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COMMENT, THE DEBATE SURROUNDING VIATICAL SETTLEMENTS

Margo L. Intrator*

I. INTRODUCTION

This paper will explore the debate surrounding viatical settlements from the perspectives of those involved in the viatical settlement, and surrounding industries, including: viatical settlement providers, brokers and sellers; life insurance companies and brokers; health care providers; legislatures and tax collectors. The word viatical comes from the Latin word *viaticum* and refers to money or other necessities for a journey and the Christian Eucharist or communion given to a person in danger of dying.¹ Section II will discuss the history and characteristics of the industry. Section III will explore advantages and disadvantages of the availability of the viatical settlement option. Section IV describes alternatives to selling the policy to viatical settlement companies and brokers, including unbrokered sales to family and friends, accelerated death benefits, loans against life insurance proceeds, traditional health insurance, reliance on governmental programs, and charity.

Section V will discuss recently enacted and proposed federal and state legislation including the National Association of Insurance Commissioners' ("NAIC") Model Viatical Settlement Act ("Model Act"), and state laws with individual examination of the laws of New York, California and Texas. I will also examine the effects of the tax and securities laws on the industry. Section VI covers areas omitted in the attempts for reform, as well as, my proposals for areas where additional reform is needed.

II. HISTORY

The viatical settlement industry is relatively young; the first company began to operate in 1989.² There are now over fifty firms involved in the \$300

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¹ WEBSTER'S THIRD NEW INT'L DICTIONARY OF THE ENGLISH LANGUAGE UNABRIDGED 2548 (1966).

² Thomas McCormack & David Petersen, "Living Benefits" for the Insured, Terminally Ill Client: A Remarkable New Resource with Tax, SSI and Medicaid Implications, 24 CLEARINGHOUSE REVIEW 1348 (April 1991).

million viatical settlement industry.³ The National Association of Insurance Commissioners estimates that the demand for viatical settlements is \$4.25 billion in the United States alone.⁴ The industry began in response to the Acquired Immune Deficiency Syndrome ("AIDS") epidemic and the high costs associated with living with the disease. Forty percent of AIDS patients are bankrupt before the disease kills them.⁵ AIDS patients require a method of gaining access to vast quantities of money to pay astronomical health care costs and other expenses at a time in their life when death is inevitably close. The financial problems are compounded as health insurance may be canceled or is simply unattainable, and the individual is often forced to quit his job or involuntarily leave as a result of his disease. The viatical settlement gives the individual an opportunity to purchase the health care desired, pay off his debts and enjoy, as fully as possible, the end of his life without the added stress of severe monetary constraints.⁶ Generally, any life insurance policy may be viaticated with the possible exception of a policy during its contestability period or a suicide exclusion.⁷

The viatical settlement industry consists primarily of two types of businesses. There are companies buying life insurance policies as assets for their investment portfolios and brokers who match purchasers with viators. The life insurance policies are normally viaticated when the patient has less than three years to live for 50-80% of face value paid in a lump sum.⁸ The life insurance policy is assigned or sold to the viatical settlement company and the

³ Ernest Sander, *'Death Futures' May Ease Lives of the Terminally Ill, Proponents Say; Trends: Some Ailing Individuals Sell Their Life Ins. Policies at a Cut Rate to Investors, Who Receive the Proceeds When the Patient Dies. So-Called Viatication Business is Growing In Popularity*, L.A. TIMES, May 22, 1994, at B4.

⁴ Rick Nelson, *Cash and Dignity for the Dying*, CORPORATE REPORTER - MINN., Sept. 1994, at 42.

⁵ *Id.*

⁶ In a survey done by the National Association of People with AIDS of nearly 2,000 AIDS patients, the largest concern was money. Almost one-third of the patients lived on \$500 per month and approximately one-third existed on \$500-\$1,000 per month. Sean Armstrong, *AIDS and the Trusted Adviser (Accelerated Life Ins. Benefits for Terminally Ill Patients)*, BEST'S REVIEW - LIFE/HEALTH INS. EDITION, Sept. 1994, at 36.

⁷ Generally a term, whole life or universal policy may be viaticated whether an individual or group policy. NAT'L VIATOR REPRESENTATIVES, INC., LEAFLET NO. NVR020593, *Twelve Questions You Need to Ask Before Selling Your Life Ins. Policy* (1993) [hereinafter *Twelve Questions*]. One settlement firm stated that as a result of intricacies of group life insurance policies, including assignability and renewed periods of contestability when converting a policy which is part of a group plan to an individual policy, prices can decrease five to seven percent. McCormack & Petersen, *supra* note 2, at 1350.

⁸ The average pay out as a percentage of face value on life insurance policies purchased by viatical settlement company, Viaticus, is 72-75%. Telephone Interview with Rhonda Bacci, Chief Financial Officer of Viaticus (Mar. 16, 1995) [hereinafter *Interview with Rhonda Bacci*].

company assumes payment of the insurance premiums until the insured individual dies. The viatical settlement company is then able to collect the life insurance proceeds. Brokers normally receive 1-6% of the face value of the policy depending on the extent of services supplied in the settlement process.⁹

An individual considering viaticating his life insurance policy has many resources available to him to avoid abuse by people who would exploit him and his situation. These resources allow the potential viator to receive the highest dollar value for his life insurance policy.¹⁰ These resources include legal advisors, financial planners, special interest groups and associations such as the National Association of People with AIDS, and the information provided in the disclosure statements of the viatical settlement companies.

Viatical settlements are presently geared predominantly to the AIDS community.¹¹ Advertising is often through word of mouth and in gay and AIDS literature.¹² Additionally, those who work with the terminally ill such as,

⁹ Brokers who act as finders, only giving names to viatical settlement companies, receive approximately 1-2% commission on the face value of the policy, brokers who "package" the policy and applications receive approximately 3-4% of the face value of the policy as commission, and brokers who represent the seller receive 5-6% of the face value as commission. David Petersen, Nat'l Assoc. of People with AIDS, *Process of Viatication* (1994). Viaticus, a viatical settlement company, offers a referral fee to brokers of .75% net face value and .25% to the Managing General Agent, this gives the broker an opportunity to capitalize on policies previously written while keeping those policies from lapsing due to the financial crisis of the insured. *The Path to New Broker Opportunities in the 1990s and Beyond*, Broker Briefing (Viaticus, Chicago, Ill.), Summer 1994, at 3-4 [hereinafter *Broker Opportunities*].

¹⁰ The viator should understand that his paramount objective is to obtain the most money for his policy, everything else is significantly less important. Several tactics may be employed to increase the payment received as it is common that offers will differ by as much of 25%. Most importantly, the viator should solicit multiple bids, the minimum being five to six. This will assist in finding a competitive bid, especially because funding for companies ebbs and flows quickly, having a substantial effect on offers. The potential viator may look at a licensing list of companies provided by states, however, this often is of little assistance. Additionally, the viator should demand that the payment be held in an escrow account or in trust by a third-party once the decision to accept the offer is made. This procedure is used to avoid problems such as a company having insufficient funds to pay the settlement after the viator has assigned his policy to them. This is especially important for a terminally ill viator who does not have the time for litigation or other complications and is desperate for the money. The viator should not use a broker unless necessary. If that is the case, he should be aware that the broker may want to sell to a viatical company with the highest commission as opposed to the highest bid. Requiring the broker to submit several written bids should alleviate that problem. Overall, the viator's first priority must be to achieve the most lucrative cash settlement possible. Petersen, *supra* note 9.

¹¹ See Michael Quint, *Pre-Death Cash: A Business Grows*, N.Y. TIMES, Nov. 14, 1994, at D3; see also *Broker Opportunities*, *supra* note 9, at 3-4.

¹² Viatical settlement companies do a great deal of advertising in the local and regional gay press. Christy Fisher, *Local Print Bumps Into National Ad Walls*, ADVERTISING AGE, May 30, 1994 at 2. A Cleveland firm placed the first billboard ad for a viatical settlement company in Fort Lauderdale, Florida. The advertisement had previously been run in periodicals geared towards the gay and lesbian community. The

health care providers, social workers, religious organizations and insurance brokers are being targeted by the industry to inform and encourage the terminally ill in regards to the potential advantages of the viatical settlement option.¹³ However, viatical settlement companies are beginning to broaden the scope of their potential client base and will attempt to increase purchases from cancer and other terminally ill individuals, as well as, possibly the very elderly who are healthy.¹⁴

Legislatures have been relatively slow in enacting legislation to regulate the environment of the purchase and sale of life insurance policies. To date fewer than ten states have enacted viatical settlement legislation although legislation is pending in other states.¹⁵ This is potentially problematic as a result of the enormous growth the industry has experienced in its relatively short existence.¹⁶ The additional anticipated growth is expected due to the large profits being realized, especially now that AIDS has become the leading cause of death for

billboard depicted a nude man in the fetal position with the words, "Terminally III - There are Options," in space rented from 3M. One week after the advertisement was erected numerous complaints had been registered. Robert McCabe, *Billboard Aimed At Terminally Ill*, SUN-SENTINEL (FORT LAUDERDALE), Oct. 1, 1994, at 6B.

¹³ A Viatical settlement company, Viaticus, suggests that brokers use clergy and social workers; nurses' associations, for example, AIDS and oncology nurses; hospital personnel, for example, nurses, discharge planners, and case managers; home infusion and respiratory therapy professionals; hospice and nursing home administrators; and local community groups, including groups for cancer, heart and other life threatening illnesses for assistance in finding referrals. Viaticus Form No. HC9402, *Marketing Viatical Settlements: Quick Reference Sheet*. But see Viator's physician, attorney, accountant or agent in his settlement may not receive any compensation, finders fee or commission from the viatical settlement provider or broker. Viatical Settlement Model Regulation § 6 (1994).

