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REGULATING VIATICAL SETTLEMENTS: IS THE INVISIBLE HAND PICKING THE POCKETS OF THE TERMINALLY ILL?

Russell J. Herron*

The newly emerging viatical settlement industry has attracted considerable attention from both insurance regulators and advocates for the terminally ill. In a viatical settlement, a terminally ill person names a viatical settlement company as beneficiary under his life insurance policy in exchange for an immediate lump-sum cash payment of less than face value of the policy. To date, viatical settlement payments to people with AIDS (PWAs) have been disturbingly low as a percentage of the face value of PWA policies. This Note examines the few enacted viatical settlement regulations and the National Association of Insurance Commissioners' model regulations as they particularly relate to PWAs). Acknowledging the importance of viatical settlements as a source of income for financially-strapped PWAs, this Note argues for a regulatory scheme in which PWAs receive greater protections and higher payouts than they receive in the current unregulated market, while still allowing viatical companies a reasonable return commensurate with the actual risks and costs of the viatical business. Part I argues that consumer protection rationales justify licensing and disclosure regulations. Part II explores controversial proposals for minimum payout regulations of viatical settlement providers, and concludes that such regulations, if carefully crafted, are warranted. Finally, Part III examines the advent of accelerated benefits provisions in life insurance policies as alternatives to viatical settlements.

INTRODUCTION

Acquired Immune Deficiency Syndrome (AIDS) often renders its victims unable to work at a time when they most need a steady income. A recent estimate places the average medical cost of AIDS treatment, from full-blown AIDS to death, at

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\$69,100 per patient.¹ Such a bill can easily bankrupt even those people with AIDS (PWAs) who are able to continue to work until the last few months before death. As a result, many PWAs not only face premature death; many also must face death in poverty. Mounting bills can exact a heavy psychological toll on PWAs at a time when they need peace of mind. As one advocate for PWAs noted, "There is no dignity in facing the last days of one's life as part of the indigent poor."² In fact, if financial worries contribute to depression, they may even hasten death.³

A 1992 survey distributed to 30,000 PWAs and HIV-positive individuals confirmed the extent of the financial need of PWAs.⁴ The National Association of People with AIDS (NAPWA) found that over 50% of respondents had difficulty paying for medicine, clothing, transportation, housing, and food.⁵ Almost 30% reported living on less than \$500 per month, while another 30% struggled to get by on between \$500 and \$1000 per month.⁶ NAPWA also estimated that as many as 50% of PWAs own life insurance.⁷ Although many of the survey's financially needy individuals probably also lack life insurance, NAPWA's survey suggests that techniques which would allow PWAs to obtain money from their life insurance policies could benefit a substantial number of PWAs.

1. *Lifetime AIDS Treatment Cost Set at \$119,274 by U.S. Agency*, AIDS POL'Y & L., Aug. 6, 1993, at 3. For a detailed discussion of the costs of AIDS treatment, see Lee Ann Dean, Note, *Acquired Immune Deficiency Syndrome, Viatical Settlement, and the Health Care Crisis: AIDS Patients Reach Into the Future to Make Ends Meet*, 25 RUTGERS L.J. 117, 122-27 (1993).

2. Life Insurance (A) Committee, 1B NAT'L ASS'N OF INS. COMMISSIONERS PROC. 779, 787 (1993) (statement of William J. Freeman, Executive Director, National Association of People with AIDS, Dec. 7, 1992) [hereinafter Freeman Statement].

3. See *Depression May Accelerate HIV Disease Progression*, AIDS ALERT, Sept. 1992, at 140 (reporting the results of a study finding that "depression accelerates declines in CD4 counts among HIV-infected people, and therefore, may hasten disease progression and death"). For a discussion of the role of CD-4 cell counts in predicting life expectancies, see *infra* Part II.B.1.

4. See Freeman Statement, *supra* note 2, at 786.

5. *Id.* at 787. Because almost 80% of the survey's respondents were white, *id.*, the survey probably understates the financial difficulties of PWAs by under representing African-American and Latino populations—groups disproportionately affected by unemployment and poverty.

6. Freeman Statement, *supra* note 2, at 787.

7. *Id.*

One such technique, the "viatical settlement,"⁸ was developed in the late 1980s as a response to the financial needs of PWAs and other terminally ill people. In a viatical settlement, a terminally ill policyholder (the viator) assigns the death benefit of his policy to a viatical settlement provider⁹ (the company), in exchange for an immediate payment of less than the expected death benefit of the policy.¹⁰ By the terms of the agreement, the entire death benefit is paid to the viatical settlement provider upon the viator's death. Although viatical settlements theoretically could be available to anyone with a dramatically shortened life expectancy, the vast majority of viatical settlements have been undertaken by PWAs, with terminal cancer patients comprising much of the remainder.¹¹

From the viator's perspective, the viatical transaction itself is fairly simple. The applicant contacts as many viatical settlement providers as he wishes and fills out detailed application forms, typically consisting of a questionnaire,¹² an

8. The term "viatical" comes from the Latin word "viaticum," which means both the Eucharist "administered to a person near or in danger of death," and "[a] supply or official allowance of money for a journey." 2 THE NEW SHORTER OXFORD ENGLISH DICTIONARY 3572 (1993).

9. A viatical settlement provider should be distinguished from a viatical settlement broker. Viatical settlement providers enter into the actual viatical agreements themselves, purchasing from the viator the right to become the irrevocable beneficiary under his policy. VIACIAL SETTLEMENTS MODEL ACT § 2(D) (Nat'l Ass'n of Ins. Comm'rs 1994) [hereinafter VIACIAL SETTLEMENTS MODEL ACT]. In contrast, viatical brokers offer to find viatical settlements for a fee or otherwise introduce or act as intermediaries between viators and viatical settlement providers. *Id.* § 2(B). This Note focuses solely on viatical settlement providers, and the generic term "company" refers to a viatical settlement provider.

10. The National Association of Insurance Commissioners (NAIC) defines "viatical settlement contract" in the VIACIAL SETTLEMENTS MODEL ACT, *supra* note 9, § 2(C). The NAIC's definition is broader than the one I have given, but not in a way that is relevant to this Note.

11. This Note focuses on PWAs because they constitute the bulk of viatical consumers. See Michael Quint, *Pre-Death Cash: A Business Grows*, N.Y. TIMES, Nov. 14, 1994, at D1, D2 (noting that terminal cancer patients currently make up only 10% of viators). Most of the discussion that follows will focus on issues of particular relevance to PWAs, although many of the conclusions reached apply equally to other viators.

12. For example, the questionnaire of Life Benefactors, L.P., a California viatical provider, requests information about the applicant's current employment, receipt of means-based government assistance, family relationships, medical history, and life insurance policy. See Life Benefactors, L.P., Questionnaire 1-4 (on file with the *University of Michigan Journal of Law Reform*). The medical history questions focus on the applicant's CD-4 cell count, the names of his treating hospitals and physicians, and the types of treatment he has been receiving for his condition. *Id.*

authorization to release medical records,¹³ and an authorization to release insurance policy information. Once the viatical provider has received all of the information, its panel of physicians evaluates the applicant's records and renders an opinion to the provider as to the applicant's prognosis.¹⁴ If the provider finds that the applicant has a sound insurance policy and, in consultation with its physicians, finds that the applicant has a qualifying condition that results in a life expectancy of less than two years, the provider then calculates a purchase price and makes an offer to the applicant.¹⁵ The offer typically amounts to between fifty and eighty percent of the policy's face value.¹⁶ If the applicant accepts the offer, the provider and applicant (now a viator) sign the purchase documents, which include a purchase agreement for the policy, a change of ownership form, and a change of beneficiary form.¹⁷ The latter two forms then are forwarded to the viator's life insurance company, which records the information, files the documents, and sends a confirmation to the viator. Once the viatical provider receives confirmation of the changes, it pays the viator, in a lump sum, the full amount of the viatical settlement, either by cashier's check or wire transfer.¹⁸ The entire process can be completed in three to six weeks.¹⁹

The viatical business first emerged in 1988,²⁰ and in a relatively short period of time the number of viatical settlement companies has grown to approximately fifty-eight in 1994. Of these fifty-eight companies, over half are located in California, New York, Florida, and Texas.²¹ These fifty-eight

13. The medical records release used by Life Benefactors includes within its scope "all past, present, or future medical information or knowledge of medical information, medical reports, physical examination reports, hospital reports, laboratory reports, options concerning [the applicant's] health, or X-ray reports relating to [the applicant] or [his] health." *Id.* at 7.

14. For a discussion of the difficulties of predicting PWA life expectancies, see *infra* Part II.B.1.

15. See LIFE BENEFACTORS, L.P., MOST OFTEN ASKED QUESTIONS AND THEIR ANSWERS [hereinafter QUESTIONS AND ANSWERS] (on file with the *University of Michigan Journal of Law Reform*).

16. See, e.g., Jennifer Berner, Note, *Beating the Grim Reaper, or Just Confusing Him? Examining the Harmful Effects of Viatical Settlement Regulation*, 27 J. MARSHALL L. REV. 581, 584 (1994) (noting that "[a] purchaser usually pays a viator fifty to eighty percent of the policy's value").

17. See QUESTIONS AND ANSWERS, *supra* note 15.

18. *Id.*

19. *Id.*

20. Quint, *supra* note 11, at D2.

21. As of March 13, 1995, California had 12 viatical companies, New York had 7, and Texas and Florida each had 6 companies. Viatical Settlement Firms (unpub-

companies purchased approximately \$300 million worth of life insurance policies, or nearly 4000 policies, in 1994.²² Most companies are quite small, having the capacity to purchase only five to ten million dollars in policies.²³ The exception, and probably the leader of a trend toward larger providers, is Chicago-based Viaticus, which expects to purchase up to \$500 million in policies within the next five years.²⁴

This rapidly growing industry has come under increasing scrutiny by state insurance regulators and legislators, largely because of the high profits that viatical settlement companies have been earning, which some regulators see as a sign of abuse.²⁵ Neither proponents nor opponents of regulation seriously dispute the existence of better-than-average profits for viatical companies, although both groups have their own motives for acknowledging high returns. Critics of viatical settlements rail against such profits in their attacks on the industry, while viatical companies trumpet unusually large returns in their investment promotional materials. Both groups have obvious incentives to overstate profit margins. The estimate of *average* profits most frequently cited in news reports places them at nearly twenty percent of the face value of the policy, with profits on *individual* viatical settlements sometimes exceeding forty percent.²⁶ These returns, coupled with the fact that, at first glance, viatical settlements seem to

lished list supplied by the National Association of People With AIDS) (on file with the *University of Michigan Journal of Law Reform*) (tabulations by the author).

