefits. *See id.*

unwashed masses of viatical settlement companies.¹³⁸ Compliance also might lead to support by, and recommendations from, vocal national AIDS advocacy groups. In theory, the viatical settlement companies could even make these disclosures out of concern for the infirm and vulnerable population of viators, but evidence of such a concern has not yet been documented.

C. Mandated Minimum Payments as a Mechanism To Ease Local Monopoly Problems and Correct Information Asymmetries

Mandating minimum payouts will ultimately benefit viators, as long as the set minimums are above the local monopoly price. The minimum payouts protect viators from local monopoly problems stemming from the uneven distribution of AIDS- and HIV-infected policyholders nationwide. Minimum payouts will also protect viators from changes in pricing that can result from changes in the demand for viatication due to innovations in treatments for AIDS and the resulting uncertainty regarding the effect of such treatments on projected life expectancies.¹³⁹

The rationale underlying industry participants' opposition to the regulation of payouts to viators for their policies is also based on the notion that some segments of the viatical industry exhibit the characteristics of a local monopoly.¹⁴⁰ Critics claim that the man-

¹³⁸ See Herron, *supra* note 23, at 938 (noting the incentive for competing companies to distinguish themselves by providing adequate information).

¹³⁹ One significant area of potential growth for the viatical industry is in the viatication of policies with insureds suffering from terminal illnesses other than AIDS. See *infra* note 175 and accompanying text (discussing the possibility of expanding the pool of potential viators to include policyholders suffering from other terminal illnesses such as cancer and heart disease).

There are four scenarios possible in the viatical industry. First is the scenario of few viatical firms and few potential viators, leading to a strong need for full information to prevent opportunistic behavior via a local monopoly. Second is the scenario of many viatical firms and few potential viators, leading to competition and obviating the need for regulation. Third is the scenario of few viatical firms and many potential viators, leading to an oligopoly. The fourth scenario is many viatical firms and many potential viators, again leading to competition and obviating the need for regulation.

The viatical market as currently configured, with AIDS patients currently making up the overwhelming majority of viators, shows areas of local monopoly and oligopoly, with information asymmetries. See generally Berner, *supra* note 112, at 601-02 (noting the protection viatical companies receive from collusive price fixing). The analysis in this section centers only on the AIDS population. However, it is equally applicable to the victims of other terminal illnesses that generate similar local monopoly and information asymmetry concerns.

¹⁴⁰ See *supra* notes 49-56 and accompanying text (examining the local monopoly problems in light of the uneven distribution of AIDS and HIV cases among the states).

dated minimum discounts would amount to price fixing and would exacerbate these local monopoly problems.¹⁴¹ In the affected segments of the market, if the minimum is set too high, or if the small number of firms leads to tacit collusion, mandating minimum payouts would arguably decrease competition to the ultimate detriment of the viators.¹⁴² The fear is that the mandated minimum will turn out to be the functional maximum that any firm pays.¹⁴³ If viators have no real choice of viatical settlement companies because of barriers to entry in the viatical industry, these local monopolists will have no incentive to pay any more than the mandated minimum.¹⁴⁴

Even in the segments of the viatical market where the number of viatical settlement companies is large enough so as not to constitute a true local monopoly, but where there still are not enough viatical settlement companies to generate any meaningful competition, critics argue that viators will nonetheless be disadvantaged because the mandated minimums will become a focal point and will encourage tacit price fixing among the few existing viatical firms.¹⁴⁵ The preferred approach, according to the critics, would be to deregulate the prices paid, and simply let the market function efficiently.¹⁴⁶

However, this approach presumes that the market can and will function efficiently in the absence of mandatory minimums. The more cogent argument is that these minimum discounts are neces-

¹⁴¹ See *supra* notes 69, 104 and accompanying text.

¹⁴² See *id.* (arguing that the regulations may have the exact opposite result than from what is desired). According to one commentator, mandated minimums may deny participating firms profit margins by:

interfering with their ability to assess risk discourag[ing] viatical settlement companies, as well as additional capital, from entering the industry. . . . As a result, viators may face a market that systematically sets prices at the minimum discount rates and then uses state regulations to explain the noncompetitive nature of the industry.