¹⁴ It is expected that the viatical settlement companies will push further into the cancer market as over half a million people die from cancer each year while only 30,000 people died from AIDS last year. Additionally, the average face value of a cancer patient's policy is \$500,000 as opposed to \$150,000 for an AIDS patient. As of the date of the article, only ten-percent of the viatical market consisted of cancer patients. Additionally, some viatical settlement companies are researching the viability of purchasing insurance policies from healthy but very old people. Quint, *supra* note 11, at D3; Dan Lonkevich, *Insurer Begins Buying Policies at a Premium*, BEST'S REVIEW - LIFE/HEALTH INS. EDITION, Sept. 1994, at 41.

¹⁵ To date, the following states have enacted legislation for the regulation of the viatical industry: California, Indiana, Kansas, New Mexico, New York, Texas and Vermont. The following states have legislation pending: Florida, Illinois, Minnesota, Missouri, North Dakota, Oregon, Pennsylvania and Virginia.

¹⁶ Approximately \$5 million in policies were brokered in 1989, \$40 million in 1990, \$100 million in 1991, \$180 million in 1992. John F. Blake, *Life Ins. Proceeds Can Be Received Tax Free Prior to Death Under New Prop. Regs.*, 79 J. TAX'N 156 (1993); more than \$200 million in 1993. Nelson, *supra* note 4, at 42. Today the viatical settlement industry represents a \$300 million business. Telephone Interview with Michelle Saxty, Associate Director of the Nat'l Viatical Assoc., (Mar. 7, 1995) [hereinafter *Interview with Michelle Saxty*].

men age 25-44,¹⁷ the expansion of the industry beyond the realm of AIDS, and the approval of the NAIC's' Model Act.

III. ADVANTAGES & DISADVANTAGES OF VIATICAL SETTLEMENTS

A. *Advantages of Viatical Settlements*

The majority of AIDS patients live under severe financial constraints.¹⁸ Giving the insured access to the funds of his life insurance policy prior to death allows the individual, in the final portion of his life, the financial flexibility to assess his options without the enormous problems related to insufficient funds. The financial stress is exacerbated because many AIDS victims lose their jobs and their health insurance or are simply unable to procure health insurance.¹⁹ The individual can use the proceeds of the viatical settlement to purchase the health care that he needs or desires. Additionally, he might take a last exciting trip, visit friends and relatives, settle debts, or attempt to make the lives of those he is leaving behind more comfortable. He will also have the opportunity to purchase "unconventional therapy" which may not be available through the health insurance he has, if he does in fact have health insurance.

If AIDS or other terminally ill patients have the funds to pay for their own therapy, they will take an enormous burden off the public coffers.²⁰ In many

¹⁷ According to a 1992 study from a compilation of death certificates in the United States by the Center for Disease Control and Prevention, AIDS is the leading cause of death for men ages 25-44 (first for black men and second for white men) and the fourth leading cause of death for women of the same age (second for black women and sixth for white women). In the overall population AIDS and HIV disease is the eighth leading cause of death. *U.S. Center for Disease Control AIDS Now Leading Killer of Young Men in U.S.*, AIDS WEEKLY CW - Henderson, Dec. 6, 1993; *Center For Disease Control Seeks Better Condom-Use, AIDS Message*, THE SAN DIEGO UNION-TRIBUNE, Nov. 21, 1993, at A34.

¹⁸ Bill Crust, President of Viatical Settlements, Inc., said of his clients, "When somebody calls us, nine times out of ten they don't need the money tomorrow, they needed the money yesterday." Carey Gillam, *New Industry Earning 20% on Terminally Ill*, KANSAS CITY BUS. J., May 28, 1993, at 1. See *supra* note 5.

¹⁹ Often health insurance is lost when individuals leave work or by the systematic exclusion of AIDS patients from procuring insurance. Additionally, attempts to prohibit insurance companies from testing for HIV have been struck down by the courts or repealed. 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 (1993).

²⁰ Brian Pardo, President of the viatical settlement company, Life Partners, Inc., claims that the industry performs an important purpose in that it will relieve the federal government of a bill for the care of indigent AIDS patients which will amount to approximately \$130 billion by the year 2000. *Accelerate! (Legislation to Allow the Terminally Ill to Receive Tax-Free Accelerated Death Benefits)*, NAT'L UNDERWRITER, Sept. 14, 1992, at 18.

cases this will result from the viator becoming ineligible for need-based welfare programs, such as Medicaid, after he receives the settlement.²¹ This will allow these programs to be allocated to those who really need them, the poor and uninsured. Additionally, this may free up more resources for research for cures to many of the terminal illnesses which plague society.

According to a survey by Viaticus and health and tax insurance actuarial consultant, Milliman & Robertson, Inc., the federal deficit would be reduced by approximately \$390 million over five years by changing the tax status of viatical settlements with an assumption of static sales, despite the fact that sales are expected to rise dramatically.²² These savings would result from four factors according to Milliman & Robertson.²³ First, the advantages include the decreased use of governmentally provided social services such as Medicaid.²⁴ Second, the taxable income of medical providers would increase if they are paid full value for their services as opposed to the discounted rate received through Medicaid reimbursements.²⁵ Third, the family and friends of AIDS patients will not be forced to stop working, losing their taxable income, when they are required to provide care for the sick individual which he would otherwise be unable to afford.²⁶ Fourth, the viatical settlement industry has been growing and financial forecasts suggest that growth will continue thereby providing another large base of taxable income for the federal government.²⁷ Furthermore, if viatical settlements are not made tax-free by regulation, individuals may choose not to viaticate their life insurance policies because of the financial consequences. This will cause the individual additional suffering because of the financial stress and an inability to purchase necessities at the end of life and, in the end, the government will not gain any income because the death benefit will eventually be received tax-free by the beneficiaries.

The ability to purchase care will give patients the opportunity to gain access to private as opposed to public care. Private health care is normally better quality, less stressful to obtain, and doctors and patients are better able to create

²¹ See *Tax Break Could Cut Deficit Viatical Firms*, INS. REGULATOR, Jan. 30, 1995, at 3 [hereinafter *Tax Break*].

²² See *Joint Statement of John Banks, Chief Executive Officer Viaticus, Inc. and Alan Perper, President, Dignity Partners Before the Committee on Ways and Means United States House of Representatives*, FEDERAL NEWS SERVICE, Jan. 20, 1995 [hereinafter *Joint Statement*].

²³ See *id.*

²⁴ See *Tax Break*, *supra* note 21, at 3.

²⁵ See *id.*

²⁶ See *id.*

²⁷ See *id.*

a relationship which will help in the care of the patient.²⁸ The self determination will also allow the viator and his family the opportunity to do everything they believe possible, or necessary, to help the viator in terms of health care, making the insured's life comfortable, etc. This will probably ease the pain of the final portion of life and coping with the death itself. Additionally, over time, this may have the effect of making more money, time and resources available to be allocated to a cure for these diseases, especially AIDS.

The option to viaticate a life insurance policy gives a cash-poor individual, even several years before he is expected to die, a method of preventing a lapse of his life insurance policy for non-payment of premiums which would result in the loss of the death benefit itself.²⁹ This loss of the entire benefit of the policy could result despite years of premium payments.³⁰ The insurance industry made a windfall of three billion dollars on defaulted insurance policies in 1994.³¹ Michelle Saxty, Associate Director of the National Viatical Association ("NVA") believes the profit earned by the insurance companies as a result of defaulted policies is a very strong incentive for the insurance industry to lobby for legislation which harms the viatical settlement industry.³²

Although viatical settlement companies are in business to make money, many believe that they are performing an important function for which there is a strong demand.³³ AIDS patients and others who have viaticated their insurance policies are generally in agreement with the positive assessment of the industry and the freedom and flexibility which they receive with the viatical settlement funds.³⁴

²⁸ See Dean, *supra* note 19, at 117.

²⁹ See Brian D. Pardo, *In Defense of the Industry*, WASH. POST, Mar. 4, 1995, at A14.

³⁰ See *id.*

³¹ See *id.*; see also *Interview with Michelle Saxty*, *supra* note 16.

³² *Interview with Michelle Saxty*, *supra* note 16.

³³ David Landay stated regarding his company, National Viatical Representatives, Inc., "We are meant to be a for-profit corporation, which one day we may be, but our concept is to act as a free service to people with AIDS and other terminally ill people. We use not only our collective knowledge about AIDS, but our first hand experience to help people any way we can." *A Life Devoted to Fighting AIDS: An Interview with Nat'l Community AIDS Partnership Trustee David Landay*, PARTNERSHIP - A PUBLICATION OF THE NAT'L COMMUNITY AIDS PARTNERSHIP, Sept. 1994, at 1. We understand the situation of the individuals who are viaticating their life insurance policies and we strive to pay as much as we can. *Interview with Rhonda Bacci*, *supra* note 8.

³⁴ Peter Baez is an AIDS patient who viaticated his life insurance policy. He stated that since he sold his policy he has not thought about AIDS once. Additionally he said, "Most people that I know [who have viaticated life insurance policies] are living longer and happier. That is the bottom line: Happiness creates longevity." Ernest Sander, *AIDS Patient Cashes In and Lives On*, L.A. TIMES, May 22, 1994, at B4.

B. Disadvantages of Viatical Settlements

My conversations with those involved in the industry repeat one significant flaw of the viatical settlement industry. The potential problem is the advantage which may be taken of terminally ill individuals, often desperate for funds, viaticating their policies for too small a percentage of its face value. Adam Tillis has AIDS; he viaticated one of his life insurance policies in 1992.³⁵ The experience itself was onerous and he only received thirty cents on the dollar.³⁶ The experience lead Mr. Tillis to open the first viatical settlement company founded by a person with AIDS or human immunodeficiency virus ("HIV").³⁷ Some blame the problem of indecently low payouts on the lack of regulations, disclosure and licensing requirements by state and federal legislatures. Others attribute the problem to those who enter the industry because they see it as an easy way to make a quick buck.³⁸

Companies purchasing viatical settlements have experienced a very high return on investment, generally 15-20% although often much higher,³⁹ especially because the return is often received relatively soon after the initial investment is made.⁴⁰ Additionally, the risk is quite low and most viators die within the time expected by viatical firms.⁴¹ The moral and ethical implications of the high profitability of the industry are exacerbated in that the return is a result of the speculation on the death of others. This has led Reverend Patrick Norris, Associate Director of the Center for Health Care Ethics at St. Louis University to wonder, "Is there anything we won't do for money?"⁴²

However, many factors must be taken into account when determining the meaning of the return on investment received by the viatical industry or the picture seen will be skewed and unrealistic. When an investment scheme is novel and untested, investors will not be willing to provide funds unless a high yield is possible to compensate for the uncertainty caused by the increased risk

³⁵ Nelson, *supra* note 4, at 42.