22. Quint, *supra* note 11, at D2.

23. *Id.*

24. *Id.*

25. The Securities and Exchange Commission has taken the position that the way some companies sell viatical settlements to investors renders them "investment contract" securities," which require registration under the Securities Act of 1933. See *SEC Files Fraud, Registration Claims Based on Sale of Death Benefit Interests*, 26 SEC. REG. & L. REP. (BNA) 1203, 1203 (1994). At least one commentator has disagreed with the SEC's conclusion. See Shanah D. Glick, Comment, *Are Viatical Settlements Securities Within the Regulatory Control of the Securities Act of 1933?*, 60 U. CHI. L. REV. 957, 958 (1993) (concluding that "whether brokered or nonbrokered, viatical settlements are not securities and therefore are not subject to the regulatory control of the '33 Act").

26. See Berner, *supra* note 16, at 585; Quint, *supra* note 11, at D2. But see Melinda Fulmer, "Knocking on Heaven's Door": ALI Offers Financial Security to the Dying, SAN ANTONIO BUS. J., June 24, 1994, § 1, at 1 (stating that the "return on a viatical investment can be as high as 14 percent").

be a "ghoulish business,"²⁷ have lead ten states to enact legislation regulating the viatical settlement industry²⁸ and several more to consider it.²⁹

As states seek the proper regulatory stance, disagreement has grown over the degree of regulation warranted. This Note, in contrast to other commentators who have concluded that much of viatical settlement regulation is a bad idea,³⁰ applies a rigorous analysis to existing and proposed viatical settlement regulations, concluding that those few states that currently regulate viatical settlements should adopt minimum payout regulations and that those states that have no viatical regulations in place would be well-served to adopt the regulatory scheme discussed. Part I argues that consumer protection rationales justify current licensing and disclosure regulations in the few states that have them. Part II explores the controversial proposals for minimum payout regulations of viatical settlement providers and concludes that such regulations, if carefully crafted, are warranted. Finally, Part III examines an alternative to viatical settlements—accelerated benefits provisions in life insurance policies—and concludes that accelerated benefits, while often preferable to viatication, do not signal the eventual obsolescence of viatical settlements.

Two important points must be noted before examining regulations aimed at informational inequalities in viatical markets. First, one of the unsettling aspects of the viatical settlement industry is that discussing viatical settlements in terms of profit and risk necessarily dehumanizes the PWAs involved in these transactions. What viatical settlement providers consider to be "risks," PWAs see as sources of great hope—that they will live

27. Quint, *supra* note 11, at D1.

28. Those ten states include the following: California, CAL. INS. CODE §§ 10113.1–2 (West 1993); Louisiana, 1995 La. Sess. Law Serv. 1976 (West); Minnesota, 1995 Minn. Sess. Law Serv. 270 (West); New York, N.Y. INS. LAW §§ 7801–7810 (McKinney Supp. 1995); North Carolina, 1995 N.C. Adv. Legis. Serv. 615; North Dakota, N.D. CENT. CODE §§ 26.1–33.1 (1995); Oregon, 1995 Or. Laws Ch. 342; Texas, 1995 Tex. Sess. Law Serv. 4672 (Vernon) (amending TEX. INS. CODE ANN. art. 3.50-6A (West Supp. 1995)); Vermont, VT. STAT. ANN. tit. 8, §§ 3826–3834 (Supp. 1995); and Washington, 1995 Wash. Legis. Serv. 403 (West).

29. For example, two bills were proposed in the Florida legislature but died in committee. S. 1688, Reg. Sess. (1995); H.R. 1207, Reg. Sess. (1995). There is pending legislation in Illinois. H.R. 1796, 89th Gen. Assembly (1995) (as amended), and in Pennsylvania, H. 1551 (1995). The Missouri Senate proposed legislation that ultimately died in committee. S. 184, 88th Gen. Assembly, 1st Reg. Sess. (1995). The list of states with proposed legislation is a growing one.

30. See, e.g., Berner, *supra* note 16, at 582; Dean, *supra* note 1, at 122.

longer than their doctors' predictions and that a cure for AIDS will be found. In the language of the viatical settlement industry, viatical settlements "mature" when the PWA dies, and the sooner the PWA dies, the greater the viatical company's profit. This Note attempts to emphasize the humanity of the viator as often as possible—something the language of the industry often makes difficult to do.

Second, it is important at the outset to recognize the limitations of viatical settlements, and of other life insurance-based approaches, as solutions to the financial problems of PWAs. Such approaches are available only for those who own life insurance and thus are unavailable to those PWAs with the most dire financial need—America's urban poor and the great majority of intravenous drug users. Viatical settlements are undoubtedly an important development in meeting the financial needs of the large number of PWAs who are fortunate enough to own life insurance, but they are by no means a financial panacea for all PWAs.

I. CORRECTING INFORMATIONAL INEQUALITIES: THE CASE FOR DISCLOSURE

The bulk of current state regulation of viatical settlements focuses on providing potential viators with enough information to make an informed choice to viaticate.³¹ Such regulation has faced little resistance, with even the most laissez-faire industry group proclaiming that it "encourages viators to become informed."³² This lack of resistance may result from the fact that "information policies 'do not necessarily impose great costs on concentrated interests such as individual producers.'"³³ This Part examines the major information disclosure requirements of existing state regulation, as well as the model regulation of the National Association of Insurance Commissioners (NAIC), and concludes that all these requirements can be justified as reasonable consumer protection measures and should therefore be adopted in more states.

31. See *infra* Part I.B.

32. NATIONAL VIACIAL ASS'N, INFORMATION BOOKLET 6 (1994) [hereinafter NVA INFORMATION BOOKLET] (on file with the *University of Michigan Journal of Law Reform*).

33. IAIN RAMSAY, CONSUMER PROTECTION TEXT AND MATERIALS 70 (1989).

Unequal information is recognized as a justification for limited market regulation. In consumer markets similar to the viatical settlement market, "information gaps between buyer and seller" can be a source of market failure, because "markets need adequate information on prices, quality and terms if they are to function efficiently."³⁴ As a result, the absence of equal information "may create a role for regulation of market transactions."³⁵

When asymmetric information exists within a consumer market,

information remedies [as opposed to direct regulation of terms] will usually be the preferable solution. Remedies which simply adjust the information available to consumers still leave consumers free to make their own choices, thus introducing less rigidity into the market. Such remedies leave the market free to respond as consumer preferences and production technologies change over time.³⁶

This asymmetry may result from the fact that consumer information is a public good, and the provider of the information will have a difficult time preventing non-paying customers from gaining access to it.³⁷ "This suggests that in consumer markets there will be an underprovision of information and a shortage of fully informed consumers."³⁸ Viatical companies have some incentive to provide viators with information, because doing so may distinguish one company from its competitors.³⁹ For example, member companies of the National Viatical Association (NVA) attempt to gain a competitive advantage by agreeing to uphold a "Code of Ethics" and list of "Standard Business Practices" which require that signatories provide certain information to potential viators.⁴⁰ Notwithstanding such efforts, "[t]he public good characteristics of

34. *Id.* at 36-37.

35. DANIEL F. SPULBER, *REGULATION AND MARKETS* 62 (1989).

36. Howard Beales et al., *The Efficient Regulation of Consumer Information*, 24 J.L. & ECON. 491, 513 (1981).

37. RAMSAY, *supra* note 33, at 42.

38. *Id.*

39. *Id.*

40. NVA INFORMATION BOOKLET, *supra* note 32, at 15-16. The NVA's Standard Business Practices require member companies to disclose the effects of viatical settlements on government benefits, tax implications of viatication, and accelerated benefits options. *Id.* at 15.

information might provide a prima facie rationale for government subsidisation of the provision of consumer information."⁴¹

In seeking to provide information to consumers, however, the proper goal should not be perfect information, which would be too costly to provide, but rather adequate information.⁴² Justifying the disclosure requirements of viatical legislation thus depends on whether or not PWAs possess inadequate information, either because the present market does not provide it or because what information the market does provide is so complex that viators have difficulty understanding it.⁴³ The former reason is more relevant here, because viatical settlements are, at least from the viator's perspective, a fairly straight-forward transaction.⁴⁴

Three remedies may address the informational inequalities in the viatical market: (1) removing existing restraints on information; (2) correcting misleading information; and (3) requiring additional information.⁴⁵ Only the latter two remedies are of importance, because there are no substantial restraints on information in viatical markets. Because existing and model regulations make effective use of these remedies, more states should adopt similar requirements.

A. Correcting Misleading Information

In an effort to prevent viatical companies from disseminating misleading information, the NAIC's Model Regulation (Model Regulation) of viatical settlement advertising provides that viatical advertisements "should be truthful and not misleading by fact or implication."⁴⁶ In addition, the regulations require that advertisements which "emphasize[] the speed with which the viatication will occur . . . must disclose the average time frame from completed application to the date of offer and from acceptance of the offer to receipt of the funds by the viator."⁴⁷

41. RAMSAY, *supra* note 33, at 42.

42. *Id.* at 41.

43. *Id.* at 41-42.

44. For a discussion of the factors which make overreaching by viatical companies possible, see *infra* Part II.D.

45. See Beales et al., *supra* note 36, at 514.

46. VIACIAL SETTLEMENTS MODEL REGULATION § 6(H)(1) (Nat'l Ass'n of Ins. Comm'rs 1994) [hereinafter VIACIAL SETTLEMENTS MODEL REGULATION].

47. *Id.* § 6(H)(2).

This regulation is aimed at early viatical providers who claimed to make cash immediately available. The Model Regulation further provides that “[i]f the advertising emphasizes the dollar amounts available to viators, the advertising shall disclose the average purchase price as a percent of face value obtained by viators contracting with the advertiser during the past six (6) months.”⁴⁸ These provisions are justifiable efforts to correct misleading information through the provision of additional information to viators—information which will allow PWAs to make more informed decisions to viaticate.