Id. But this analysis holds true only if the regulations have no connection to the market rate. If, as the working group planned, the mandated minimums are actually an approximation of competitive market rates, the industry will not become "noncompetitive" because of the minimums. See 1994-2 NAIC PROC., *supra* note 72, at 572 (adding that there could be future adjustments of the minimums).

¹⁴³ See *Berner, supra* note 112, at 599-600.

¹⁴⁴ See *Herron, supra* note 23, at 946-59 (discussing windfall profits for viatical firms, and their relationship to the need for minimum price regulation).

¹⁴⁵ See *Berner, supra* note 112, at 601-02.

¹⁴⁶ See *id.* at 602-03; see also 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, 147 (1993) (arguing that mandated minimums will interfere with the viatical firms' ability to assess risk, and thus will deny them reasonable profits, driving them from the industry to the detriment of potential viators); *Schultz, supra* note 7, at 104-05 (explaining that competition will result in competitive settlement rates and protect viators from possible exploitation by viatical settlement companies).

sary to correct the local monopoly problems. The bottom line is that viators need some minimum price protection to insure that they receive a fair settlement.¹⁴⁷ In the absence of mandated minimums, the local monopolists could discount a policy's face value far below any realistic estimate of the present value of the policy. Viators may be too sick to travel to, or even to investigate, other markets in order to seek a better price. Minimum price regulation guarantees them a price no lower than the mandated minimum. The better way to approach this conflict is to permit the mandated minimums, but to periodically reconsider the amounts of competition locally, and also the levels at which the minimums are set, striving to have them reflect realistic estimates of market prices in the industry as a whole. The minimums will protect viators as long as the regulated price is lower than the potential monopoly price.¹⁴⁸

Critics of mandated minimums also argue that, instead of insuring that viators receive a fair settlement, minimum payouts will in fact have the opposite effect for certain viators and thus should not be permitted.¹⁴⁹ Two of the most important factors in calculating the present value of a policy are the life expectancy of the insured and the credit worthiness of the issuing insurance company.¹⁵⁰ Mandatory minimums could arguably eliminate viatication as an option for certain viators.¹⁵¹

The first objection to minimum discounts is that they could hurt viators with life expectancies much longer than twenty-four months.¹⁵² The minimum payouts in the NAIC Models start at eighty percent of the policy face value for viators with life expectancies of less than six months, and the mandated percentages decline as the life expectancy of the viator increases, to fifty percent of the policy face value for all viators with a life expectancy of twenty-four

¹⁴⁷ See Herron, *supra* note 23, at 936 (concluding that those states that currently regulate viaticals should adopt mandated minimums, and those states that do not yet regulate viaticals would be well-served to adopt regulation with the mandated minimums).

¹⁴⁸ A mandated minimum payout scheme contemplates competition that may or may not establish a price higher than the minimum. However, if the minimum is set too high, viatication will cease.

¹⁴⁹ See Schultz, *supra* note 7, at 114 (putting forth the unsupported assertion that "an industry without minimum discount rates ensures that viators can receive the maximum amount possible for their policies").

¹⁵⁰ See Herron, *supra* note 23, at 954.

¹⁵¹ See Schultz, *supra* note 7, at 113.

¹⁵² See Dean, *supra* note 146, at 147.

months or more.¹⁵³ As new treatments for AIDS- and HIV-infected patients are developed, the life expectancies of viators who respond successfully to these treatments should increase, generating an increasing number of viators with life expectancies greater than twenty-four months. The regulation requires viatical firms to pay at least fifty percent of the face value, with no mechanism presently in place to differentiate between viators with life expectancies longer than twenty-four months.¹⁵⁴ Thus, under the current NAIC Models, viators with life expectancies longer than twenty-four months could be unable to viaticate their policies, because the mandated fifty percent minimum may exceed the actual present value.¹⁵⁵

This problem may be solved by an adjustment to the mandated minimums, to include specific payments for viators with longer life expectancies, with the percentages decreasing inversely with the increasing life expectancies.¹⁵⁶

The final objection to mandated minimums is that they could also hurt viators holding policies issued by insurance companies with low ratings, by effectively preventing viators from selling the policies for a deeper discount.¹⁵⁷ This concern arises from the use of the strength of the issuing insurance company as the ultimate credit in the deal in calculating the purchase price.¹⁵⁸ In the absence of regulation, policies of a top-rated insurance company would be pur-

¹⁵³ See VIATICAL SETTLEMENTS MODEL REGULATION § 4 (National Ass'n of Ins. Comm'rs 1994).