³⁶ *Id.*

³⁷ *Id.*

³⁸ Interview with Michelle Saxty, *supra* note 16.

³⁹ Stephanie Forest, *A Ghoulish Debate Over Cashing In On Death: Should Buying Life Ins. Policies of the Terminally Ill Be Better Regulated?*, BUSINESS WEEK, Sept. 19, 1994, at 40.

⁴⁰ Average life expectancy of policies purchased by Viaticus is 25.6 months. However, Viaticus will make exceptions for individuals with special circumstances. Interview with Rhonda Bacci, *supra* note 8.

⁴¹ McCormack & Petersen, *supra* note 2, at 1348.

⁴² Forest, *supra* note 39, at 40.

of financial loss.⁴³ The calculations of the return on investment may also not take into account factors such as the cost of possible litigation by those contesting the viatical settlement, the possibility of a cure or an incorrect assessment of life expectancy in which case the viatical settlement company must continue to pay the life insurance premiums until the actual death of the viator, unexpected fluctuations in interest rates, the possibility of the changes in the laws affecting this new industry, the soundness and quality of the issuer insurance company, and a multitude of other factors in this emerging and controversial new industry.⁴⁴

The lack of regulation in the field has left vast areas where actions lead to unknown consequences, creating an environment of instability for buyers, sellers and brokers of viatical settlements. These areas include the possibility that viatical settlements may be classified as securities, requiring adherence to the disclosure and other requirements of the Securities and Exchange Commission and state securities authorities.⁴⁵ The question is whether or not the proceeds are taxable as income, as compared to life insurance proceeds received "by reason of death of the insured," which are not taxable under the Internal Revenue Code.⁴⁶ Further confusion in the area is a result of questions regarding whether or not an individual may continue to receive money from need based public assistance programs after viaticating his life insurance policy.⁴⁷

Life insurance is generally purchased to provide for beneficiaries, to supplement retirement income, education expenses, and funeral expenses of the insured and his loved ones. When these funds are diverted and spent by the named individual on the policy, the beneficiaries are left without the benefit and stability the funds were purchased to ensure. This problem may be, but by no means always is, ameliorated because presently, many viators are homosexual men not leaving behind a wife and children who are dependent on the funds for their sustenance. The problem will be exacerbated as the conditions which will be sufficient for viatication of a life insurance policy expands to include a wider variety of diseases and very old individuals without a specific ailment. This change in the structure of the viatical settlement industry will have the effect of exposing more needy beneficiaries to an

⁴³ See Peggy S. Wallace, *In Defense of Viatical Settlements*, NAT'L UNDERWRITER, LIFE & HEALTH/FINANCIAL SERVICES EDITION, Nov. 9, 1992, at 51.

⁴⁴ See Sander, *supra* note 3, at B4.

⁴⁵ See *infra* notes 186-194.

⁴⁶ I.R.C. § 101(a)(1).

⁴⁷ Thomas McCormack, Nat'l Assoc. of People with AIDS, *How to Get and Sell Life Ins.*

existence without the life insurance proceeds which had arguably been purchased for their well-being.

Funds received through a viatical settlement may be subject to a lien imposed by creditors.⁴⁸ If the individual must declare bankruptcy (and forty percent of AIDS patients are forced into bankruptcy prior to death),⁴⁹ creditors can claim income if it is received within one-hundred and eighty days of bankruptcy discharge, or if settlement is made during or before bankruptcy proceedings.⁵⁰ However, the insured may not be forced by creditors, a trustee in bankruptcy, or a bankruptcy court to viaticate his policy.⁵¹ Additionally, government agencies cannot force an individual to viaticate his life insurance policy in order to apply for, obtain, or keep government assistance.⁵²

Even with the expedited processing of the application, it generally takes approximately two months for the viator to receive his funds.⁵³ Considering the monetary situation which normally precipitates the choice to viaticate a policy and the pressure felt by the insured due to his impending death, the two-month period will often seem too long and an insurmountable obstacle. Luckily, however, the viatical settlement companies, aware of the financial plight of viators, appear to be dramatically speeding up the application process to alleviate some of the problems facing the terminally ill.⁵⁴

IV. ALTERNATIVES TO VIATICATING ONE'S LIFE INSURANCE POLICY

There are many alternatives available to a terminally ill individual as opposed to viaticating a life insurance policy. The individual could spend other assets, borrow money, borrow against the life insurance policy, or accelerate the death benefit, if allowed under the particular life insurance policy. In terms of payout on face value received, tax and government assistance consequences, and money for the well being of beneficiaries after viators death, viatication is

⁴⁸ *Id.*

⁴⁹ Nelson, *supra* note 4, at 42.

⁵⁰ McCormack, *supra* note 47.

⁵¹ The Prudential, *Living Needs Benefits: Get the Most Out of Your Life Ins.* (1994) [hereinafter *Get the Most Out of Your Life Ins.*].

⁵² *Id.*

⁵³ National Viator Representatives, Inc., claim four to six weeks is average length for proceed disbursement. *Twelve Questions*, *supra* note 7. *But see* The average period from first contact to receipt of proceeds is three to four months. McCormack & Petersen, *supra* note 2, at 1349.

⁵⁴ *See 12 Questions*, *supra* note 7.

usually the worst alternative. This information, along with possible alternatives to viaticating a life insurance policy is widely disseminated in literature available for terminally ill individuals needing to gain access to their life insurance proceeds. This information is also stated in the disclosure information attached to most viatical settlement applications.⁵⁵

A. Spending Savings, Mortgaging Property & Borrowing Money

Viaticating one's life insurance policy is the most common way of obtaining money from one's life insurance prior to death.⁵⁶ However, it offers the lowest payment as a percentage of face value on the life insurance policy of the insured. As the only benefit the viator receives from the transaction is cash, viaticating the life insurance policy is the worst way for an insured person to access his life insurance proceeds prior to death.⁵⁷ Additionally, if the insured chooses to viaticate his policy he will, as the law exists today, be subject to tax on the proceeds as income, may be subject to liens held by creditors,⁵⁸ and may lose government benefits that are based on need.⁵⁹ In California⁶⁰ and New York,⁶¹ the individual will not be subject to state income tax. However, state income tax is quite small in comparison to federal income tax.

Those advising the terminally ill recommend several options over viatical settlements.⁶² These alternatives include tax-free options such as borrowing money from family and friends, spending savings, mortgaging property, borrowing against cash accumulated in the life insurance policy, and borrowing money using the policy as collateral.⁶³ These alternatives also have the advantage of leaving a portion of the funds for the beneficiaries, generally the

⁵⁵ *Viatical Disclosure Statement*, Viatical Settlement Application (Viaticus, Chicago, Ill.), Oct. 1994 [hereinafter *Disclosure Statement*].

⁵⁶ McCormack, *supra* note 47.

⁵⁷ See Petersen, *supra* note 9.

⁵⁸ McCormack, *supra* note 47.

⁵⁹ *Id.*

⁶⁰ Cal. Rev. & Tax. Code § 17131.5 (West 1991).

⁶¹ N.Y. Tax Law § 612 (Consol. 1994).

⁶² See generally, McCormack, *supra* note 47; see also *Disclosure Statement*, *supra* note 55; Telephone Interview with David Landay, President of *National Viators Representatives* (Feb. 8, 1995).

⁶³ If possible, the insured in need of funds should attempt to borrow against the policy as this can generally be done at a low interest rate and will not be subject to income tax nor will it be used when determining eligibility for federal need based programs. Albert E. Crenshaw, *Fatally Ill Should Be Wary On Sale of Death Benefits; Experts Warn Scams, Suggest Checking Other Options*, WASH. POST, Aug. 23, 1992, at H3. McCormack & Petersen, *supra* note 2, at 1350.

expected recipient at the time of purchase. In situations where family and friends are unable to provide cash for the insured but have equity in their home, the family or friends may be able to procure a federally insured reverse mortgage on their home with no monthly payments.⁶⁴ The insured would assign the family or friend the policy, thereby avoiding income tax and payments to viatical settlement companies.⁶⁵

The individual may also attempt to purchase additional life insurance to help supplement the death benefit which would have gone to the beneficiary. Although difficult, even an HIV positive individual may be able to purchase life insurance under limited circumstances.⁶⁶

In many situations these suggested alternatives, although offering a better return on investment, are not realistic because the insured either does not have access to these funds, or because the funds do not exist. In the case of a person who does not, or chooses not to, access the death benefit of his life insurance policy, the individual may live on private health insurance, if available, on assistance provided by the government, or on private charities.

B. Accelerated Death Benefits

Many insurance companies⁶⁷ have begun offering an accelerated death benefit option on all or a portion their new policies and may also provide riders for old policies.⁶⁸ Often the accelerated death benefit rider will be added to the

⁶⁴ McCormack, *supra* note 47.

⁶⁵ *Id.*

⁶⁶ *See id.*

⁶⁷ According to a 1994 survey by the American Council of Life Insurance and the Life Insurance Marketing and Research Association approximately 215 traditional life insurers representing 70% of the life insurance in-force in this country offer accelerated death benefits on some of their policies. However, the rider is included in only eighteen million policies or approximately one-half of one-percent of all life insurance policies. This is up from 113 companies and approximately three million clients with an accelerated death benefits option in 1991. *See Armstrong, supra* note 6, at 36. There has been a sixteen fold increase since 1991 in the number of policyholders with some type of accelerated death benefit option. *ACLI Supports Accelerated-Death Benefit Bills*, NAT'L UNDERWRITER, LIFE & HEALTH/FINANCIAL SERVICES EDITION, Jan. 30, 1995, at 4 [hereinafter *ACLI Supports Accelerated Death Benefit Bills*].