B. Requiring Additional Information

Imperfect consumer information can result in a “misallocation of consumer resources.”⁴⁹ If viators do not have information about alternatives to viatical settlements, they may viaticate when doing so will not maximize the value of their insurance policies. To ensure that viatication is the best option for the PWA, all ten existing state laws⁵⁰ and the NAIC’s Model Act (Model Act) require that the viatical company inform the applicant of “alternatives to viatical settlement contracts . . . including, but not limited to, accelerated benefits.”⁵¹ The Model Act and existing state laws also require that viatical companies inform the applicant of the tax treatment of the viatical settlement.⁵² The Internal Revenue Service (IRS) issued a private letter ruling in 1994 stating that amounts received from viatical settlements must be included as part of taxable income.⁵³ Part of the Republican “Contract with America,” the

48. *Id.* § 6(H)(3).

49. RAMSAY, *supra* note 33, at 42–43.

50. *See supra* note 28.

51. *E.g.*, VIACICAL SETTLEMENTS MODEL ACT, *supra* note 9, § 8(A); CAL. INS. CODE § 10113.2(d)(1) (West 1993); N.Y. INS. LAW § 7807(b)(2) (McKinney Supp. 1995); VT. STAT. ANN. tit. 8, § 3831(1) (Supp. 1995). For a discussion of accelerated benefits as an alternative to viatical settlement, see *infra* Part III.

52. *E.g.*, VIACICAL SETTLEMENTS MODEL ACT, *supra* note 9, § 8(B); CAL. INS. CODE § 10113.2(d)(2); N.Y. INS. LAW § 7807(b)(3); VT. STAT. ANN. tit. 8, § 3831(2).

53. Priv. Ltr. Rul. 94-43-020 (July 22, 1994). The IRS determined that the settlement amount received by the viator is taxable to the extent that it exceeds his adjusted basis in the insurance contract. *Id.*; see also Darlene Chandler, *IRS Letter on Taxation of Policy Sold to Viatical Co.*, NAT’L UNDERWRITER, Feb. 20, 1995, at 22 (discussing Private Letter Ruling 94-43-020).

Contract with America Tax Relief Act of 1995,⁵⁴ would amend the Internal Revenue Code to exempt from taxation both viatical settlements and accelerated benefits by terminally ill people,⁵⁵ who are defined as those with life expectancies of twenty-four months or less.⁵⁶ The bill was passed by the House of Representatives and awaits action in the Senate.⁵⁷

Viatical companies also must inform applicants of viatication's "consequences for interruption of public assistance."⁵⁸ Money received from a viatical settlement counts as income and will result in an interruption of means-based government benefits, including Medicaid, food stamps, and Supplementary Security Income (SSI).⁵⁹ The mere possibility of viatication, however, generally does not count as a source of income to which government agencies can require a person applying for assistance to turn.⁶⁰ Similarly, New York law provides that health care facilities and practitioners cannot "coerce or require

54. H.R. 1215, 104th Cong., 1st Sess. (1995).

55. *Id.* § 221; *see also* 'Contract' Contains Viaticals Clause, INS. REGULATOR, Jan. 16, 1995, at 8 (discussing the Senior Citizens' Equity Act, which would provide favorable tax treatment of accelerated death benefits).

56. H.R. 1215, *supra* note 54, § 221(a).

57. 2 Cong. Index. (CCH) 35,016 (Sept. 1, 1995).

58. *See, e.g.*, CAL. INS. CODE § 10113.2(d)(3); N.Y. INS. LAW § 7807(b)(4); *see also* VT. STAT. ANN. tit. 8, § 3831(4); VIATICAL SETTLEMENTS MODEL ACT, *supra* note 9, § 8(B). The Viatical Settlements Model Act and the Vermont statute are not as vague as the California and New York statutes. *Compare* VIATICAL SETTLEMENTS MODEL ACT, *supra* note 9, § 8(D) (requiring that the applicant be informed of "[t]he fact that receipt of a viatical settlement may adversely effect [sic] the recipient's eligibility for Medicaid or other government benefits or entitlements and that advice should be obtained from the appropriate agencies") *and* VT. STAT. ANN. tit. 8, § 3831(4) (requiring that the applicant be informed of "[t]he fact that receipt of proceeds from a viatical settlement may adversely affect the recipient's eligibility for Medicaid or other government benefits or entitlements, and that advice should be obtained from the appropriate agencies") *with* CAL. INS. CODE § 10113.2(d)(3) (requiring that the applicant be informed of the "[c]onsequences for interruption of public assistance") *and* N.Y. INS. LAW § 7807(b)(4) (same).

59. QUESTIONS AND ANSWERS, *supra* note 15. Life Benefactors' pamphlet advises that "[s]ome transactions may be structured to prevent loss of means-based benefits." *Id.*

60. New York law provides that, in determining eligibility for and the amount of public assistance, including aid for dependent children and Supplementary Security Income,

[t]he department shall not consider the availability of an option for an accelerated payment of death benefits . . . or an option to enter into a viatical settlement . . . as an available resource . . . provided, however, that the payment of such benefits shall be considered in determining eligibility for and amount of such assistance.

or attempt to coerce or require any person . . . to enter into a viatical settlement . . . as a condition of admission, providing[,] or continuing care."⁶¹

Other disclosure requirements include informing the viator that the proceeds of the settlement "could be subject to the claims of creditors,"⁶² and that the viator has the right to rescind the settlement within a specified period.⁶³ Viatical companies also must disclose the "date by which the funds will be available to the viator and the source of the funds."⁶⁴ In New York, viatical companies must disclose "the identity of any person who will receive any fee or compensation from the viatical settlement company with respect to the viatical settlement and the amount and terms of such compensation."⁶⁵ New York also requires that viators be informed "how viatical settlements operate,"⁶⁶ a somewhat ambiguous requirement. Vermont requires that the viatical company disclose "[t]he fact that the viatical settlement contract is null and void if the viatical settlement provider fails to tender payment of the proceeds as provided in the viatical settlement contract."⁶⁷ Finally, although no state regulation currently requires it, viatical companies should be required to disclose to viators the fact that if the viator secures a disability waiver of premium,⁶⁸ either on his own or at the request of the company, the

61. N.Y. PUB. HEALTH LAW § 20(2) (McKinney Supp. 1995).

62. *E.g.*, VT. STAT. ANN. tit. 8, § 3831(3); VIATICAL SETTLEMENTS MODEL ACT, *supra* note 9, § 8(C). Neither California nor New York require disclosure of this information. *See* CAL. INS. CODE § 10113.2; N.Y. INS. LAW § 7807.

63. Under the Model Act, that period is 30 days after execution or 15 days after receipt of the funds, whichever is less. VIATICAL SETTLEMENTS MODEL ACT, *supra* note 9, § 8(E). The rescission period is 15 days after receipt of funds in New York, N.Y. INS. LAW § 7807(b)(5), and 7 days after execution in Vermont, VT. STAT. ANN. tit. 8, § 3831(5). In California, although the viator has 15 days after execution of the settlement to rescind, CAL. INS. CODE § 10113.2(n), the viatical company is not explicitly required to disclose this right, because the provision is not in the disclosure section of the statute. *See* CAL. INS. CODE § 10113.2(d).

64. *E.g.*, VIATICAL SETTLEMENTS MODEL ACT, *supra* note 9, § 8(F); VT. STAT. ANN. tit. 8, § 3831(6). California and New York do not require disclosure of this information. *See* CAL. INS. CODE § 10113.2; N.Y. INS. LAW § 7807.

65. N.Y. INS. LAW § 7807(b)(6).

66. *Id.* § 7807(b)(1).

67. VT. STAT. ANN. tit. 8, § 3831(7). Section 3832(e) states the conditions under which a viatical settlement contract is deemed void. *Id.* § 3832(e).

68. A disability waiver of premium in a life insurance contract typically provides "that if the insured becomes disabled, . . . the insurer will waive the payment of premiums that become due on the policy during the continuance of disability, however long disability may last." MURIEL L. CRAWFORD, LAW AND THE LIFE INSURANCE CONTRACT 206 (1994).

company's administrative costs decrease, and the viator should receive a slightly higher payout.

All of these disclosure requirements seek to ensure that the viator does not operate in a state of ignorance of his legal rights under the states' viatical regulations and of the consequences of viatication. Simply requiring disclosure, however, is not enough. The timing of the disclosure of information can have a substantial impact on whether that information has its intended effects. The NAIC's Model Act mandates that disclosure of all required information be made "no later than the date the viatical settlement contract is signed by all parties."⁶⁹ Vermont's law similarly requires disclosure "prior to the execution of the viatical settlement contract by the viator."⁷⁰ These provisions would allow viatical companies to disclose important information—such as alternatives to viatication, the effects of viatication on means-tested government benefits, and the taxability of the settlement—very late in the process, at a point when the viator is unlikely to pull out to explore other options or carefully consider the information that he has just been given. This is a serious flaw in the NAIC's Model Act and Vermont's statute, one which requires correction. California has recognized this defect and instead requires that all disclosures be made "at the time of *solicitation* for the viatical settlement."⁷¹ New York similarly requires disclosure "[u]pon receipt of an *application* for a viatical settlement."⁷² States adopting their own regulations should follow the lead of California and New York in this respect.

C. Licensing Requirements

The Model Act and all existing state statutes require that viatical providers be licensed by the state's insurance commissioner.⁷³ An application for a license must include a licensing fee⁷⁴ and must disclose the identity of shareholders,

69. VIACIAL SETTLEMENTS MODEL ACT, *supra* note 9, § 8.

70. VT. STAT. ANN. tit. 8, § 3831.

71. CAL. INS. CODE § 10113.2(d)(1) (emphasis added).

72. N.Y. INS. LAW § 7807(b) (emphasis added).

73. *See, e.g.*, VIACIAL SETTLEMENTS MODEL ACT, *supra* note 9, § 3(A); CAL. INS. CODE § 10113.2(b)(1); N.Y. INS. LAW § 7802(a); VT. STAT. ANN. tit. 8, § 3827(a).

74. VIACIAL SETTLEMENTS MODEL ACT, *supra* note 9, § 3(B). The amount of this licensing fee varies widely from state to state. California's initial licensing fee is

partners, officers, and employees of the viatical company.⁷⁵ After the filing of the application, the insurance commissioner generally is given the power to investigate such people regarding their character, competence, experience and training, and business reputation and to issue a license upon finding the applicants to be worthy in these categories.⁷⁶ Because viatical companies occupy a position of trust and confidence with viators,⁷⁷ who entrust to companies confidential medical information and large sums of money, a licensing requirement is a reasonable way to ensure the trustworthiness of viatical providers.