¹⁵⁴ See *id.* (providing minimum percentages for the time periods of less than 6 months, 6 to 12 months, 12 to 18 months, 18 to 24 months, and 24 months or more).

¹⁵⁵ According to William J. Freeman, Executive Director of NAPWA:

Viatical settlement companies take on very real risks when buying a policy. These risks are related to time and the rating of the underlying insurance company. The length of time that the viatical settlement company will hold the policy will naturally effect its carrying costs, since there is no way that the insured person's exact longevity can be determined—particularly as more effective therapies are being developed that offer the promise of extended life for people with AIDS. We fear that a regulated minimum payout would eliminate or severely restrict the ability of an individual with a longer life expectancy to sell his or her policy for a deeper discount; no company would be able to finance a settlement for an individual with several years of life expectancy.

1993-1 NAIC PROC., *supra* note 42, at 787.

¹⁵⁶ The original percentages were drafted by the NAIC years before the disclosure of the new drug therapies that appear to successfully reduce the viral load of some AIDS patients below detectable levels. This new technology simply generates the need to amend appropriate provisions of the NAIC Models, not to eliminate them.

¹⁵⁷ See 1993-1 NAIC PROC., *supra* note 42, at 787.

¹⁵⁸ See *id.*

chased at a smaller discount than policies issued by a lower-rated insurance company because of the decreased risk of default associated with the top-rated insurers.¹⁵⁹ Mandated minimums could discourage, and perhaps eliminate, viators' option of selling a lower-rated insurance policy.¹⁶⁰

The NAIC Models contains a mechanism to deal with this concern. The Model Regulation provides that the set percentages can be reduced by five percent for viatication of policies written by insurers rated in lower than the top four categories by A.M. Best, or rated comparably by another rating agency.¹⁶¹ Again, if the five percent correction proves insufficient, the percentage can be adjusted to more appropriately reflect market conditions.¹⁶²

Regulation should not be enacted or evaluated in a vacuum, but should be a function of the needs of the given industry. Thus, changes in the composition of the viatical industry, fueled by changing demand for viatication, will help shape the continuing debate on the necessity of mandating minimums, and will help determine the appropriateness of the set levels of minimums.¹⁶³

¹⁵⁹ See *id.*

¹⁶⁰ See *id.*

¹⁶¹ See VIATICAL SETTLEMENTS MODEL REGULATION § 4 (National Ass'n of Ins. Comm'rs 1994).

¹⁶² See *supra* note 156 and accompanying text.

¹⁶³ The NAIC working group was reconstituted in 1995, and spent much of 1996 monitoring state activity in the regulation of viatical settlements. See 1996-1 NAIC PROC., *supra* note 107, at 591 (providing reports on activities in some states). The working group decided that the NAIC Models might already be "antiquated," and that, due to increased life expectancies of viators, as well as marketing efforts to expand the pool of potential viators beyond AIDS patients, the minimum payouts might need to be changed. See 1995 Winter National Meeting, 1996 PROC. NAT'L ASS'N INS. COMMISSIONERS 763, 763 [hereinafter 1995-4 NAIC PROC.]. The working group agreed to monitor state adoption of the NAIC Models, to accumulate information from the states on any necessary modifications, and to consider an actuarial study to help determine approximate minimum payouts. See *id.* at 778 (noting that state experience would provide such information). The working group agreed to make appropriate recommendations to the NAIC for any modifications needed thereto. See 1994-2 NAIC PROC., *supra* note 72, at 550; see also 1995-4 NAIC PROC., *supra*, at 778 (explaining that the working group would gather information on possible modifications for states adopting the Viatical Settlements Model Act and Regulation).