I have used Prudential Insurance Company's ("Prudential") accelerated death benefit rider as a representative of the accelerated death benefits being offered by the insurance industry. Prudential was the first major United States insurance company to offer accelerated death benefits and has paid the greatest number of claims, over 680 amounting to over \$55 million. The average payment is \$80,000. About half have been to cancer patients, 27% to AIDS patients and the remainder to patients with heart ailments. *Armstrong, supra* note 6, at 36; *Quint, supra* note 11, at D3.

⁶⁸ Prudential requires a cumulative face value of \$50,000 on all life insurance policies held by Prudential to be eligible for an accelerated death benefit and a cumulative amount of \$25,000 face value if

policy at no cost to the insured and no fees will be charged until the benefit is paid.⁶⁹ The American Council of Life Insurers' Executive Vice-President of Federal Affairs, Daniel Mica, believes that the number of insurance companies offering accelerated death benefit options will rise as soon as the confusion surrounding the income tax implications are settled.⁷⁰

If the policy holder's life insurance company provides an accelerated death benefit, the insured may accelerate part or all of the face value of his death benefit prior to actually dying.⁷¹ If the insured chooses to receive only part of the death benefit available, he must continue to pay an adjusted premium to keep his life insurance policy in-force.⁷² Upon the death of the insured, his beneficiaries will receive the death benefit reduced by the amount of the accelerated benefit previously paid.⁷³ The insured may choose to receive the funds either in a lump sum or on a monthly basis.⁷⁴ The funds will be made available to the insured at a much lower cost through an accelerated death benefit than would be possible through a viatical settlement.⁷⁵ The funds will be made available on a certification by a medical professional that the insured will die within six months or one year or other possible "trigger." Insurance companies can generally construct the accelerated death benefit to include one or more of four "triggers" which consist of: (1) terminal illness;⁷⁶ (2) the diagnosis of a "dread disease;"⁷⁷ (3) the need for long-term care in a nursing home, home health care or the inability to perform certain activities for daily living;⁷⁸ or (4) permanent confinement to a long-term home with expectation

the insured is over fifty-five years of age. Telephone Interview with Michael Grabarkiewicz, Insurance agent with Prudential Ins. Co. (Feb. 8, 1995) [hereinafter *Interview with Michael Grabarkiewicz*].

⁶⁹ Prudential does not charge for the rider on the policy, however, a discount for early payment is applied and a processing fee of \$150 is deducted. The Prudential, *Living Needs Benefits: We're There When You Need Us Most* (1994) [hereinafter *We're There When You Need Us Most*]. Armstrong, *supra* note 6, at 36.

⁷⁰ See *Tax Break*, *supra* note 21, at 3.

⁷¹ *Get the Most Out of Your Life Ins.*, *supra* note 51.

⁷² *Id.*

⁷³ *Id.*

⁷⁴ *Id.*

⁷⁵ See *infra* note 79 stating Prudential's various payouts on its accelerated death benefit options as compared to the payments made by Viaticus for its viatical settlements, *supra* note 8.

⁷⁶ Diagnosis of a disease with a reasonable expectation of death within specific time period, usually six to twenty-four months. Kathryn Sullivan & Joann Canning, *Life Benefits From Insurance May Be Taxable*, 49 TAX'N FOR ACCT. 38 (1992).

⁷⁷ Insurance usually list specific disease such as cancer, stroke, severe heart or kidney disease, Alzheimer's or the need for a major organ transplant. *Id.*

⁷⁸ Activities include eating, dressing, transferring, etc. *Id.*

of permanence.⁷⁹ The insured need not, however, use the money for the care of the situation which satisfied the particular "trigger."⁸⁰

To insure that policy holders receive adequate information for informed decision making and for the legal protection of the insurance companies, the insurance companies make disclosures to their policy holders regarding possible repercussions from the use of the accelerated death benefit.⁸¹ These disclosures generally include: a statement that the accelerated death benefit is not intended or designed to replace health or long-term care insurance, that some of the payments may be subject to income tax, the possibility of outliving the periodic payments or the death benefit accelerated by the insured, and the possibility of affecting the insured's ability to receive governmental aid and entitlements.⁸² Additionally, although not giving financial or legal advice, the insurance companies may suggest that professional advice from financial planners and lawyers is necessary to reach a competent decision.⁸³ Finally, the insurance companies suggest, according to their present interpretation of the law, that the insured may not be required by a governmental agency, creditor, trustee in bankruptcy or bankruptcy court to access his accelerated death benefit.⁸⁴

The accelerated death benefit has the advantage that the policy holder will normally receive a higher percentage of the face value of his policy as compared to a viatical settlement. In addition, under the proposed legislation by the Internal Revenue Service ("IRS") and Congress, it appears very likely that the definition of a death benefit under the Internal Revenue Code⁸⁵ will be

⁷⁹ See *id.* Prudential will pay up to 70-80% of face value on its "Nursing Home Option." The insured must be in the nursing home for at least six months and furnish evidence, usually documentation from a qualified physician is sufficient although, Prudential reserves the right to investigate further. Prudential will pay up to 90-95% for its "Terminal Illness Option" again, normally requiring only documentation from a qualified physician with a reserved right for Prudential to investigate further. The documentation must state that the life expectancy of the insured is six months or less. This option is usually available if the insured requires a vital organ transplant. *Get the Most Out of Your Life Ins.*, *supra* note 51.

⁸⁰ Prudential allows the funds to "... be used for any expenses—mortgage payments, medical bills, etc.—or to maintain or improve your standard of living during a difficult time." *We're There When You Need Us Most*, *supra* note 69.

⁸¹ *Get the Most Out of Your Life Ins.*, *supra* note 51. *Interview with Michael Grabarkiewicz*, *supra* note 68.

⁸² *Get the Most Out of Your Life Ins.*, *supra* note 51.

⁸³ *Id.*

⁸⁴ *Id.*

⁸⁵ I.R.C. § 101.

expanded to include certain accelerated death benefits in the tax-free treatment afforded death benefits.⁸⁶

The major disadvantage of an accelerated death benefit is it is not available to broad classes of people, for example, those who are terminally ill with more than six months or a year to live, those without an accelerated death benefit clause in their policy, or a person with AIDS (not considered a "dread disease") unless he meets the requirement of another "trigger."⁸⁷ Individuals in these groups form a significant portion of the viatical settlement market. Furthermore, in the case of an individual with a longer life expectancy, the potential to increase the quality of life with the proceeds of the life insurance policy is greater, especially because the individual is probably in better health and better able to enjoy the money or seek beneficial medical treatment. Additionally, the viatical settlement can potentially serve a broader spectrum of people as they are not limited to the "triggers" of the accelerated death benefit option.⁸⁸ Overall, accelerated death benefits pay a higher percentage of face value, but viatical settlements provide significantly greater flexibility.

V. RECENT & PROPOSED LEGISLATION

The viatical settlement industry has grown exponentially since its origin in 1989 and regulation is now beginning to permeate all aspects of the business. Overall, the viatical settlement industry accepts that legislation is necessary and many encourage it.⁸⁹ Many in the industry believe an increase in legislation

⁸⁶ Prop. Treas. Reg. § 1.7702-2(d)(1) defines a qualified accelerated death benefit as a benefit paid prior to death if by contract the benefit is only payable if the insured is "terminally ill." Prop. Treas. Reg. § 1.7702-2(e) defines terminal illness as an illness or physical condition that is reasonably expected to result in death within twelve months of payment of the accelerated death benefit despite treatment. If one interprets the preceding proposed regulation together with I.R.C. § 101(a)(1) and concentrates on the clause "by reason of" rather than the word "death" one can reasonably interpret that the benefit is a death benefit, admittedly accelerated, and that benefit is being paid by reason of the death of the insured, and therefore, should be exempt from federal income tax. Blake, *supra* note 16, at 156. The Contract With America Tax Relief Act of 1995, H.R. 1215, 104th Cong., 1st Sess. (1995), has been approved by the House Ways and Means Committee and would make proceeds paid under a life insurance contract tax-free if the individual was terminally ill or chronically ill. *House Ways and Means Committee Chairman Bill Archer (R-Texas) Chairman's Mark For "Contract With America Tax Relief Act of 1995," Scheduled for Markup Beginning Mar. 13, 1995*, DAILY REPORT FOR EXECUTIVES, Mar. 10, 1995, at 47.

⁸⁷ *Interview with Michelle Saxty, supra* note 16. *See supra* note 77.

⁸⁸ One of the most serious problems with accelerated death benefits is that AIDS is not a specified "dread disease." *Interview with Michelle Saxty, supra* note 16. *See supra* note 77.