Once a company has been granted a license, the insurance commissioner is empowered to revoke or refuse to renew it for a number of reasons, including misrepresentations in the application for the license,⁷⁸ fraudulent or dishonest practices or incompetence in conducting business,⁷⁹ a pattern of unreasonable payments to viators,⁸⁰ conviction of a crime involving fraud or moral turpitude,⁸¹ or violation of any provision of the state's viatical settlement act.⁸² In addition to the disclosure requirements, a licensed viatical company is typically required

\$2833, with an annual renewal fee of \$177. CAL. INS. CODE § 10113.2(b)(1), (3). New York's initial fee is \$2500, with an annual renewal fee of \$1000. N.Y. INS. LAW § 7802(b)-(c). Vermont's initial fee is only \$50, with an annual renewal fee of the same amount. VT. STAT. ANN. tit. 8, § 3827(b)-(c).

75. *E.g.*, VIACIAL SETTLEMENTS MODEL ACT, *supra* note 9, § 3(D); CAL. INS. CODE § 10113.2(b)(1); N.Y. INS. LAW § 7802(d); VT. STAT. ANN. tit. 8, § 3827(d).

76. *E.g.*, VIACIAL SETTLEMENTS MODEL ACT, *supra* note 9, § 3(F); N.Y. INS. LAW § 7802(f); VT. STAT. ANN. tit. 8, § 3827(f). California vests additional discretion in its commissioner, allowing him to deny a license application if "it is determined that it is contrary to the interests of the public to issue a license to the applicant." CAL. INS. CODE § 10113.2(b)(1).

77. The National Viatical Association acknowledges in its statement of standard business practices that representatives of viatical companies have fiduciary duties. NVA INFORMATION BOOKLET, *supra* note 32, at 16.

78. *E.g.*, VIACIAL SETTLEMENTS MODEL ACT, *supra* note 9, § 4(A)(1); N.Y. INS. LAW § 7803(a)(1); VT. STAT. ANN. tit. 8, § 3828(a)(1).

79. *E.g.*, VIACIAL SETTLEMENTS MODEL ACT, *supra* note 9, § 4(A)(2); N.Y. INS. LAW § 7803(a)(2); VT. STAT. ANN. tit. 8, § 3828(a)(2).

80. *E.g.*, VIACIAL SETTLEMENTS MODEL ACT, *supra* note 9, § 4(A)(3); VT. STAT. ANN. tit. 8, § 3828(a)(3).

81. *E.g.*, VIACIAL SETTLEMENTS MODEL ACT, *supra* note 9, § 4(A)(4); N.Y. INS. LAW § 7803(a)(3); VT. STAT. ANN. tit. 8, § 3828(a)(4).

82. *E.g.*, VIACIAL SETTLEMENTS MODEL ACT, *supra* note 9, § 4(A)(5); N.Y. INS. LAW § 7803(a)(4); VT. STAT. ANN. tit. 8, § 3828(a)(5); *cf.* CAL. INS. CODE § 10113.2(b)(2) (providing that the commissioner can revoke or refuse to renew a license if granting or continuing the license is "contrary to the interests of the public").

to file for the insurance commissioner's approval a copy of all viatical settlement forms used by the company.⁸³

Although one commentator has suggested that licensing viatical settlement companies "impair[s] a viator's right to sell their [sic] insurance policies,"⁸⁴ most members of the industry accept licensing and other regulation as a necessary step to lend accountability and credibility to the growing industry.⁸⁵ The staunchly anti-regulation National Viatical Association (NVA), which in 1994 represented over half of the nation's viatical companies,⁸⁶ has become something of a fringe group, with the number of member companies it represents dropping to fifteen as of early 1995.⁸⁷ The Viatical Association of America (VAA) apparently has ascended to take the NVA's place as the industry's leader, embracing as a reasonable cost of doing

83. *E.g.*, VIACIAL SETTLEMENTS MODEL ACT, *supra* note 9, § 5; CAL. INS. CODE § 10113.2(c).

84. Berner, *supra* note 16, at 59. In making this argument, Ms. Berner adopts the arguments of fringe members of the viatical settlement industry who claim that regulation of viatical settlements is an infringement of the viator's right to alienate freely his property. *See, e.g.*, NATIONAL VIACIAL ASS'N, UNTITLED (n.d.) (stating that regulation of viatical settlements is a "needless infringement on the rights of individual citizens") (on file with the *University of Michigan Journal of Law Reform*). Interestingly, only viatical companies, and not viators, have promoted this property rights argument. The only "right" with which licensing interferes is a consumer's right to undertake a major economic transaction with possibly unscrupulous and unaccountable viatical companies. *See* Sean Armstrong, *AIDS and the Trusted Advisor*, BEST'S REV., Sept. 1994, at 40. Armstrong quotes former Iowa Insurance Commissioner David Lyons as saying that "the veil on [the property rights argument] is pretty thin. If you talk to most insureds, their concern is that we do not unduly restrict a market." *Id.*

85. *See, e.g.*, Jim Connolly, *Viatical Cos. Seem Ready to Embrace Regulation*, NAT'L UNDERWRITER, Nov. 28, 1994, at 21 (noting that "[t]he general sentiment of those in the viatical settlement industry is that greater regulatory scrutiny will make the business more credible and profitable"); *see also* Viatical Ass'n of Am., *Viatical Settlement Companies Form New Trade Association* (Press Release) (Feb. 24, 1995) [hereinafter Press Release] (noting that the 26 member companies of the Viatical Association of America (VAA) "unanimously voted to support the efforts of state insurance commissioners to regulate the viatical industry based on the Viatical Settlements Model Act") (on file with the *University of Michigan Journal of Law Reform*).

86. Cynthia Crosson, *N.Y. Viatical Companies Face Tough New Regulation*, NAT'L UNDERWRITER, Aug. 8, 1994, at 3.

87. Letter from Michelle L. Saxty, Administrative Director, National Viatical Association, to the author (Mar. 1, 1995) (including list of "Member Companies in Good Standing" as of Feb. 13, 1995) (on file with the *University of Michigan Journal of Law Reform*). NVA members who disagreed with Brian Pardo, the Association's president who is an outspoken opponent of viatical regulation, recently attempted to oust him as president. *An Official Says Industry Can Police Policy-Buying*, N.Y. TIMES, Nov. 14, 1994, at D2. When the VAA held its inaugural meeting in Chicago and decided to exclude Pardo, Pardo tried unsuccessfully to get an injunction to prohibit the meeting. *Id.*

business all the provisions in the NAIC's Model Act, but not the NAIC's minimum payout regulations.⁸⁸

By narrowing the information gaps between PWAs and companies, the information disclosure requirements of state and model regulations help ensure that PWAs have the information needed to confirm that viatication is the best option available to them. Although providing such information is not costless, it is inexpensive, requiring companies to do little more than print an informational sheet to be given to all applicants and keep viators informed throughout the settlement process. Licensing viatical settlement providers will help keep unscrupulous operators out of an industry which, much like the securities industry, involves a fiduciary relationship between the client and the company. These proposals are all reasonable and effective methods for the protection of viators.

II. PRICE REGULATION OF VIATICAL SETTLEMENTS: IS MINIMUM PRICE REGULATION NEEDED?

According to the best estimate, a viatical settlement company averages about twenty percent profit on a policy's face value.⁸⁹ It is important to emphasize, however, that print news reports are the only source of data on viatical company profits. This lack of hard data on viatical profits requires that an assumption be made, and an assumption of a twenty percent average profit margin is reasonable based on available reports.⁹⁰

88. See Press Release, *supra* note 85. While the VAA supports the provisions contained in the NAIC's Model Act, it does not support the NAIC's Model Regulation of minimum payouts. Telephone Interview with William Kelley, Executive Director, Viatical Association of America (Apr. 21, 1995). Its members believe that those regulations do not fully take account of the risk viatical companies assume. *Id.* For disagreement with that position, see *infra* Part II.B.

89. See *supra* note 26 and accompanying text.

90. If this assumption overstates viatical profits, it does so by not much more than 5%. Certainly, no one has ever suggested that viatical companies are averaging less than 10% profit. Even with profits around 15%, it does not necessarily follow that viatical regulation would do more harm than good. Whether profits average 15% or 20%, the conclusions reached in Part I, *supra*, about licensing and information disclosure requirements would remain unchanged, since those requirements impose minimal costs on viatical settlement companies.

A lower profit average, however, could effect the analysis of minimum payout regulations that follows. If the average profit margin of viatical companies is actually 15%, the minimum payouts required by the NAIC's Model Regulation at the least would have to be adjusted downward. If companies actually are profiting only 15%

These reported average profits of twenty percent have resulted in a call for regulations setting minimum payouts to viators.⁹¹ Such minimums are by far the most controversial facet of viatical settlement regulation. The disagreement focuses on what many perceive to be the windfall profits that viatical companies reap at the expense of viators and others argue are legitimate business earnings. Whether corrective action is needed depends on whether these windfalls truly exist and, if they do, on what one concludes is the source of these windfalls.

The priority of any approach, whether it is a minimum payout regulation or the laissez-faire approach favored by some commentators,⁹² should be to protect PWAs from making a bad bargain in the sale of their policies while at the same time preserving viatication as an option. No consideration is given to the goal of maximizing viatical investor returns, although recognition is given to the necessity of ensuring reasonable returns on investment and, to the extent necessary, a risk-reward sufficient to attract viatical investors. Whether minimum payout regulations can set a proper balance between these considerations is the key question.

This Part explores three possible explanations of windfall profits for viatical providers. First, windfall profits may not in fact be windfalls at all. Low payouts by viatical companies might be necessary to ensure a reasonable profit in light of the substantial risks taken by viatical companies. Second, if profits are indeed disproportionate to risk, they may be the result of a temporary supply-demand lag in the viatical market. If this lag causes windfall profits, minimum payout regulation might harm competition by discouraging companies from entering the market, thereby preventing the increase in supply that would result in reasonable profits to investors and larger payouts to viators. Finally, windfall profits may result from longer-term,

on average, requiring them to increase payouts might drive them out of business by making it difficult for them to attract investors. That result is clearly contrary to the intent of the regulatory scheme envisioned in this Note. But average profits of 15% do not necessarily mean that minimum payout regulations are per se unwarranted. They still might be reasonable as a way of keeping renegade viatical companies from making manifestly unfair purchase offers to unwary PWAs.