As with the prior working group, the chairman of the reconstituted working group sought suggestions from members and the audience on any changes to the model law or regulation that might be considered by the working group, pointing out that the models were developed when there was very little experience on viatical settlements, and as the industry continues to develop, opportunities for improvement might exist. See 1995 Fall National Meeting, 1995 PROC. NAT'L ASS'N INS. COMMISSIONERS 1, 81 (noting that a discussion of these comments would occur at the Winter National Meeting).

Commissioner Glen Pomeroy of North Dakota had additional comments to make on the issue of viatical settlements, seemingly aimed at the securities law issues raised by viatical

CONCLUSION

Increasing demand for viatical settlements may draw more firms into the industry, arguably lessening the need for mandated minimums. The viatical industry started out with a handful of firms, and now consists of more than seventy five firms, with volume for 1996 expected to have reached five hundred million dollars.¹⁶⁴ The addition of new viatical settlement companies may help alleviate some of the demographic disparity leading to the local monopoly problem in some segments of the industry, and thus may increase competition.

However, the nature of the demand for viatication is not uniform because of the uneven geographical distribution of potential viators. Traditionally, the overwhelming majority of viators were AIDS- and HIV-infected.¹⁶⁵ In the early years of the industry, the number of AIDS cases increased consistently and dramatically, fueling an

settlements in cases such as *SEC v. Life Partners*, 87 F.3d 536 (D.C. Cir. 1996). See *supra* note 8.

Commissioner Pomeroy also asked, at the summer 1995 National Meeting, that an analysis be done of the insurable interest concern about companies purchasing life insurance policies and marketing them on the secondary market. See *Summer 1995 National Meeting*, 1995 PROC. NAT'L ASS'N INS. COMMISSIONERS 1, 14 (concluding "that most companies are not making a secondary market themselves"); see also Osborn, *supra* note 8 at 485-89 (discussing insurable interests and complications in the assignment of policies).

At meetings of the Viatical Settlement Working Group since the adoption of the NAIC Models, industry representatives indicated that the core of the NAIC Models had been accepted by the states, with the two primary areas of inconsistency being licensing of brokers and pricing. See 1996-1 NAIC PROC., *supra* note 107, at 618-19 (noting that the "states are not in agreement on how to treat intermediaries, and people with longer expectancies impact pricing of the viatical settlements"). According to Gary Choades of Viaticus, a large viatical settlement company, some states are letting the market determine the pricing range for viatical settlements, instead of setting the minimum payments as suggested in the NAIC Models. See *id.* (providing the example of Louisiana which "does not regulate the market beyond a 24-month period").

At the June 7, 1997 Viatical Settlement Working Group Committee Meeting, the working group considered a draft of revisions to the Model Act, incorporating provisions from state laws such as New York, Illinois, Florida, and Texas, as well as input from viatical trade associations and industry participants. See *Minutes of Meeting of Viatical Settlements Working Group of the Life Insurance (A) Committee (June 7, 1997)* (on file with author) (noting that the purpose of the meeting was "to go through the draft and identify areas that need more extensive discussion"). The revisions cover strengthening the grounds for revocation of viatical licenses, broadening the filing requirements for disclosure statements, and increasing the protection provided with respect to confidential information. See *id.* The goal of the working group was the adoption of a revised Model Act by the end of 1997. See *id.*

¹⁶⁴ See *supra* notes 16, 46-47.

¹⁶⁵ See Sommer et al., *supra* note 37, at 54.

ever-increasing demand for viatication.¹⁶⁶ But, based on recent trends, the CDC reports an overall slowing in the growth rate of AIDS, arguably in part because of new powerful drugs therapies.¹⁶⁷ As a result, many AIDS patients are outliving their projected life expectancies. Demand for viatical settlements by AIDS patients has increased as a result of these new treatments, which are very expensive,¹⁶⁸ and, because of their experimental nature, are unlikely to be covered by traditional health insurance to the extent the viator has any such coverage.¹⁶⁹

The changing nature of the demand for viatical settlements has led to an increase in the number of firms in the industry, but recent developments in treating AIDS may cause the viatical industry, as currently configured, to constrict.¹⁷⁰ The reports from the 1996 In-

¹⁶⁶ See Askin, *supra* note 72, at 49.