⁸⁹ John R. Banks, President of Viaticus stated, "If this industry is going to mature, it has to accept regulation that helps make sure things are handled in the right manner. We are dealing with sick people who

will increase overall profitability and credibility of the industry.⁹⁰ Steve Simon, Chairman and Chief Executive Officer of CAPX Corp., the largest viatical settlement company in the United States, stated that regulation will, "...cause a shakeout of poorly run and capitalized companies."⁹¹

The NAIC has recently adopted the Model Act,⁹² and several states have passed legislation while several other states have legislation pending. Increased state legislation is expected now that the Model Act has been adopted. Congress and the IRS are examining the possibility of making accelerated death benefits and, possibly viatical settlement proceeds, income tax-free in the future. In March 1995, House Ways and Means Committee Chairman, Bill Archer (R-Texas), modified the Senior Citizens' Equity Act to include tax-free treatment for certain accelerated death benefits and viatical settlements; the previous draft provided favorable tax treatment only for certain accelerated death benefits.⁹³ The bill was approved by the House Ways and Means Committee and favorably reported to the House floor.⁹⁴ However, the new bill is much larger, more complicated and more politically controversial than the Senior Citizens' Equity Act, decreasing its overall possibility of approval. Additionally, litigation is pending against a viatical settlement firm and its president alleging trading in violation of federal securities law.

are selling what may be their most significant asset." Quint, *supra* note 11, at D3; State Representative, Glen Maxey (D - Austin), has introduced a bill in Texas regulating the viatical settlement industry, he states that he has spoken to numerous people involved in the industry and they are completely supportive of the proposed legislation; they understand that the entire industry may be permanently damaged by the media if the young industry, which is prone to abuse, is in fact abused by the unscrupulous. Daryl Janes, *Lawmaker Wants Early Death Benefits Regulated*, AUSTIN BUS. J., Feb. 3, 1995, at 5. But Brian D. Pardo, President of Life Partners, Inc., and President of the National Viatical Association, believes that the industry can police itself and that attempts to regulate the market are an attempt by the insurance industry to avoid losing a portion of the approximately three billion dollars per year they earn when the insured allow their life insurance policies to lapse, sometimes after decades of premium payments. Quint, *supra* note 11, at D3. However, Michael Grabarkiewicz, insurance agent, stated that in his opinion viatical settlements companies effectively take advantage of AIDS patients and pay too low of a return. He did admit, however, that some people would be uncovered if forced to rely on the accelerated death benefit available through insurance carriers. *Interview with Michael Grabarkiewicz*, *supra* note 68.

⁹⁰ Jim Connolly, *Viatical Companies Seem Ready to Embrace Regulation*, NAT'L UNDERWRITER, LIFE & HEALTH/FINANCIAL SERVICES EDITION, Nov. 28, 1994, at 21.

⁹¹ *Id.*

⁹² See discussion *infra* part V.A.

⁹³ The first draft was the Senior Citizens' Equity Act, H.R. 8, 104th Cong., 1st Sess. (1995), which is now included in the Contract With America Tax Relief Act of 1995, H.R. 1215, 104th Cong., 1st Sess. (1995).

⁹⁴ A.B. Stoddard, *Markup: House Committee Approves Tax Revision Legislation*, STATES NEWS SERVICE, Mar. 14, 1995.

A. *National Association of Insurance Commissioners' Viatical Settlement Model Act and Viatical Settlement Model Regulations*

The Model Act and the Viatical Settlement Model Regulations were drafted and finally approved by the NAIC in September 1993, and June 1994, respectively. The Model Act provides states with a comprehensive legislation scheme that may be used as a blueprint when creating their own legislation. Among the provisions of the Model Act are licensing requirements and reasons for license revocation, reporting requirements, disclosure requirements, minimum returns viators must receive for their policies, advertising restrictions, and other general rules.

According to Carolyn Johnson, Senior Counsel and Models Law Coordinator for the NAIC, the NAIC's goal in formulating the Model Act was to provide a level of protection for consumers which did not currently exist.⁹⁵ The scope of the legislation is extremely broad, to avoid inadvertently harming the young industry while bringing the wide variety of viatical settlement options within the auspices of the Model Act.⁹⁶

The Model Act gives the authority to regulate viatical settlement providers and brokers to the chief insurance regulator of the state (the "commissioner").⁹⁷ The Model Act provides that no person or corporation may act as a viatical settlement provider without first obtaining a license from the commissioner that is renewed yearly.⁹⁸ The applicant must pay a licensing fee, submit a detailed plan of operation, be "competent and trustworthy," intend to act in good faith, and have experience and a good business reputation.⁹⁹ In the absence of a written agreement, the broker will be presumed to be an agent of the viatical settlement provider.¹⁰⁰ The commissioner is given broad discretion in evaluating license applications and renewals,¹⁰¹ approving of contract forms,¹⁰² establishing standards for evaluating reasonableness of payments,¹⁰³ requiring

⁹⁵ Telephone Interview with Carolyn Johnson, Senior Counsel of the *Nat'l Assoc. of Ins. Commissioners* (Mar. 6, 1995)[hereinafter *Interview with Carolyn Johnson*].

⁹⁶ *Id.*

⁹⁷ Viatical Settlement Model Act § 3 (1994). Viatical Settlement Model Regulation §§ 1, 2 (1994).

⁹⁸ Viatical Settlement Model Act § 3 (1994).

⁹⁹ *Id.*

¹⁰⁰ Viatical Settlement Model Regulation § 2 (1994).

¹⁰¹ Viatical Settlement Model Act § 3 (1994).

¹⁰² Viatical Settlement Model Act § 5 (1994).

¹⁰³ Viatical Settlement Model Act § 10 (1994).

a surety bond,¹⁰⁴ and determining licensing fees.¹⁰⁵ The commissioner may also demand a list of all shareholders, partners, officers and employees, and deny a license if he believes the individual does not meet the standards set forth in the Model Act and is in a position to materially alter the applicants conduct.¹⁰⁶ The commissioner may suspend, revoke or refuse to renew a license if the applicant misrepresented himself in his application, is found guilty of fraudulent or dishonest practices or is otherwise untrustworthy or incompetent in his capacity as a viatical settlement provider, has a pattern of unreasonable payments, is convicted of felony or misdemeanor involving fraud, or has otherwise violated the Model Act.¹⁰⁷ The Model Act also sets out disclosure requirements for viatical settlement firms including possible alternatives to viaticating the policy, possible tax implications and the need to seek advice from a tax advisor, the possibility of successful claims by creditors, possible effect on public assistance and the need to seek advice from the appropriate governmental agencies, the right of the viator to rescind the contract within the lesser of sixty days of execution of the contract or fifteen days of receipt of proceeds, the date the funds will be available, and the source of the funds.¹⁰⁸ The Model Act also provides that a doctor must submit a written statement that the viator is of sound mind and not under undue influence.¹⁰⁹ The viator must submit a witnessed document that he understands the process and is entering the contract voluntarily.¹¹⁰ The medical records submitted by the viator to the viatical settlement provider are subject to the confidentiality rule for medical records in the state.¹¹¹ There is a requirement that an approved escrow agent or trustee holds the funds as soon as the insurance company acknowledges that the policy has been transferred to the viatical settlement provider.¹¹² The regulations also provide specific requirements on who may not receive a finders fee,¹¹³ how

¹⁰⁴ *Id.* Viatical Settlement Model Regulation § 1 (1994).

¹⁰⁵ Viatical Settlement Model Act § 10 (1994).

¹⁰⁶ Viatical Settlement Model Act § 3 (1994).

¹⁰⁷ Viatical Settlement Model Act § 4 (1994). Viatical Settlement Model Regulation §§ 2, 3 (1994).

¹⁰⁸ Viatical Settlement Model Act § 8 (1994).

¹⁰⁹ Viatical Settlement Model Act § 9 (1994).

¹¹⁰ *Id.*

¹¹¹ *Id.*

¹¹² *Id.*

¹¹³ Viator's physician, attorney, accountant or agent in his settlement may not receive any compensation, finders fee or commission from the viatical settlement provider or broker. Viatical Settlement Model Regulation § 6 (1994).

often a viator may be contacted regarding his health status,¹¹⁴ and advertising standards.¹¹⁵

The NAIC is aware that as a result of the industry's short life it lacks sufficient information to create a Model Act which will not need adjustment.¹¹⁶ The regulation accompanying the Model Act requires filing of annual reports so the Model Act can be made more accurate, reasonable and provide better protection for consumers.¹¹⁷

Although some members of the viatical industry were not helpful to the NAIC in terms of input, many representatives of the viatical industry were involved in the creation of the Model Act.¹¹⁸ However, none of the viatical firms were actually involved in the drafting of the Model Act.¹¹⁹

Many in the industry, including the National Viatical Association ("NVA"), would prefer to regulate themselves. In fact, any company that chooses to be a member of the NVA must be in compliance with NVA's "Code of Ethics" and "Standard Business Practices."¹²⁰ These standards are quite similar to the regulations promulgated by the NAIC in the Model Act, except principally, under the Model Act the commissioner is the overseer and can use state machinery to compel compliance, as opposed to the NVA's codes where compliance is necessary for membership in the NVA but not for transacting business within the state.¹²¹ The Associate Director of the NVA, Michelle Saxty, stated that if regulation is inevitable, the viatical settlement industry

¹¹⁴ Every three months if life expectancy is over one year, and once per month if life expectancy is less than one year. Model Reg. *supra* note 113.

¹¹⁵ Advertising must not be misleading by fact or implication and if speed of payment is promoted, advertisement must disclose average time from application to offer and offer to payment. If high payments are promoted, disclosure of average payment as percentage of face value for the last six months must be disclosed. Model Reg. *supra* note 113.

¹¹⁶ Reporting requirements include date contract formed, life expectancy, face value of policy, amount paid by viatical settlement provider and if the viator died, date of death and fees paid by the firm to keep policy in-force for each viatical settlement. Additionally, the viatical firm must provide the number of applications received, accepted and rejected by disease, policies viaticated by issuer and policy type, number of primary and secondary market transactions, portfolio size and amount of outside borrowing. Viatical Settlement Model Regulation § 5 (1994). *Interview with Carolyn Johnson, supra* note 95.

¹¹⁷ Viatical Settlement Model Regulation § 6 (1994).

¹¹⁸ *Id.* Viaticus worked closely with NAIC to develop the Model Act. "We truly believe that a responsible regulation of this industry is in the long-term best interest of viators, their family and our business." *Broker Opportunities, supra* note 9, at 4.

¹¹⁹ *Interview with Carolyn Johnson, supra* note 95.

¹²⁰ Nat'l Viatical Ass'n, *Viatical Settlements* (1995) [hereinafter *Viatical Settlements*].