91. Minimum payout regulations also can be characterized as maximum price regulations: requiring a company to pay the viator 70% of the policy's face value in effect limits the viatical company's "price" to a maximum of 30% of the policy's face value. One must be careful, however, not to equate "price" with "profit." See *infra* Part II.B.

92. See sources cited *supra* note 30.

invidious causes that would justify minimum payout regulation, such as overreaching by viatical companies. Which of these sources most nearly approximates the reality of the market will determine the proper regulatory response.

A. The NAIC Model Regulation

The NAIC hinted that minimum payout regulations might be in the works when it included in its Viatical Settlements Model Act a provision empowering state insurance commissioners to "[e]stablish standards for evaluating the reasonableness of payments under viatical settlement contracts."⁹³ Other states with viatical settlement legislation followed suit, adopting provisions empowering the state insurance commissioners to set a reasonable payout schedule.⁹⁴

Not long after adopting the Model Act, the NAIC began drafting minimum payout standards. Initially, the NAIC proposed minimum payouts, based on the viator's life expectancy, according to the schedule shown in Table 1.

TABLE 1⁹⁵
NAIC DRAFT MINIMUM PAYOUT MODEL REGULATION

LIFE EXPECTANCY (MONTHS)	MINIMUM PAYOUT (% FACE VALUE)
<6	90
6 to <12	85
12 to <18	75
18 or more	70

In its final form, the NAIC adopted a version of the regulation which extended its reach to viators with longer life expectancies and which dramatically reduced the minimum payouts required under the initial version. The regulation as adopted, and

93. VIACIAL SETTLEMENTS MODEL ACT, *supra* note 9, § 10(B).

94. *See, e.g.*, CAL. INS. CODE § 10113.2(f); VT. STAT. ANN. tit. 8, § 3833(2).

95. VIACIAL SETTLEMENTS MODEL REGULATION § 4 (Nat'l Ass'n of Ins. Comm'rs Draft Feb. 16, 1994) [hereinafter MODEL REGULATION Draft] (on file with the *University of Michigan Journal of Law Reform*).

recently as enacted in Louisiana⁹⁶ and Minnesota,⁹⁷ sets minimum payouts according to the schedule in Table 2.

TABLE 2⁹⁸
NAIC MINIMUM PAYOUT MODEL REGULATION

LIFE EXPECTANCY (MONTHS)	MINIMUM PAYOUT (% FACE VALUE)
<6	80
6 to <12	70
12 to <18	65
18 to <24	60
24 or more	50

In both the draft and final versions of the model regulation, viatical companies can deviate from the minimum figures by up to five percentage points if the insurer's financial rating is lower than the four highest categories.⁹⁹

The reasons behind the changes in the NAIC model regulation should be clear. A regulation which requires a viatical company to pay a minimum of seventy percent of a policy's face value to a person with a twenty-month life expectancy may effectively preclude viatication for that person, because the company may not be able to cover its risks adequately in the thirty percent margin that the regulation allows and thus may not enter into such settlements. By reducing the minimum payout requirement to fifty percent for people with life expectancies of twenty-four or more months, the NAIC presumably sought to ensure that viatical companies have the flexibility to cover their risks when dealing with people with life expectancies that exceed eighteen

96. 1995 La. Sess. Law Serv. 1979 (West).

97. 1995 Minn. Sess. Law Serv. 274 (West).

98. VIATICAL SETTLEMENTS MODEL REGULATION, *supra* note 46, § 4; *see also Model Rule Sets Viatical Minimums*, INS. REGULATOR, Oct. 3, 1994, at 8, 8 (discussing the minimum payout schedule).

99. MODEL REGULATION DRAFT, *supra* note 95, § 4; VIATICAL SETTLEMENTS MODEL REGULATION, *supra* note 46, § 4. The relevant rating is that given by the A.M. Best Company or "a comparable rating by another rating agency." *Id.* A.M. Best analyzes the performance of the insurance industry. *See generally* A.M. BEST CO., BEST'S INSURANCE REPORTS, PROPERTY-CASUALTY, UNITED STATES (1995) (providing ratings and statistical data based on an insurance company's annual financial statement).

months. The adopted regulation is thus more finely tuned to the viatical market than the draft version.

B. Are Viatical Companies Reaping Windfall Profits?

Viatical companies and some commentators have attempted to justify the low payouts of viatical companies by pointing to the substantial risks that viatical companies assume.¹⁰⁰ These risks come from many sources, some substantial and others chimerical. Whether viatical companies reap windfall profits depends on whether these risks are substantial enough to explain the current level of payouts.

1. *The Risk of Misestimating Life Expectancy*—The primary risk to viatical companies derives from the possibility that viators will outlive the companies' best estimates of their life expectancies. Although a company has access to and bases its estimate of the viator's life expectancy on an evaluation of his entire medical history,¹⁰¹ it will likely rely heavily on the viator's CD-4 cell count in determining his life expectancy.¹⁰² As AIDS progresses, a person's CD-4 cell count decreases and, with it, the body's ability to stave off infection.¹⁰³

The cost to viatical companies if the viator outlives the company's life expectancy prediction can be quite substantial. What many perceive to be woefully inadequate payouts may in fact represent the margins necessary to compensate viatical companies for the risk that viators will outlive the company's best life expectancy estimates and thereby cut into viatical investors' rate

100. *E.g.*, Dean, *supra* note 1, at 142–43 (stating that critics of low viatical payouts “fail to account for the costs and risks associated with viatication [sic] investment”).

101. *See supra* note 13.

102. This reliance stems from the fact that CD-4 cell counts correlate strongly with susceptibility to infection. *See* Lawrence K. Altman, *New Study Questions Use of AZT in Early Treatment of AIDS Virus*, N.Y. TIMES, Apr. 2, 1993, at A1 [hereinafter Altman, *New Study*] (discussing effectiveness of treating AIDS before symptoms develop). CD-4 cells are the specialized immune cells that fight infections in human blood. *Id.* at A2. A healthy human has a CD-4 cell count of approximately 1000 cells per cubic millimeter of blood. *Id.* Under the most recent definition of AIDS provided by the Centers for Disease Control, a person infected with the HIV virus who has 200 or fewer CD-4 cells per cubic millimeter of blood has AIDS. *See* Stefano Vella et al., *Differential Survival of Patients with AIDS According to the 1987 and 1993 CDC Case Definitions*, 271 JAMA 1197, 1197 (1994); Lawrence K. Altman, *Federal Health Officials Propose an Expanded Definition of AIDS*, N.Y. TIMES, Oct. 28, 1992, at B9.

103. *See* Altman, *New Study*, *supra* note 102, at A2. CD-4 count is not always a reliable predictor of life expectancy. *See infra* notes 104–10 and accompanying text.

of return or perhaps even cause a loss. Whether this risk is great enough to justify low viatical payouts thus depends on the medical question of the accuracy of predictions of PWAs' life expectancies.

The life expectancy of a PWA, from diagnosis of full-blown AIDS until death, typically ranges from one to three years, with two years being average.¹⁰⁴ A PWA, however, may live as many as five to seven years longer than that average.¹⁰⁵ "AIDS, like most other chronic diseases, does not follow regular rules of disease expression or mortality."¹⁰⁶ Professor Osborn notes that "CD4 counts are quite good predictors of a person's susceptibility to opportunistic infections, which in turn tend to be the potentially lethal factors in AIDS; however, many people have lived for a long time with virtually no CD4 cells AND no [opportunistic infections]."¹⁰⁷ As a result, "the individual variation in clinical course is so wide that prediction about life expectancy is very uncertain for a given person."¹⁰⁸

The uncertainty is further complicated by the variability which results from CD-4 tests themselves. As a result of this variability,

[a] single [CD-4] test . . . does not allow very accurate predictions. A series of tests reduces the variability and improves the prognostic power. If you consider getting prognosis of death within a one year period good, the prognostic power of repeated tests is pretty good. You could never, however, get down to predicting to the month.¹⁰⁹

104. See *Male AIDS Patients Are Living Longer, Healthier*, AIDS ALERT, July 1993, at 107 (reporting a study which found that "participants diagnosed with AIDS since 1988 have an average length of survival of 24 months compared to 11.6 months for participants diagnosed in 1984").

105. See *id.* at 108 (discussing PWAs surviving more than six years after infection).

106. Electronic mail message from Professor June E. Osborn, M.D., University of Michigan, School of Public Health, to the author (Apr. 21, 1995) [hereinafter Osborn message] (on file with the *University of Michigan Journal of Law Reform*).

107. *Id.*; see also Barbara J. Turner et al., *CD4+ T-Lymphocyte Measures in the Treatment of Individuals Infected with Human Immunodeficiency Virus Type 1: A Review for Clinical Practitioners*, 154 ARCHIVES INTERNAL MED. 1561, 1565 (1994) ("Although AIDS-defining complications are common once the CD4+ count is less than [200 cells per cubic millimeter of blood], the association of CD4+ count and risk of death in persons with AIDS is not as well defined.").

108. Osborn message, *supra* note 106.

109. Electronic mail message from Professor James Koopman, M.D., University of Michigan, School of Public Health, to the author (Apr. 20, 1995) (on file with the *University of Michigan Journal of Law Reform*); see also Turner et al., *supra* note 107, at 1564 ("Using information from more than one [CD-4 test] offers a . . . strategy to reduce the impact of laboratory and intraindividual variation in [CD-4] counts.").

The possibility of misestimation of any given PWA's life expectancy is therefore quite substantial.

Nevertheless, while CD-4 counts cannot be accurate predictors of a particular PWA's life expectancy, the fact remains that, on average, CD-4 counts are quite reliable. A particular viator may outlive a viatical company's estimation of his life expectancy and cut into the company's profit margin. Over many viators, however, the same company should have a fairly good prediction record and a correspondingly good profit record. For every PWA who lives a year longer than a viatical company predicted he would live, another PWA will die a year sooner than the same viatical company predicted. The inaccuracies of CD-4 counts can cut both ways. As the president of one viatical company noted, "I've seen a guy with a [zero] T-cell count go two years, and I've seen one with a 260 T-cell count die in eight days."¹¹⁰

If a viator outlives the company's estimation of his life expectancy, the effect that his survival can have on viatical company profits can be quite substantial. Table C shows the present value to a viatical company of a \$100,000 life insurance policy paid a given number of years in the future.