¹⁶⁷ According to the CDC, from 1992 through 1995, estimates of newly diagnosed AIDS opportunistic infections [hereinafter AIDS-OI] suggested that AIDS cases were increasing at a rate less than five percent per year in the U.S., as compared to higher rates of increase from 1990 through 1992. See CDC 1996 YEAR-END SURVEILLANCE REPORT, *supra* note 1, at 5; see also *Drop in New Cases, Deaths Reported*, WORLD NEWS DIG., Oct. 23, 1997, at 770 (noting that the incidence of AIDS had decreased from 1995 to 1996); *HIV/AIDS Trends Point to Progress and Pose Continuing Challenges for Next Era in HIV Prevention*, PR NEWswire, July 6, 1996, available in LEXIS, News Library, Txtnews File (stating that "[a]nnual increases in new AIDS cases have slowed from more than 85% in the mid-eighties").

As the epidemic of HIV infection has dispersed from the cities where AIDS cases were first recognized in 1981 (Los Angeles and New York), different populations and geographic areas have been affected over time. . . . It is likely that, in the near future, these trends will continue and numbers of estimated AIDS-OIs will stabilize or decline slightly. However, these overall trends at the national level are likely to mask diverse local sub-epidemics.

Centers for Disease Control & Prevention, U.S. Dep't of Health & Human Servs., *HIV/AIDS Surveillance Report* (visited Feb. 13, 1998) <gopher://cdcnaac.org:72/00/4/midyear 96/intro96.txt>.

¹⁶⁸ The drugs can cost up to \$16,000 per year, with another \$4000 for tests and related expenses. See Jane Bennett Clark, *New Weapons Against AIDS—At a Price: The Latest Treatments Cost Up to \$20,000 a Year*, KIPLINGER'S PERS. FIN. MAG., Feb. 1, 1997, at 102.

¹⁶⁹ And recent legislation made viatical settlement payments for viators with life expectancies of 24 months or less non-taxable at the federal level, further increasing the demand. See *supra* notes 8, 89 and accompanying text (discussing the tax law implications of viatical settlements).

¹⁷⁰ Changes in the treatments for AIDS, with the promise of longer life expectancies, has already affected the viatical industry. Dignity Partners, once the media darling of the viatical industry, has now fallen victim to the latest innovations in AIDS treatment. See *Dignity Partners Announces Second Quarter Earnings*, BUS. WIRE, Aug. 14, 1996, available in LEXIS, News Library, Bwire File (discussing the company's net income decreases as the result of competition and longer life expectancies). In 1994, the San Francisco based firm was the first to sell notes securitizing the proceeds of viaticated policies. See *Ironwood Capital and Dignity Partners Completes the First Ever Asset Securitization of Viatical Settlements in the Amount of \$35 Million*, BUS. WIRE, Mar. 2, 1995, available in LEXIS, News Library,

ternational AIDS conference in Vancouver, British Columbia were front page news stories for days, using words such as "increased life expectancy" and "cure" over the objections of the scientists.¹⁷¹ Since

Bwire File. Standard & Poor's rated the \$35 million transaction as an "A" and, as a reflection of the market's optimism about the future of the viatical settlement industry, published new rating criteria for viatical settlement deals in its November 1995 *Structured Finance*. See *id.*

In the prospectus for its \$21.7 million initial public offering, Dignity listed as a risk factor that

"[t]he development of a cure or vaccine against diseases and other terminal illnesses (including AIDS) or the development of a treatment which extends the life expectancy of individuals with such illnesses could delay substantially the collection of the face value of policies purchased by the company. . . . Any such delay could materially reduce the company's actual yield on its portfolio."

Carlsen, *supra* note 1, § 1, at 3. Dignity planned to increase its portfolio by including policies from AIDS patients with life expectancies in excess of 24 months, and policies from patients with terminal illnesses other than AIDS. See Anne Colden, *Dignity Partners' Future Murky as AIDS Mkt Shifts*, DOW JONES NEWS SERV., July 29, 1996, available in WL.