¹²¹ See generally Viatical Settlement Model Act §4 (1994); Viatical Settlement Model Regulation §§ 2, 3 (1994); *Viatical Settlements, supra* note 120.

should have a much stronger input.¹²² The NVA is concerned that now that the viatical settlement industry has grown the insurance companies will attempt to protect themselves from the new competition.¹²³ The animosity between the insurance and viatical industries is accentuated because the insurance industry stands to lose part of the approximately three billion dollar windfall in lapsed policies they earned last year.¹²⁴ This windfall came at the expense, at least partially, of terminally ill individuals who were unable to afford their premium payments.¹²⁵ Additionally, Ms. Saxty stressed that the problems in the industry have been minimal,¹²⁶ the NVA has covered the losses and reported a Clearwater, Florida viatical firm, Credit Life Corp., that behaved improperly and collapsed financially to state insurance commissioner,¹²⁷ and the requirements of most recent legislation had previously been adopted by viatical settlement companies on their own prerogative prior to the enactment of the legislation.¹²⁸ Finally, the NVA is concerned that the insurance industry is attempting to burden the viatical settlement industry to such an extent that the viatical settlement industry might disappear whereupon the insurance companies may choose to discontinue their accelerated death benefit programs.¹²⁹

Some commentators are also apprehensive that the Model Act's licensing and reporting requirements are too burdensome and will dissuade the small investor from entering the marketplace which will consequently deflate prices

¹²² Interview with Michelle Saxty, *supra* note 16.

¹²³ *Id.*

¹²⁴ *Id.* Pardo, *supra* note 29, at A14.

¹²⁵ Interview with Michelle Saxty, *supra* note 16. Pardo, *supra* note 29, at A14.

¹²⁶ As of April 1991 no complaints had been received by any state insurance agency or AIDS association. McCormack & Petersen, *supra* note 2, at 1349. *But see* Pending case against Legacy Benefits Corp. involving allegations of fraud in the viatical settlement of a policy. The policy was purchased from an AIDS patient for \$420,000; the face value of the policy was \$700,000 and Legacy Benefits Corp. was simultaneously negotiating for immediate resale for \$518,000. Certain industry members claim that this type of whistle-blowing exemplifies the ability of the business to police itself. *An Official Says Industry can Police Policy Buying*, N.Y. Times, Nov. 14, 1994, at D2. *See also* Case pending in Pennsylvania regarding alleged undue influence by viatical settlement firm, Living Benefits, Inc., in its purchase of AIDS patient's life insurance policy for 67% of face value. Estate of the AIDS patient claims patient was suffering from AIDS dementia at the time of the sale. Shannon Duffy, *Lawsuit Filed Over Viatical Deal; Complaint Alleges AIDS Dementia Prompted Man to Sell Life Policy*, The Legal Intelligencer, Apr. 21, 1994, at 13.

¹²⁷ A Kiplinger's Report, *How to Unlock Ins. for the Terminally Ill*, THE TAMPA TRIBUNE, Feb. 16, 1995, at 7.

¹²⁸ Interview with Michelle Saxty, *supra* note 16.

¹²⁹ *Id.* The regulations of the NAIC are so burdensome that viatical settlement companies will not be able to exist in states where their regulations are adopted. *Viatical Settlements*, *supra* note 119.

offered to consumers.¹³⁰ The Model Act attempts to alleviate this problem by providing an exception from all requirements of the Model Act for any natural person who purchases only one policy per calendar year.¹³¹ For the small investor who does not meet the requirements of the exception of the Model Act, purchases more than one policy per calendar year or is a non-natural person, the reasonableness of the licensing fee will depend on the state,¹³² and the reporting requirements should be very manageable if very few policies are purchased.

The NVA has a legitimate concern that the insurance companies will lobby for regulation that will be unduly burdensome or artificially disadvantageous to the viatical settlement industry. However, their argument that the Model Act will force viatical settlement firms out of any state which adopts it is disingenuous.¹³³ First, the NVA's "Code of Ethics" and "Standard Business Practices" are similar to the requirements of the Model Act.¹³⁴ Second, legislation similar to the Model Act presently exists in states such as New York and California, and numerous viatical settlement firms are licensed and prospering under the regulation.¹³⁵ Third, the licensing fees, although determined by the individual states, are not prohibitively high.¹³⁶ Fourth, reporting requirements are not particularly onerous in that the requested information is probably normally compiled as part of internal recording and accounting procedures.¹³⁷ Fifth, the advantages of a model act create an environment of regularity across the different states making compliance with each additional state's regulations minimally burdensome. Finally, as of February 13, 1995, the NVA recommended a total of only fifteen member companies as being in good standing.¹³⁸ In an industry of over fifty firms, the NVA's regulation just does not appear to be pervasive or comprehensive enough, by itself, to provide significant protection to consumers, and remove the need for government regulation.

¹³⁰ 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 (1994).

¹³¹ Viatical Settlement Model Act § 2 (1994).

¹³² See *infra* note 135.

¹³³ See *supra* note 129.

¹³⁴ See *supra* note 120.

¹³⁵ New York and California actually have the highest number of viatical settlements. *Joint Statement*, *supra* note 22.

¹³⁶ For example, New York's licensing fee is \$2,500 with a \$1,000 annual renewal fee (N.Y. Ins. Law § 7802 (McKinney 1994)), California's licensing fee is \$2,833 with a \$177 annual renewal fee (Cal. Ins. Code § 10113.2 (West 1993)), and Vermont's licensing fee is \$50 (Vt. Stat. Ann. tit. 8, § 3827 (1994)).

¹³⁷ See *supra* note 115.

¹³⁸ Nat'l Viatical Ass'n, *Member Companies (In Good Standing)* (1995).

Ms. Saxty of the NVA also claims that selling a life insurance policy is analogous to the sale of a car or home, and therefore should not be burdened by significant legislation.¹³⁹ For example, a used car salesman's profits are not regulated by law.¹⁴⁰ Additionally, the legislation has been called inappropriate, paternalistic, and inhibiting of the general preference in this country for free alienation of personal property, solely because the seller is terminally ill.¹⁴¹ However, public policy considerations in light of the great strain of the situation, the magnitude of the consequences, the possibility of incompetency of the insured, and the reasonableness of the legislation, suggests that the regulation can be used to enhance protection of the consumer without unduly burdening the industry.

The NAIC used available industry averages to determine minimum payouts for viaticating policies.¹⁴² It should be noted that, presently, no state legislation prescribes minimum payout guidelines as does the NAIC. The NAIC guidelines mandate that for individuals with less than six months to live, 80% of the face value must be paid; 70% for those expected to live six months to one year; 65% for those expected to live one year to eighteen months; 60% for those expected to live eighteen months to two years; and 50% for those expected to live over two years.¹⁴³ The formula may be decreased by five percent for insurance companies with lower ratings.¹⁴⁴ The NAIC is aware that these numbers may need to be altered as doctors and actuaries become more proficient at predicting life expectancy.¹⁴⁵ However, commentators and industry spokespeople are concerned that the minimum price guidelines will hurt the consumer by decreasing flexibility¹⁴⁶ and effectively lowering viatical settlement prices offered industry-wide, as prices begin to settle around the

¹³⁹ Interview with Michelle Saxty, *supra* note 16.

¹⁴⁰ *Id.*

¹⁴¹ Berner, *supra* note 130, at 581.

¹⁴² Interview with Carolyn Johnson, *supra* note 95.

¹⁴³ Viatical Settlement Model Regulation ¶ 4 (1994).

¹⁴⁴ *Id.*

¹⁴⁵ Interview with Carolyn Johnson, *supra* note 95. Doctors are getting much more accurate at assessing life expectancy by T-Cell counts in AIDS patients. Interview with Michelle Saxty, *supra* note 16.

¹⁴⁶ The biggest problems with that NAIC guidelines is that it makes it financially very difficult to offer settlement to individuals with life expectancies beyond three years and does not allow offers of settlement to individuals with special circumstances. For example, a policy with a \$274,000 face value and a \$65,000 yearly premium would be impossible to viaticate under the NAIC minimum guidelines for a person with a three-year life expectancy, i.e., the premium that would need to be paid by Viaticus and the viaticum given to the policy holder would greatly exceed the face value of the policy. However, the guidelines are reasonable for normal situations and Viaticus actually normally pays more than the NAIC minimums. Interview with Rhonda Bacci, *supra* note 8.

minimum guidelines prescribed by statute.¹⁴⁷ There is also a fear that minimum prices will prevent viatical settlement companies from being able to offer settlements to those with longer life expectancies.¹⁴⁸ However, minimum prices are now at or above NAIC guidelines, without legislatively prescribed minimums, making the projected effect less significant than feared by opponents.

B. State Law

Fewer than ten states have adopted viatical settlement legislation with legislation pending in eight other states.¹⁴⁹ However, now that the Model Act has been approved by the NAIC and the Contract With America Tax Relief Act of 1995¹⁵⁰ has been approved by the House Ways and Means Committee, more states will probably enact their own legislation.

New York and California have the most comprehensive regulations and licensing requirements and the highest number of viatical settlements.¹⁵¹ Both schemes are similar to the Model Act. California, in January 1992, was the first state to require licensing for viatical settlement firms.¹⁵² The California act requires specific disclosures, submission of a detailed operating plan to the insurance commissioner, a financial status report, experience in the field, and methods for obtaining medical information to insure strict confidentiality for the patient's medical records.¹⁵³

The New York law also requires licensing, specific disclosures (including brokers' commissions and life expectancy assumptions), use of escrow or trust accounts, allowance of recession after fifteen days of receipt of funds, and a proscription against creditors, state public assistance and judgment debtors from forcing an insured individual to viaticate a life insurance policy.¹⁵⁴

¹⁴⁷ See generally Berner, *supra* note 130, at 581; *Interview with Michelle Saxty, supra* note 16. But see Ms. Bacci of Viaticus believed that there is too much competition in the market for prices to decrease, for example, Viaticus has lost policies for \$100. *Interview with Rhonda Bacci, supra* note 8.

¹⁴⁸ Dean, *supra* note 19, at 117.

¹⁴⁹ See *supra* note 15.

¹⁵⁰ H.R. 1215, 104th Cong., 1st Sess. § 221 (1995).