TABLE 3¹¹¹
PRESENT VALUE OF \$100,000 LIFE INSURANCE POLICY
PAID ONE TO FOUR YEARS IN THE FUTURE, WITH
RATE OF RETURN ASSUMPTIONS

YEAR	5%	10%	15%	20%
1	<i>\$95,200</i>	<i>\$90,900</i>	<i>\$87,000</i>	<i>\$83,300</i>
2	<i>\$90,700</i>	<i>\$82,600</i>	<i>\$75,600</i>	<i>\$69,400</i>
3	<i>\$86,400</i>	<i>\$75,100</i>	<i>\$65,800</i>	<i>\$57,900</i>
4	<i>\$82,300</i>	<i>\$68,300</i>	<i>\$57,200</i>	<i>\$48,200</i>

110. Eric Zicklin, *Financial AIDS*, SPY, Feb. 1994, at 14, 16.

111. Figures are calculated by the author from data in WILLIAM A. KLEIN & JOSEPH BANKMAN, *FEDERAL INCOME TAXATION* 63 tbl. 1-7 (1993). Dollar amounts in italics are payout amounts that would be acceptable under the NAIC's model minimum payout regulation for a PWA with a life expectancy of one year, allowing \$3000 for the viatical company's administrative costs. For a discussion of the sources of the roughly \$3000 in administrative costs born by the viatical settlement company, see *infra* Part II.B.3.

Table 3 shows, for example, that if a viatical company desired at least a 15% return on its investment, it would pay no more than \$75,600 now for a \$100,000 life insurance policy payable in two years. Most importantly, what initially appears to be a 25% profit turns out to be a 15% profit when the time-value of money is taken into account. Table 3 also shows that if the company had known that the viator would live for three years instead of two,¹¹² it would have paid only \$65,800 (or about 66% of face value) for his policy to maintain its 15% rate of return. This \$9800 contingency cuts into the company's profits and is a risk that all viatical companies must bear.

To minimize the risk of net losses, viatical companies have been insisting on relatively low payouts.¹¹³ By doing so, they ensure that, even if the viator outlives their best estimate of his life expectancy, they still have a large margin of error before their miscalculation results in a net loss. A viatical company which maintains this margin of error can still earn a positive rate of return—even if it is only around five percent—if the viator substantially outlives its best estimate of his life expectancy.

Of course, a five percent rate of return might not be enough to please investors who could have earned at least that much in no-risk investments in government bonds. Investors will insist on a higher return for the risk that they are taking, but they likely will be willing to risk a five percent return when a viator lives substantially longer than expected for the chance of a thirty percent return when a viator dies before expected.

Consider the effect of the NAIC's Model Regulation¹¹⁴ in the following hypothetical. Sam, a PWA, applies to ABC Viaticals, a viatical settlement provider, to viaticate his \$100,000 life insurance policy. After ABC Viaticals's physicians review all of Sam's medical history, they determine that his life expectancy is approximately one year. On that basis, ABC Viaticals offers and Sam accepts a viatical settlement of \$80,000—an amount that *exceeds* the NAIC's minimum payout model regulation by

112. A few viatical companies recently have shown a willingness to accept policies of persons with life expectancies that exceed two years, although none have been willing to go beyond three years. See James Daw, *U.S. Firm Seeks Investors in Death: Millions Made on Life Insurance of Terminally Ill*, TORONTO STAR, May 27, 1994, at E1, E8; Josephine Marcotty & Glenn Howlatt, *Terminally Ill Can Use Cash to Pay Bills, Fulfill Dreams*, MINNEAPOLIS STAR TRIB., Nov. 14, 1993, at 1D.

113. See *supra* note 26 and accompanying text.

114. See *supra* Part II.A. tbl. 2.

fifteen percent.¹¹⁵ If ABC Viaticals's physicians have predicted Sam's life expectancy correctly, the company will have realized approximately a twenty percent return, even after allowing \$3000 for the company's administrative costs.¹¹⁶ That twenty percent return at the end of the future year equals a profit of roughly \$17,000. If Sam lives only six months, ABC Viaticals earns 40% return on its investment.

If, in spite of the best estimates of ABC Viaticals's physicians, Sam lives two years instead of one, the company still receives more than a ten percent return on its investment. If Sam lives three years, ABC Viaticals would still receive a return of approximately five percent on its initial \$100,000 investment. In fact, only if Sam lives for *four* years does the company realize less than a five percent return on its purchase of Sam's insurance policy. Thus, the NAIC's minimum payout regulations leave ample room for ABC Viaticals to profit handsomely, while still protecting Sam from a grossly inadequate payout.

Two factors thus are relevant in concluding that the risk of the viator's extended survival does not warrant the current level of viatical payouts and that the NAIC's Model Regulation sets appropriate payout minimums. First, misestimations resulting from reliance on CD-4 counts will balance out across many PWAs over time. On average, the company's predictions will be reasonably accurate, and its overall profits reasonably stable. Second, the NAIC's minimum payout regulations provide ample room for profit in the face of extended viator survival, allowing the viator to substantially outlive his life expectancy without a net loss to the company. The risk that the viator will outlive the viatical company's best estimate of his life expectancy does not explain the low payouts currently offered by viatical companies.

2. *Other Risks*—Viatical companies assume other risks in the settlement process for which they should receive reasonable compensation. The financial stability of the viator's insurance company is one such source of risk. If the insurance company folds, or otherwise defaults on its obligations under the policy, the viatical company might be left with a valueless policy: it has paid to become the beneficiary of a policy that will not be paid. Many states, however, protect policyholders against insurer defaults by assuming financial responsibility for the policy

115. See *supra* Part II.A tbl. 2.

116. See *supra* Part II.B.1 tbl. 3. For a discussion of administrative costs, see *infra* Part II.B.3. Of course, the provider's administrative costs go up as the viator lives longer.

benefit in the event that the insurer becomes insolvent. Viatical companies themselves can protect against the risk of default by the insurer by only purchasing policies issued by highly rated insurance companies. Companies that wish to buy less highly-rated policies, however, should be encouraged to do so, because by so doing they make viatication an option for more PWAs. The NAIC Model Regulation provides such encouragement. Section Four of that regulation allows viatical companies to take account of the risk of default in the settlement amount by lowering their payout by five percentage points if the viator's insurance company has an A.M. Best rating lower than the four highest ratings.¹¹⁷

Beyond default, any factor that could distort the accuracy of the viatical company's estimation of the viator's life expectancy is a source of risk for a viatical company. The possibility that a cure will be found for AIDS, or that better life-lengthening AIDS treatments will develop, are two such risks. Like the risk that the viator will outlive the company's prediction of his life expectancy, a life-prolonging treatment for AIDS could result in a diminished return or net loss to the viatical company.

Although the "risk" of an AIDS treatment or cure¹¹⁸ may be a real threat to the long-term viability of the viatical settlement companies, those risks are probably not very substantial at the level of the individual viator. A cure for AIDS, if found, might

117. See *supra* note 99.

118. Recall the reminder in the Introduction of this Note that one of the more disturbing aspects of the viatical settlement industry is that improved AIDS treatments and cures become a "risk," not a benefit. This fact can have disturbing public policy implications. Consider "notoriously anti-gay" Texas State Representative Warren Chisum, who has invested \$200,000 in viatical settlements and who has "voted against . . . a variety of . . . programs to help AIDS victims." Molly Ivins, *Death Futures Trade a Sad Wrinkle in Capitalism*, HOUSTON POST, Mar. 16, 1994, at A27 (editorial). There is considerable danger in having "someone shaping public policy who has an open monetary interest in seeing that the [AIDS] epidemic continues and that no cure is found." *Id.*

The NAIC's Model Regulation contains a conflict-of-interest rule providing that "[v]iatical settlement providers and brokers shall not solicit investors who could influence the treatment of the illness of the viators whose coverage would be the subject of the investment." VIATICAL SETTLEMENTS MODEL REGULATION, *supra* note 46, § 6(G). It is arguable that the viatical companies that solicited Representative Chisum's investment would fall within this regulation. The emphasis of the regulation is on the "illness of the viator," not the viator himself, so it would seem that § 6(G) would not require that Chisum be able to influence a particular viator's treatment, as long as he could influence the treatment of that viator's illness. Whether this regulation would apply to Chisum thus depends on whether "treatment" is limited to direct medical care, or whether it includes, for example, legislation that would provide free treatment to PWAs.

mean that viatical companies can no longer viaticate the policies of PWAs, but it will not likely mean that those PWAs whose policies the companies already own will be cured.¹¹⁹ A cure for AIDS probably would help HIV-positive individuals and only those PWAs who are in the earlier stages of AIDS. AIDS may have progressed too far in many viators, for whom a cure tragically may come too late. Moreover, a cure for AIDS would by no means signal the end of the viatical settlement industry. The ongoing diversification of viatical companies into policies of terminal cancer patients and other terminally ill people lessens the exposure of viatical companies to the possibility of a cure or life-prolonging treatment for AIDS and a consequent decline in business.

Finally, one purported source of risk should be discredited. Although some commentators have claimed that viatical companies should be compensated for the risk of litigation by disappointed prior beneficiaries or those with legal interests in the policy,¹²⁰ these risks are largely nonexistent. Revocable beneficiaries under a life insurance policy have no legal right to enforce, and thus no claim to bring, when the viator replaces them with the viatical company as beneficiary.¹²¹ To minimize the risk of litigation further, viatical companies require anyone who does have an interest in the policy to sign a written release of their interest before the company accepts the policy for viatication.¹²² As a result, litigation brought by someone with prior ownership or some other legal interest in the policy rarely will occur. Even if it does occur, it likely will be dismissed because of the waiver.

That this risk of litigation is minimal has been born out by the case law reported to date. Of the four reported cases involving viatical companies, none has been brought by a disappointed former beneficiary.¹²³ In fact, one of those cases, *Goldberg v.*

119. See Zicklin, *supra* note 110, at 14 (quoting the vice president of a California viatical settlement company as saying "[e]ven if a cure for AIDS were found tomorrow, no one with a 24-month life expectancy could be helped").

120. See, e.g., Dean, *supra* note 1, at 135 n.87, 142 & n.110.

121. See CRAWFORD, *supra* note 68, at 244 (noting that policyowners can terminate at will the rights of a revocable beneficiary).