But, in the summer of 1996, Dignity announced that in light of the developments announced at the International AIDS Conference in Vancouver it was temporarily ceasing to process new applications for AIDS- and HIV-infected viators while it analyzed the research results. See *Dignity Partners Announces Second Quarter Earnings*, *supra*. Dignity noted that over 95% of its business historically has been viators with AIDS or HIV. See *Despite Win Over SEC, Viaticals' Profits Face Threat*, BESTWIRE, July 19, 1996, available in LEXIS, News Library, Ttxnws File. The medical developments announced at the conference were "welcome news for many, [but] if the treatments are effective in the long term, the company's results [would] be adversely affected." *Id.* Following this announcement, Dignity's stock dropped by 77% in one day. See Colden, *supra*. Dignity began selling off its policies and began a repurchase of its shares to correct what the company perceived as an overreaction by the market to its announcement. See *Dignity Partners Announces Share Repurchase Program*, BUS. WIRE, Oct. 18, 1996, available in LEXIS, New Library, Bwire File (relating the approval of a share repurchase program and the Board's belief that the market overreacted); *Dignity Partners Announces Second Quarter Earnings*, *supra* (noting the corporation's August 2, 1996 agreement to sell off policies).

Dignity then decided to cease its viatical settlement business and to sell off its non-AIDS policies. See *Dignity Partners Announces Earnings, Sale of Policies, Sale of Equity Investment and Cessation of Viatical Settlement Business*, BUS. WIRE, Mar. 31, 1997, available in LEXIS, News Library, Bwire File.

The NVA issued a press release entitled "Protease Inhibitors are Not Inhibiting All Viatical Settlement Firms," to put their spin on the results of the Vancouver Conference and Dignity's decision to suspend its viatical purchases from AIDS patients, reiterating the remarks of some Conference speakers that the new treatments did not represent a cure, and finishing up with a pledge to continue to provide AIDS patients with viatication opportunities "as part of a series of viable financial options, which can offer fiscal dignity during the most trying times." National Viatical Association, Press Release (July 25, 1996) (on file with author).

¹⁷¹ The U.S. Food and Drug Administration rushed the new drugs through the approval process during the last year because early studies showed patients' conditions improved dramatically and swiftly after they took the drugs, yet no researcher can attest to positive or negative long-term effects from the drugs. They are just too new for anyone to know if the medicine has a lasting effect or drives the virus to organs, such as the brain, in which it is hard to detect abnormalities without highly invasive procedures.

the life expectancy of the viator is a major factor in the calculation of the amount paid for a policy, this information had the potential for dramatic repercussions in the viatical industry.

An ironic complication is that the very treatments that increase demand for viatication make the viaticated policy, because of potentially increased life expectancies, a less attractive investment.¹⁷² So viatical firms are seeking to expand the pool of potential viators to policyholders suffering from terminal illnesses other than AIDS,¹⁷³ such as cancer and heart disease, and by marketing viatication to the elderly,¹⁷⁴ and not just to the AIDS- and HIV-infected segments

In addition, the drugs don't work for an estimated 15 to 40 percent of patients. In some patients, the drugs simply don't block the appropriate enzymes; in others, they cause intolerable side effects, including extreme nausea, diarrhea and fatigue that does not subside.

Bob Condor, *New Drugs Making a Difference for People with AIDS*, LAS VEGAS REV. J., Apr. 27, 1997, at A18.

So these protease inhibitors do not cure AIDS. According to the HIV Insight National Data Base, of 6700 AIDS and HIV patients with access to medical care, 24% are taking the new drug therapies, and of those, only 15% have shown improvement. See Clark, *supra* note 168, at 102 (noting the effect of protease inhibitors on HIV and AIDS patients).

¹⁷² While no one is advocating maximizing investor returns as any part of the goal of regulating the viatical industry, the plain truth is that if these investment vehicles do not yield a sufficient return, all but the truly altruistic investors will simply take their investment capital to other ventures. Without investors, the industry as currently configured would grind to a halt.

¹⁷³ According to Gary Choades of Viaticus, a large viatical settlement company, approximately 40% of his firm's viatication business is with non-AIDS patients. See 1996-1 NAIC PROC., *supra* note 107, at 618 (noting the expansive nature of the viatical settlement industry).