¹⁵¹ *Joint Statement, supra* note 22.

¹⁵² Alfred Haggerty, *Cal. Licenses First Three Viatical Settlement Firms*, NAT'L UNDERWRITER, LIFE & HEALTH/FINANCIAL SERVICES EDITION, Apr. 20, 1993, at 13.

¹⁵³ Howard Saks, *Viatical Settlement Companies Licensed*, 21 Est. Plan. 186 (1994). Cal. Ins. Code §§ 10113.1, 10113.2, 11022 (West 1993).

¹⁵⁴ For excellent explanation of New York statutes, see Carole Lamson, *Legal Introduction in Living Benefits in Life Ins.: Perspectives and Developments*, 65 N.Y. St. B.A. 16 (1993). See also N.Y. CPLR Law

Despite the strict requirements of the New York and California legislation, as of November 1993, thirteen companies had received licenses to transact business in New York,¹⁵⁵ as of August 1994, approximately twenty companies had requested licenses in New York,¹⁵⁶ and as of April 1993, three licenses were received and thirteen others were being processed by the state insurance commissioner of California.¹⁵⁷

Other states, such as Texas, have viatical settlement regulations which are much less comprehensive than the laws of New York or California. The Texas statute merely defines a viatical settlement and gives exclusive jurisdiction, except if covered under securities law, to the state insurance board.¹⁵⁸ Presently, the only two states which collect a state income tax and do not subject viatical settlement or accelerated death benefit proceeds to their state income tax are California and New York.¹⁵⁹

C. Federal Income Tax Law

Viatical settlements are not presently exempt from federal income tax.¹⁶⁰ The proposed treasury regulations which would expand the scope of tax-free life insurance proceeds under the Internal Revenue Code¹⁶¹ do not include an exception for viatical settlements, as they do for certain accelerated death benefit proceeds.¹⁶² Additionally, the proposed regulations cover only "terminal illness," defined as a reasonable expectation of death in less than twelve months,¹⁶³ a definition which would exclude a large segment of the viatical settlement market. The final regulations have not yet been passed despite their introduction in 1992, leaving an environment of confusion in the

§ 5205 (Consol. 1994), N.Y. Ins. Law §§ 201, 301, 2611, 3220, 7801-7810 (Consol. 1994), N.Y. Pub. Health Law § 20 (Consol. 1994), N.Y. Soc. Serv. Law § 366 (Consol. 1994), N.Y. Tax Law § 612 (Consol. 1994).

¹⁵⁵ See Lamson, *supra* note 154, at 16.

¹⁵⁶ Cynthia Crosson, *New York Viatical Companies Face Tough New Regulation*, NAT'L UNDERWRITER, LIFE & HEALTH/FINANCIAL SERVICES EDITION, Aug. 8, 1994, at 3.

¹⁵⁷ Haggerty, *supra* note 152, at 13.

¹⁵⁸ Tex. Ins. Code Ann. § 3.50-6A (1995).

¹⁵⁹ Cal. Rev. & Tax. Code § 17131.5 (West 1991). N.Y. Tax Law § 612 (Consol. 1994).

¹⁶⁰ Seller must declare as income the settlement amount, less premiums paid, plus dividends received, plus outstanding loans. McCormack & Petersen, *supra* note 2, at 1350.

¹⁶¹ Tax exemption for life insurance proceeds paid "by reason of the death of the insured." I.R.C. § 101(a)(1). For more in depth coverage see Blake, *supra* note 16, at 156.

¹⁶² Private viatical settlements are not covered under the proposed regulations as they resemble a sale or exchange of a capital assets.

¹⁶³ Prop. Treas. Reg. § 1.7702-2(e). See *supra* note 86.

area of tax treatment for viatical settlements and accelerated death benefits. Although not permitted to be cited as precedent,¹⁶⁴ a private letter ruling was issued by the IRS in July 1994, stating that proceeds of viatical settlements are taxable as income.¹⁶⁵ The IRS once again did not take the opportunity to exclude viatical settlement proceeds from federal income tax.

Despite the short comings of the proposed regulations, those in the insurance industry and the AIDS community are excited about the proposals.¹⁶⁶ The good will towards the IRS is enhanced because the proposed changes in the tax structure are a voluntary measure, a proposed regulation, versus the holding of an adverse court decision.¹⁶⁷

The IRS has not withdrawn the proposed regulation, but the Treasury Department is attempting to have the change in tax treatment incorporated into comprehensive health care legislation¹⁶⁸ approved by Congress. The Contract With America Tax Relief Act of 1995¹⁶⁹ is part of the Republican *Contract With America*.¹⁷⁰ It has been approved by the House Ways and Means Committee and is now before the entire House of Representatives with passage expected.¹⁷¹ The status of the Contract With America Tax Relief Act of 1995 in the Senate is unknown and Rhonda Bacci, Chief Financial Officer of Viaticus, believes that passage in the Senate will be considerably more difficult.¹⁷² Additionally, aides to members of the Senate Finance Committee have stated that the bill will probably have problems in the Senate because of the extent of the tax cuts at a time when deficit cutting is such a priority in congressional politics.¹⁷³ Section 221 of the proposed statute would amend the

¹⁶⁴ I.R.C. § 6110(j)(3).

¹⁶⁵ Amount received by taxpayer from an assignment of a life insurance policy is considered a sale of property under I.R.C. § 1001(b). The amount taxable as gross income, "gain from whatever source derived," under I.R.C. § 61(a), is calculated as the portion of total proceeds which exceeds taxpayers adjusted basis. Priv. Ltr. Rul. 94-43-020 (July 22, 1994).

¹⁶⁶ *Death and Taxes (Proposed IRS Regulations Will Allow Early Payment of Life Ins. Benefits to the Terminally Ill)*, TIME, Dec. 28, 1992, at 18.

¹⁶⁷ Darlene Chandler, *Accelerated Benefits Receive Favorable Tax Treatment (Tax Facts & Tactics)*, NAT'L UNDERWRITER, LIFE & HEALTH, Mar. 8, 1993, at 18.

¹⁶⁸ Steven Severin & Stephen Corrick, *Sale Treatment for Viatical Settlements of Life Insurance*, 82 J. TAX'N 35 (1995).

¹⁶⁹ H.R. 1215, 104th Cong., 1st Sess. § 221 (1995).

¹⁷⁰ See Newt Gingrich, Dick Arme, & The House Republicans, *Contract With America* 115-123 (1994).

¹⁷¹ Stoddard, *supra* note 94.

¹⁷² Interview with Rhonda Bacci, *supra* note 8.

¹⁷³ *Ways-Means Committee to Mark Up \$188.8 Billion Tax Cut Legislation*, BNA PENSIONS & BENEFITS DAILY, Mar. 13, 1995.

Internal Revenue Code¹⁷⁴ to permit certain accelerated death benefits under a life insurance contract on the life of the insured to be received free from federal income tax.¹⁷⁵ Viatical settlements will also be covered by the proposed legislation if the life insurance policy is sold or assigned to a viatical settlement provider.¹⁷⁶ To qualify the individual must be terminally ill¹⁷⁷ or chronically ill.¹⁷⁸ This bill has received bipartisan support, therefore, passage by the House of Representatives appears very likely.¹⁷⁹ If the bill is enacted it will become effective for the taxable years beginning after December 31, 1995.¹⁸⁰ H.R. 99¹⁸¹ is very similar to the Contract With America Tax Relief Act of 1995, and was introduced by Barbara Kennelly, a democrat from Connecticut, the hub of the insurance industry. Many industry spokespeople expect the resolution of the tax issues to increase the availability of viatical settlements and accelerated death benefits.¹⁸²

The granting of tax-free status to viatical settlements and accelerated death benefits would not have a significant negative impact on the federal deficit.¹⁸³ The proceeds of the life insurance policy would generally not be taxable if paid "by reason of the death of the insured," which is normally less than two years from the actual date of payment, as most viatical settlements occur within the

¹⁷⁴ I.R.C. § 101.

¹⁷⁵ H.R. 1215, 104th Cong., 1st Sess. § 221 (1995).

¹⁷⁶ A viatical settlement provider is a person regularly engaged in the purchase or assignment of life insurance contracts. Additionally, the person must be licensed in the state where the insured individual resides. If the state does not require licensing, the person must meet the disclosure and general rules provided in the NAIC's Model Act §§ 8 and 9. See *supra* notes 106-110. H.R. 1215, 104th Cong., 1st Sess. § 221 (1995).

¹⁷⁷ Certified by a physician as having illness or physical condition which can reasonably be expected to result in death in less than twenty-four months.

¹⁷⁸ Chronically ill defines an individual who has been certified by a health care practitioner as unable to perform at least two of the following activities, without substantial assistance, for at least ninety days: eating, toileting, transferring, bathing, dressing and continence. H.R. 1215, 104th Cong., 1st Sess. § 7702B (1995).

¹⁷⁹ Mary Jane Fisher, *New Congress May Expand Employee Benefits Horizon*, NAT'L UNDERWRITER, PROPERTY & CASUALTY/RISK & BENEFITS MNGT. EDITION, Jan. 30, 1995, at 12.

¹⁸⁰ H.R. 1215, 104th Cong., 1st Sess. § 221 (1995).

¹⁸¹ H.R. 99, 104th Cong., 1st Sess. (1995).

¹⁸² Mr. Mica, Executive Vice-President of the American Council of Life Insurance for Federal Affairs, stated that many insurance officials have indicated that they are reluctant to offer accelerated death benefit options until the tax confusion is clarified. *ACLI Supports Accelerated Death Benefit Bills*, *supra* note 67, at 4.