122. See, e.g., QUESTIONS AND ANSWERS, *supra* note 15.

123. See, e.g., SEC v. Life Partners, Inc., No. 94-1861, 1995 WL 517641, at *2 (D.D.C. Aug. 30, 1995) (involving the SEC's case against defendant viatical company alleging that the company violated various provisions of the Securities Act of 1933 and Securities Exchange Act of 1934); *Stephens v. Meininger (In re Credit Life Corp.)*, 184 B.R. 839, 840 (Bankr. M.D. Fla. 1995) (involving a policyholder who sought reversal of bankruptcy court's imposition of a stay on his civil suit against viatical

Miller,¹²⁴ pitted viatical companies against each other. In *Goldberg*, a viator completed a viatical settlement only to learn that another viatical company was willing to pay him a substantially higher settlement.¹²⁵ The viator asked the initial company to rescind its agreement with him and allow him to enter into the agreement for a greater amount with the second company.¹²⁶ The initial company eventually agreed, accepting its money back plus an additional amount to cover costs,¹²⁷ but then brought a claim for tortious interference with contractual relations against the second viatical company.¹²⁸ The court held that no tortious interference with contract had occurred because there had been no underlying breach of contract by the viator.¹²⁹ If *Goldberg* is any indication, viatical companies apparently risk litigation with competitors over who signed the viator first more than they risk litigation by prior beneficiaries or people with property interests in the viator's policy.

3. *Administrative Costs*—A viatical company must pay significant administrative costs for each policy it viaticates. One source places the average administrative cost at \$3000 per viatication.¹³⁰ These costs derive from mailing and telephone expenses, legal fees incurred in the viatication process, including the expense of securing releases from prior beneficiaries, and the fees of the physicians who conduct a review of each PWA's medical history.¹³¹

These administrative costs also include the viatical company's expenditures in paying the viator's insurance premiums between viatication and death. The viatical company, however, does not always incur this expense. Many insurance policies offer a disability waiver of premium, under which the insurer or the

company to determine ownership of his life insurance policy); *Protective Life Ins. Co. v. Sullivan*, 892 F. Supp. 299, 300 (D. Mass. 1995) (involving a suit by a life insurance company against a viatical company alleging that the policyholder initially procured the policy through fraud and misrepresentation); *Goldberg v. Miller*, 874 F. Supp. 874, 876 (N.D. Ill. 1995) (involving a viatical company's suit against a policyholder and a competitor company for breach of contract and tortious interference with contract, respectively). This list of cases is based on a search of the Allcases database on Westlaw in November 1995.

124. 874 F. Supp. 874 (N.D. Ill. 1995).

125. *Id.* at 875-76.

126. *Id.* at 876.

127. *Id.*

128. *Id.* at 875.

129. *Id.* at 879.

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

131. *Id.* at 16-17.

policyholder's employer agrees to take over the policyholder's payment of premiums in the event that the policyholder becomes disabled and unable to pay the premium himself.¹³² If the viator's policy offers such a waiver of premium and the viator has not exercised the waiver option, the viatical company will encourage, though probably not require, the viator to secure the disability waiver. If the viator secures the waiver before viaticating his policy, the viatical company will not have to take over payment of the policyholder's premiums upon viatication and should therefore increase its payout to the viator.¹³³

All of these risks and costs are real and substantial, but they are not substantial enough to explain the current low level of viatical payouts, which result in an average profit of around twenty percent after administrative expenses have been taken into account.¹³⁴ Of course, taking all of these risks and costs into account strongly refutes the initial reactions of the press and some commentators that viatical companies enjoy no-risk, windfall profits at the expense of PWAs. Yet, even after an exhaustive and detailed look at the risks and costs of viatical settlements, the fact remains that viatical companies' profits are disproportionate to the risks that they take and the costs that they bear, and they cannot be explained wholly on those bases.

In spite of this evidence, student commentators, some advocates for PWAs, and representatives of most viatical companies have adopted a laissez-faire approach to minimum payout regulations, displaying a Friedmanesque reverence for the power of market competition.¹³⁵ For the most part, these people resemble Chicago-school economists, who "tend[] to be rather more sanguine than other economists about the proximity of real

132. CRAWFORD, *supra* note 68, at 206.

133. NVA INFORMATION BOOKLET, *supra* note 32, at 9. Companies "should" increase their payments but do not necessarily do so. There is plenty of room for viatical companies to require that the viator secure the disability waiver without increasing its payout offer. Viators might not realize that, by exercising the waiver, they are providing a substantial benefit to the viatical company for which they should be compensated in the settlement.

134. See *supra* note 26 and accompanying text.

135. See, e.g., Freeman Statement, *supra* note 2, at 787 (emphasizing marketplace notions of efficiency and receiving the best price for the insurance policy); Berner, *supra* note 16, at 600 (arguing that, "by discouraging higher settlement offers, the operation of minimum rate regulations denies viators the benefits of the competitive nature of the open market"); Dean, *supra* note 1, at 147 (arguing that minimum payout regulations "deny [companies] reasonable profit margins" and will reduce competition); *supra* note 88 (discussing the fact that the Viatical Association of America does not support minimum payouts).

world markets to the perfect state. Correspondingly, [they] tend[] to be slower than others to perceive the need for corrective action."¹³⁶ Average profits of twenty percent, not wholly explained by risk and higher than investments of comparable riskiness, can be deemed "supernormal" profits. But calling viatical profits "supernormal" does not by itself make a case for minimum payout regulation. For example, these profits may be the result of a temporary supply-demand lag in the viatical market, or they may be a proper reward for the innovation of viatical settlement companies. If a supply-demand lag is the cause, minimum payout regulation might harm competition by discouraging companies from entering the market, thereby preventing the increase in supply that would result in more reasonable profits to investors and larger payouts to viators. If viatical settlements remain an innovation, supernormal profits might be a proper reward for that innovation and therefore worth maintaining for the time being. The next section explores possible market explanations for and functions of supernormal viatical profits, seeking to determine whether the viatical market is as close to the perfect state as is assumed by other commentators and whether minimum payout regulation would be beneficial or harmful to the viatical market under those alternative explanations.

C. An Industry-Wide View of the Viatical Settlement Industry

Large profit margins like the twenty percent average margin enjoyed by the viatical settlements industry suggest that the market is not performing as it should. Such "persistent . . . excess or *supernormal* profits are generally signs of unworkable performance."¹³⁷ The ideal performance for an industry "should move as long-run averages toward amounts just sufficient to pay normal interest returns on owners' investments, plus a 'risk reward' to successful firms sufficient to offset the losses of unsuccessful ones."¹³⁸ "Supernormal profits" are thus profits which are disproportionate to risk and to normal interest

136. A.J. DUGGAN, *THE ECONOMICS OF CONSUMER PROTECTION: A CRITIQUE OF THE CHICAGO SCHOOL CASE AGAINST INTERVENTION* 17 (1982).

137. JOE S. BAIN, *INDUSTRIAL ORGANIZATIONS* 14 (1968) (emphasis added).

138. *Id.*

returns in other industries and investments.¹³⁹ The fact that supernormal profits have been the norm in the viatical settlements market suggests a lack of workable competition which might necessitate regulatory intervention.

Professor Bain has suggested that supernormal profits in an industry can result from four causes:

1. Misestimation of future demand or cost, or lagging adjustment to changing demand or cost, resulting in positive "windfalls" to firms or industries. . . .
2. The riskiness of business investment in various lines, resulting in the payment of "risk rewards" to successful risk-takers (but also in losses to the unsuccessful gamblers).
3. The introduction of innovations . . . by some firms, resulting in "reward to innovation [sic]." . . .
4. Monopolistic or monopsonistic restriction of output and raising of selling prices in relation to costs by the industry

¹⁴⁰

Determining which of these dynamics explains the supernormal profits enjoyed by the viatical industry will go a long way in determining the proper regulatory response, if indeed any regulatory response is warranted. Before examining each of these explanations, however, it will be useful to reexamine briefly the current development of the viatical settlement market.

1. *The Current Landscape of the Viatical Market*—The first viatical settlement company commenced business in 1988.¹⁴¹ In a relatively short period of time, the number of companies grew to approximately fifty-eight in 1994. Of these fifty-eight companies, over half are located in California, New York, Florida, and Texas.¹⁴² As a result of this concentration of companies, the competitiveness of the market for viaticals varies naturally and

139. *Id.*

140. *Id.* at 397–98.

141. Quint, *supra* note 11, at D2.

142. As of March 13, 1995, California had 12 viatical companies, New York had 7, and Texas and Florida had 6 companies each; the remaining 27 were located in Alabama (1), Georgia (3), Illinois (3), Kansas (1), Kentucky (1), Louisiana (2), Maryland (2), Massachusetts (1), Michigan (1), Minnesota (1), Missouri (2), New Jersey (1), North Carolina (1), Ohio (4), Utah (1), and Virginia (2). Viatical Settlement Firms (unpublished list supplied by the National Association of People With AIDS) (on file with the *University of Michigan Journal of Law Reform*) (tabulations by the author).

substantially from state to state. Viatical companies can buy policies nationwide,¹⁴³ and many advertise their toll-free telephone numbers in nationally circulated gay publications like *The Advocate* and *Poz*, a magazine for HIV-positive gay men. These fifty-eight viatical companies together purchased approximately \$300 million worth of life insurance policies, or nearly 4000 policies, in 1994.¹⁴⁴ Most companies are rather small, having the capacity to purchase only five to ten million dollars in policies.¹⁴⁵

2. *The Supply-Demand Lag*—With only fifty-eight relatively small viatical companies in business in 1994, the supply of settlements may have lagged far behind demand. When supernormal profits result “because considerable time is necessarily consumed in expanding capacity to meet an experienced increase in demand”—a “supply-demand lag”—they “are justifiable as a necessary incident of the efficient working of a market system under dynamic conditions with uncertainty, and desirable as incentives to hurry a more appropriate adjustment of supply to demand.”¹⁴⁶ If there is far greater demand for viatical settlements than the existing viatical settlement companies can provide, and supernormal viatical profits result from this supply-demand lag, minimum payout regulation might take away needed incentives for new firms to enter the viatical industry.

Information that can determine the level of development of the viatical industry is quite sparse, but that does not render all conclusions unduly speculative. The supply that viatical settlement companies currently are able to provide is a fraction of the demand for viatical settlements. In 1994, viatical companies bought fewer than 4000 policies.¹⁴⁷ Safely assuming that the 4000 policies represent a small fraction of the number of terminally ill people who in 1994 owned life insurance and who, had they known of the possibility of viatication, would have elected to viaticate, it follows that the demand for viatical settlements vastly exceeds the supply that existing viatical

143. Those states that license viatical companies require licensure not only of companies located in the state but also of companies that buy policies of viators residing in the state. *E.g.*, CAL. INS. CODE §§ 10113.1(d), .2(b)(1); N.Y. INS. LAW § 7802(a), (f)(3); VT. STAT. ANN. tit. 8, § 3827(a), (f)(4).