¹⁷⁴ A subgroup of the Viatical Settlement Working Group reviewed the NAIC Models to: identify those sections of the regulation which might need to be revised, or sections which might need to be added, to reflect the use of viatical settlements in cases where life expectancy is longer than three years. This work is being undertaken to consider a response to industry statements that the market for viatical settlements is moving to the elder population, or those persons with cancer, Alzheimer's disease, or other conditions which do not have the relatively short life expectancy that has been true for persons with AIDS.

Minutes of Meeting of Viatical Settlements Working Group of the Life Insurance (A) Committee (June 2, 1996) (on file with author).

of the population.¹⁷⁵ At the same time, insurers are showing a willingness to insure the lives of AIDS patients.¹⁷⁶

The viatical settlement industry has experienced tremendous growth since it began almost a decade ago. Viatical settlements provide a valuable service to their terminally-ill participants, and at least market rate of return on investment for the viatical settlement companies. But some form of regulation is needed to protect viators and to help correct the current local monopoly and information asymmetries evident in today's viatical industry.¹⁷⁷ The unpleasant economic reality is that the investors in the purchased policies must also be protected in some sense, because without them, even perfect regulation cannot turn life insurance into cash or medical supplies. The NAIC Models are a good start, but the debate on regulation in general, and on the NAIC Models specifically, is far from over.¹⁷⁸ As the viatical industry grows, regulatory con-

¹⁷⁵ A new viatical firm, Cancer Viatical Services, of Dallas, Texas, owned and operated by a former member of the NVA, is providing viatication of policies to cancer patients. See *New Services Offered for Cancer Patients*, PR NEWswire, Apr. 22, 1997, available in LEXIS, News Library, Ttxtnews File. However, instead of taking a percentage of the policy as its fee, the firm collects its fee from the investors, based on the amount paid to the client; so the higher the proceeds to the viator, the higher the fee to the viatical firm. See *id.*; see also Askin, *supra* note 72 (illustrating the benefits of viatical services for the elderly).

¹⁷⁶ Some insurance companies are now experimenting with selling life insurance policies to HIV-infected persons. Guarantee Trust Life Insurance Co., of Glenview, Illinois, a firm that specializes in insuring impaired individuals, is offering whole life coverage to certain people ages 20 to 49 with HIV, but not full-blown AIDS. See *Insurer Flooded with Queries About HIV Life Policy*, BESTWIRE, Apr. 23, 1997, available in LEXIS, News Library, Ttxtnews File. The insurance is not available to patients who contracted HIV through the injection of drugs. See *id.*

The company decided to insure the lives of certain AIDS patients after months of research and developmental work, including studying data from CDC, insurance industry mortality tables, information from Guarantee's reinsurer, interviews with local doctors treating HIV-infected patients and with national HIV experts, and consultations with people in the HIV community and consultants who work with them. See *id.*

¹⁷⁷ The general sentiment in the industry is that greater regulatory scrutiny will help the industry, making it more credible and profitable by eliminating poorly run or poorly capitalized companies. See Jim Connolly, *Viatical Companies Seem Ready To Embrace Regulation*, NAT'L UNDERWRITER, Nov. 28, 1994, at 21.

¹⁷⁸ The NVA, which is generally opposed to the NAIC Models and any "regulation of anticipated events that have not materialized over the last five years," has drafted its own Viatical Settlements Model Act. See Connolly, *supra* note 177 (quoting Brian Pardo, then president of NVA and Life Partners, a viatical firm in Waco, Texas). Life Partners was the subject of a recent attempt by the SEC to regulate sales of fractionalized interests in pools of policies as securities for purposes of the Securities Act of 1933. See *supra* note 8 and accompanying text.