¹⁸³ The Treasury Department estimates that it will cost the United States \$100 million over five years to make accelerated death benefits tax-free. Albert Crenshaw, "Accelerated Death Benefits" Could Become Tax-Exempt, WASH. POST, Jan. 22, 1995, at H1. See also *supra* notes 21-27.

last twenty-four months of the viator's life, and most accelerated death benefits are paid within the last six or twelve months of the insured's life.¹⁸⁴ Also, as stated earlier, the funds would make many individuals ineligible for need-based programs, would give medical personnel higher taxable income, as reimbursements for medical costs from the government are lower than private rates charged to individuals, would relieve family members and friends of the need to stop working to provide care to the individual, and would increase the taxable income of the growing viatical industry.¹⁸⁵

D. Securities Regulation

There has been debate as to whether or not viatical settlements are securities under the ambit of the Securities Act of 1933, the regulatory control of the Securities Exchange Commission ("SEC"), state securities departments, and the extensive disclosure requirements necessary for securities. Commentators and industry members believe that viatical settlements are not securities,¹⁸⁶ and claim attempts by the SEC to regulate the viatical settlement market is outside of its jurisdiction.¹⁸⁷ Additionally, some AIDS activists believe the SEC's actions are incorrect and dangerous because of the potential of crippling the industry, which is so valuable to the AIDS community, through increased costs and bureaucracy.¹⁸⁸

¹⁸⁴ McCormack & Petersen, *supra* note 2, at 1350.

¹⁸⁵ See *supra* notes 21-27 for explanation of the joint study by Viaticus and Milliman & Robertson, Inc..

¹⁸⁶ "Viatical settlements are not securities subject to the regulatory control of the Securities Act of 1933. Although not eligible for exemption as an 'insurance product' under 15 U.S.C. § 77c(a)(8), they do not fall within the definition of a security under 15 U.S.C. § 77b(1), because they fail to satisfy all four prongs of the *Sec. and Exch. Comm'n v. Howey Co.*, 328 U.S. 293 (1946), test. Moreover, substance must prevail over form, and viatical settlements are similar in form, but not in substance, to securities. Viatical settlements play no role in capital markets or capital formation. Therefore, they can not be 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 (1993). NVA President and President of Life Partners, Inc., Brian D. Pardo claimed that viatical settlements are definitely insurance transactions (exempt under 15 U.S.C. § 77c(a)(8)). Tony Munroe, *SEC Sues Dealer in Death Futures*, WASH. TIMES, Aug. 27, 1994, at D5; John Banks CEO of Viaticus claimed that he did not believe that brokers would be able to survive the reporting requirements of the SEC. Jeffrey Taylor, *SEC Sues Life Partners, Inc., Alleging Illegal Brokering of Insurance Policies*, WALL ST. J., Aug. 26, 1994, at A2. Ms. Saxty of the NVA stated that she believed that the SEC was wasting it's time in its suit against Mr. Pardo and Life Partners, Inc.. *Interview with Michelle Saxty, supra* note 16.

¹⁸⁷ See Taylor, *supra* note 185, at A2.

¹⁸⁸ Bill Freeman, Executive Director, of the National Association of People With AIDS, claimed the SEC's actions were "contemptible."

State and federal securities regulators have been involved in several situations where litigation has ensued. The SEC has filed suit against the viatical settlement firm Life Partners, Inc., and its President, Brian D. Pardo, alleging illegal trafficking of unregistered securities.¹⁸⁹ The SEC is claiming that the structure of the product sold by Life Partners, Inc., involved policies owned by Mr. Pardo or the company, who then sold interests in the policies to investors, thereby creating a securities transaction.¹⁹⁰ However, the SEC made a point of stressing that this suit is not an attack on the entire viatical settlement industry, but instead, an attempt to address a particular transaction type.¹⁹¹

In 1992, the North Dakota Securities Commissioner, Glen Pomeroy, issued a cease-and-desist order against two viatical firms for violating state securities laws by failing to comply with state licensing and disclosure requirements.¹⁹² This action, like that against Mr. Pardo and Life Partners, Inc., above, was not an attack on the entire viatical settlement industry, but solely an attack on the particular type of products being sold.¹⁹³

The SEC and other securities regulators appear to be acting under the belief that the typical viatical settlement, like accelerated death benefits, are insurance transactions. The result being that viatical settlements are excluded from securities law and under the ambit of state insurance law. However, the SEC and state insurance commissioners appear ready to prosecute cases where the particular sales method becomes so unorthodox that it goes beyond the scope of the insurance transaction exception.¹⁹⁴

¹⁸⁹ Munroe, *supra* note 186, at D5.

¹⁹⁰ The method of grouping policies together and reselling them to investors is a security transaction, claims the SEC. Investors are purchasing the policies in the form of "investment contracts," under the scope of the definition of securities under 15 U.S.C. § 77b(1). Munroe, *supra* note 186, at D5.

¹⁹¹ *Id.* Taylor, *supra* note 186, at A2.

¹⁹² Steven Brostoff, *Move to Bar Speculation in AIDS Victims Policies*, NAT'L UNDERWRITER - LIFE & HEALTH EDITION, Aug. 24, 1992, at 23.

¹⁹³ The system involved mailing a menu of anonymous terminally ill individuals life expectancies', white blood cell counts, infections, insurance carrier, death benefit and acquisition cost to potential investors. Brostoff, *supra* at note 192.

¹⁹⁴ Neil Sullivan, Deputy Commissioner for Securities in Massachusetts's said, "From the state's perspective, we have to determine whether these practices constitute an investment contract and, if it does, then it may trigger securities law and liabilities." Dick Lehr, *AIDS Patients Reap Benefits by Selling Their Insurance*, BOSTON GLOBE, July 25, 1993, at 1.

VI. PROPOSALS FOR AREAS REQUIRING ADDITIONAL LEGISLATION

Viatical settlements are a new and helpful option to those who are sick and close to death. Because of the possibility of abuse by the industry, and the potential of unequal bargaining power, regulation is necessary to protect viators. The Model Act approved by Congress is an excellent and comprehensive preliminary step in the consumer protection area. Because the Model Act has no actual power to regulate behavior, individual states must begin to enact legislation, hopefully using the Model Act as a blueprint.

The minimum prices in the Model Act should be carefully monitored to insure that they offer an equitable sales prices to viators and a legitimate return to the viatical settlement company and its investors. It should become possible to raise the minimum prices as the novelty of the industry diminishes, making investors less apprehensive and more willing to invest despite lower, yet still reasonable returns.¹⁹⁵ Additionally, the accuracy of predictions of life expectancies will increase over time, which should also allow legislatures to raise the minimum prices that viators must receive. Furthermore, legislators should create another life expectancy category, three to five years, with a slightly lower mandatory minimum pay out to allow viatical settlement companies to continue to be flexible in dealing with individuals with longer life expectancies or special circumstances.

Individual states should also attempt to enter reciprocity agreements with other states regarding licensing and reporting requirements. Each state should be able to collect its own licensing and renewal fees. However, a standardized license application and annual report format should be developed to enable viatical settlement companies to provide services to individuals in all states, while keeping overhead costs low in order to maximize funds available to viators.

The exception for individual purchasers should be enlarged to allow natural persons to buy two or three life insurance policies per year. The viator is the person the legislation is created to protect; if the viator can receive more money from a person who buys two or three policies per year, the legislation should not prevent this by being too burdensome. A possible compromise is no regulation for a natural person purchasing one or two policies per year,

¹⁹⁵ See Wallace, *supra* note 43.

minimum regulation for a natural person purchasing three to five policies per year, and full regulation for all others.

Lastly, the tax issue must be resolved. The uncertainty creates an environment where individuals and companies are afraid to act. The adoption of the Contract With America Tax Relief Act of 1995 by the House Ways and Means Committee is a strong first step and, ideally, the House of Representatives and the Senate will quickly pass the proposed act. If the tax-free status of accelerated death benefits and viatical settlements is not enacted as part of the Contract With America Tax Relief Act of 1995 as a result of the very political and controversial nature of the bill, another less complicated bill could be proposed and enacted solely to regulate the tax status of accelerated death benefits and viatical settlements as quickly as possible. The Contract With America Tax Relief Act of 1995's tax-free treatment of viatical settlement proceeds for individuals with a life expectancy of less than twenty-four months carries a small overall cost¹⁹⁶ while the potential goodwill and compassion are great. However, it is imperative that the version approved provide tax-free status to the proceeds of both accelerated death benefits and viatical settlements. The two products serve overlapping market segments, and the artificial tax-benefit given to one product would have the effect of injuring the consumer, not solely the viatical settlement industry.

Need-based government assistance should be decreased for individuals who choose to viaticate a life insurance policy. The need-based assistance should be allocated to those who are poor, and if an individual viaticates a significant life insurance policy, he is not poor. I believe that the assistance should be cut by a percentage which is linked to the viatical settlement amount and the determination on the federal income tax issue. If the proceeds are received tax-free, assistance should be cut by approximately 75-100%, if the proceeds are not income tax-free, assistance should be cut by approximately 50-75% also taking into account the size of the viatical settlement. Ideally this money can be reallocated to other poor and terminally ill individuals or for medical research.

VII. CONCLUSION

Over the past six years viatical settlements have become an important option for individuals with terminal illnesses. Although it is not always the best

¹⁹⁶ See *supra* notes 21-27 for an explanation of the joint study by Viaticus and Milliman & Robertson, Inc.

option, it is often the only option available. Legislation is required for the effective and equitable use of viatical settlements. However, consumers will suffer if insurance companies play too significant a role in formulating the laws which regulate the viatical settlement industry. To some extent, insurance companies appear to be attempting to reduce competition by harming the viatical settlement industry which is having a collateral detrimental effect on the consumer. If regulation removes the artificial advantages from the insurance companies, both the insurance companies and the viatical settlement companies will be forced to compete on the merits of their services which will create more lucrative settlements for viators, better service and greater flexibility in the products offered to consumers.

Legislatures were initially slow to act. Presently the NAIC's Model Act has been approved, seven states have enacted viatical settlement legislation, eight states have legislation pending, proposed regulations are pending in the Treasury Department, and legislation has been approved by the House Ways and Means Committee regarding the federal income tax status of viatical settlement proceeds. All of this legislative activity will create a more efficient and equitable environment for consumers and viatical settlement companies. Overall, this will improve the lives of the most ill and needy among us.