According to NVA President W. Scott Page, the NVA Model reflects "the actual workings of the industry and the sensitivities of the individuals it serves, rather than a hypothetical case or one drawn by subjective parties that put the interests of the life insurance industry ahead

straints on it must evolve as well. Additional concerns could arise, such as the increased incidence of fraud,¹⁷⁹ and, if more traditional insurance companies create or purchase viatical settlement firms, potential conflicts of interest.¹⁸⁰

The viatical settlement industry is experiencing growing pains in response to its rapid growth and the changing treatments and increasing life expectancies for AIDS- and HIV-infected policyholders.

of the actual interests of consumers and the terminally ill." *Viatical Association Drafts Its Own Model Law*, BESTWIRE, Nov. 5, 1996, available in LEXIS, News Library, Txtwns File. The NVA version, although similar to the NAIC Models, differs in some significant respects. Their version purports to protect viators, with some vague language about fiduciary duties, but seems really designed to protect and encourage viatical settlement companies to buy policies. See *Beneficial Regulation*, *supra* note 72 (listing the differences between the NVA draft and the NAIC Models).

The NVA version contains a provision making the viatical broker a "fiduciary" for the viator, and contains provisions permitting a cure period for license renewals, removes the requirement of providing a detailed business plan, and provides for reciprocity for firms' licenses and approved forms. The model also contains a provision insulating the viatical settlement company from civil liability in the event that they follow a Commissioner order and are sued. See *id.* It is unclear whether any or all of these provisions would be enforceable. The NVA Models were to be presented at the November 17, 1996 meeting of the National Conference of Insurance Legislators. See *id.*

The NVA got itself some very favorable press on its efforts. An article entitled *Fairer, Sensible, Broadly Beneficial Regulation of Living Benefits Industry Drafted by the National Viatical Association*, which is really a news release from the NVA, points out that the NAIC is considered the lobbying arm of the insurance industry, and that the NAIC Models apply to viatical firms but exempt carriers, creating a "non-level playing field that stifles competition, reduces the payout to ill persons, dislocates funding sources, and results in higher health care costs to taxpayers." *Id.*

Another group, the National Conference of Insurance Legislators, recently adopted its own model act addressing viatical life insurance policy concerns. See Diane West, *Viatical Model Act Adopted by NCOIL*, NAT'L UNDERWRITER, July 28, 1997, at 21. The model is based on a bill recently vetoed by the Missouri legislature. See *id.* (noting that the model "attempts to tighten state regulations on [parties] involved in viatical settlements").

¹⁷⁹ Some areas of fraud are not specific to the viatical settlement industry. A California viatical company, Personal Choice Opportunities, was recently charged with defrauding 950 investors of more than fifty million dollars, purportedly raised to finance viatical settlements. The firm promised a 25% annual return, but has never made any payments from insurance benefits since the program began. See Marcia Vickers, *For 'Death Futures,' the Playing Field Is Slippery*, N.Y. TIMES, Apr. 27, 1997, § 3, at 5. According to William E. Kelley, Executive Director of the Viatical Association of America, fraudulent schemes such as this one are especially unfortunate, because they "cast[] . . . a shadow over legitimate and law-abiding viatical settlement companies." Ron Lent, *Federal Authorities Broaden Case Involving Alleged Viatical Scam*, J. COM., Apr. 28, 1997, at A8.

¹⁸⁰ See 1994-2 NAIC PROC., *supra* note 72, at 550. In June, 1994, the NAIC asked the American Council of Life Insurance [hereinafter ACLI] to survey its members about their present and anticipated involvement in the viatical industry, including whether the members have formed or invested in viatical settlement companies; and if so, whether they believe it to be prudent practice to buy back their own policies through a viatical settlement company they have an interest in. The ACLI declined to conduct the survey. See 1994-3 NAIC PROC., *supra* note 63, at 517.

To further complicate the mix, the new tax legislation makes proceeds from viatical settlements exempt from federal income taxes in most cases.¹⁸¹ These changes in the dynamics of the industry present problems, but also present opportunities. The more favorable tax treatment may draw new potential viators into the market. And the results of additional studies of the long term effects of these new AIDS treatments may be years away, giving the industry a chance to step up efforts to bring victims of other terminal illnesses into the market. These changes have made the case for enforcement, disclosure, and minimum payments provisions even more critical, and will continue to define the necessity and scope of regulation in this evolving industry.

¹⁸¹ The tax-free status is conferred on viatical settlements paid after December 31, 1996 to viators with a life expectancy of less than two years by a viatical firm licensed in the state where the viator lives. See *supra* notes 8, 89 and accompanying text for a discussion of the tax law implications of viatical settlement payments.