144. Quint, *supra* note 11, at D2.

145. *Id.*

146. BAIN, *supra* note 137, at 398.

147. Quint, *supra* note 11, at D2.

companies can provide.¹⁴⁸ This assumption is borne out by anecdotal evidence from a viatical representative, who stated: "We have more sellers than we can possibly handle There are about five policies available for every single-policy buyer."¹⁴⁹ Although the viatical industry is growing at a rapid pace, it will be years before companies can attract enough investment to approach the demand for viatical settlements.

Because a supply-demand lag exists, viatical companies can pay less for policies than they would have to pay in a more competitive market. Minimum payout regulation in such an underdeveloped market actually could harm PWAs. The simple but powerful argument put forth by members of the viatical settlement industry and some advocates for PWAs contends: "The natural dynamics of the marketplace force [viatical] companies to strive for the efficiency that will allow them to offer the largest settlement."¹⁵⁰ Minimum payout regulations reduce viatical companies' supernormal profits, thereby removing the incentive for new companies and investors to enter the viatical market. This results in little new competition for existing companies and also stagnates the number and amount of payouts available to the terminally ill. The solution, opponents of regulation claim, lies in allowing the competitive pressures of the free market to drive settlement amounts higher.¹⁵¹ Low payouts to viators are the result of a temporary lack of competition. By allowing the market to develop unfettered by minimum payout regulation, new companies will continue to enter the market, competition will increase, and higher payouts to viators and more reasonable returns for viatical investors will result.

This argument may be correct and at least calls for great caution in setting minimum payout levels. It does not, however, lead necessarily to the conclusion that any minimum price regulations would diminish substantially the incentives to enter the viatical market. Whether minimum payout regulations will have the feared effect of diminished entry depends entirely upon where the minimum payout is set. If minimum

148. See Fulmer, *supra* note 26, § 1, at 1 ("The fact that not many firms are competing for the business means that there is little pressure to give clients larger cash settlements").

149. Zicklin, *supra* note 110, at 17 (quoting the president of a New York viatical settlement company).

150. Freeman Statement, *supra* note 2, at 787.

151. See *supra* note 135 and accompanying text.

payouts are set too high, they would take away much of the incentive for new firms to enter the viatical industry and could thereby prevent the increased supply that would result in larger payouts to viators and more reasonable profits to investors. Setting minimums too low would preserve incentives to enter the viatical market but would vitiate much of the consumer protection effects that provided the impetus behind regulation in the first place. The challenge is to set minimum payouts that preserve (but necessarily diminish) incentives to entry and still provide meaningful protection for PWAs.

The NAIC's draft minimums too strongly favored viators and likely would have had a substantial adverse effect on entry incentives.¹⁵² The draft regulations allowed little room for the viator to outlive his life expectancy and still provide the viatical company with a return commensurate with that risk.¹⁵³ The NAIC wisely rejected them. The minimums actually adopted by the NAIC, however, will not likely have a substantial effect on incentives for entry and will provide a significant measure of protection for viators.¹⁵⁴ As discussed earlier, those minimums allow significant room for the viatical company to earn a healthy return even on a viator who significantly outlives his life expectancy.¹⁵⁵ One cannot say that new viatical companies will cease to attract investors in the face of these regulations, when the regulations still make possible favorable rates of return. The more skilled the company becomes at accurately predicting the life expectancy of the PWA, the greater the company's profit on the policy. Although the minimum payout regulations surely will make viaticals less attractive to investors than they were with no regulation, even payout-regulated viatical settlements will remain a profitable investment under the NAIC's model.

Although supernormal profits may result from a lag between the supply of settlements which viatical companies can provide and the demand for settlements which currently exists, the NAIC's minimum payouts will not interfere unduly with market development. Moreover, the supply-demand lag might be only partly responsible for supernormal profits. Such profits also might result from something more invidious—like overreaching

152. See *supra* Part II.A. tbl. 1.

153. See *supra* Part II.A.

154. See *supra* Part II.A. tbl. 2.

155. See *supra* Part II.B.1.

by viatical companies—that makes minimum payout regulations desirable as a consumer protection measure.¹⁵⁶

3. *Profit as a Risk-Reward*—Professor Bain's second cause of supernormal industry profits is "the riskiness of business investment."¹⁵⁷ The risk that the viator will substantially outlive the viatical company's best estimate of his life expectancy¹⁵⁸ justifies a risk-reward but is not substantial enough to explain the twenty percent average profit which viatical companies currently enjoy.¹⁵⁹ The problem with viewing the supernormal profits of the viatical industry as a proper risk-reward is that, over a period of time, in a properly functioning market, "the risk rewards earned by successful firms should be at least roughly offset by the losses of unsuccessful [sic] firms."¹⁶⁰ Although only a few viatical firms have failed, the losses of the few companies that have failed do not approach the profits of those that have succeeded.¹⁶¹ A risk-reward was justified in the first years of the viatical industry, as companies entered an uncertain and highly speculative market characterized by legal uncertainty. Now, with no state prohibiting viatical settlements seven years after their creation, and with the NAIC's model regulation in place, that climate of uncertainty has waned considerably.

4. *Rewards for Innovation*—A reward to viatical companies also might be justified in the first years of the industry, not as a risk-reward but as a reward for innovation. This is Professor Bain's third explanation for supernormal profits.¹⁶² While supernormal profits may exist to reward entrepreneurs for the innovation of viatical settlements, innovation rewards should not be long term.¹⁶³ "Such rewards should emerge as the

156. Part II.D *infra* considers this possibility.

157. BAIN, *supra* note 137, at 397.

158. See *supra* Part II.B.1–2.

159. See *supra* note 26 and accompanying text.

160. BAIN, *supra* note 137, at 399.

161. At least one of the viatical firms that failed did so willfully, by taking the money of PWAs and disappearing with it. See Nan Lee, *Was Insurance Policy Buyout a Rip-off? AIDS Victims Sue Viatical Firm for Fraud*, DAILY REP. (Atlanta Bar Ass'n, Fulton County, Georgia), Mar. 21, 1994, at 1, 2 (noting one PWA who dealt with a corrupt viatical settlement company and who settled for only \$45,000 for a policy with a \$180,000 face value, only \$31,000 of which was actually paid to him). Unfortunately, while reports of successful viatical firms abound, the failings of viatical firms rarely are reported. Only when a viatical firm bilks viators out of their money and then closes does the press pay attention. See, e.g., *id.* at 2–3.

162. BAIN, *supra* note 137, at 397–98.

163. *Id.* at 400.

successful innovator 'leads the parade' in . . . increasing revenue with a new product, enjoying some period of extra profits until he has been fully and successfully imitated by other firms in his industry."¹⁶⁴ The viatical industry is young, but not so young that all viatical firms are "innovators" worthy of a reward for innovation. The existence of nearly sixty viatical companies suggests that the initial innovators have been "successfully imitated by other firms" and that the time for supernormal profits as a reward for innovation has since passed.¹⁶⁵ As Professor Bain notes, "true rewards to innovation . . . should not favor all firms, or even all principal firms, in an industry equally."¹⁶⁶ Supernormal viatical profits therefore cannot be explained on this basis.

5. *Monopsony*¹⁶⁷—Even though supernormal profits result at least partly from a supply-demand lag, there remains the possibility that supply may *never* catch up with demand, or that it may catch up only after an unacceptably long period. In spite of the existence of nearly sixty viatical companies, a monopsonistic market structure might exist. This is Professor Bain's final cause of supernormal profits:¹⁶⁸

[T]he only sort of excess profits that tend to be reflected in long-term average profits for entire industries are monopolistic excess profits. All other types of excess profit are likely to occur sporadically and irregularly, or to be confined to only part of the firms of an industry.¹⁶⁹

One viatical company representative hinted that viatical companies enjoy a monopsony when he stated that "[t]here are more policies here [in the United States] than we could ever afford to buy."¹⁷⁰ Of course, viatical companies looking for investors have obvious incentives to overstate their potential

164. *Id.*

165. *See id.*

166. *Id.* at 401.

167. If viatical settlements are considered a service sold by a viatical settlement company to the viator, then *monopoly* would be the correct term here. If viatical settlement companies are considered not as sellers of a service but as buyers of life insurance policies, then *monopsony* is the correct term. Either characterization is plausible, but the author thinks the latter more accurately depicts the viatical settlement industry.

168. BAIN, *supra* note 137, at 398.

169. *Id.* at 401.

170. Daw, *supra* note 112, at E1, E8 (quoting Frederick Hollander, vice-president of the Florida viatical company United Benefits).

for growth; but there is also truth in the viatical representative's statement. Although the number of PWAs who have life insurance and are financially strapped is unknown, viatical companies purchased only around 4000 policies in 1994.¹⁷¹ That number is much lower than even a conservative estimate of the number of policies available in the pool of financially strapped PWAs with life insurance. When the number of PWAs is combined with the more than 500,000 terminal cancer patients who die each year in the United States,¹⁷² it quickly becomes clear that it will be a long time before the viatical industry can catch up to demand.

It may be that this supply-demand lag which currently makes large profits possible is not at all temporary, but likely to stretch years into the future. The possibility of monopsony also argues for minimum payout regulation as the only way to restrain companies from exploiting their superior position in the market to reap high profits at the expense of the terminally ill.

6. *A Narrowing Market*—The fact that viatical settlements are not the only source of money to which some PWAs can turn in order to lessen their financial strain decreases concerns about the superior position of viatical firms in relation to demand. The life insurance industry's aggressive response to the proliferation of viatical settlement companies through the rapid expansion of accelerated benefits increasingly and substantially will reduce the demand for viatical settlements, as well as provide an alternative—and in many respects superior—source of funds.¹⁷³ From 1991 to 1994, the number of life insurance companies offering an accelerated benefit option increased ninety percent, from 113 to 215 companies.¹⁷⁴ The expanded availability of accelerated benefits also likely will slow new entries into the viatical market.

Nevertheless, viatical settlements will remain an option for PWAs when an accelerated benefit arrangement is impossible—that is, when the PWA has a life expectancy of more than

171. See Quint, *supra* note 11, at D2.

172. *Id.*

173. For a more detailed discussion of the accelerated benefits option, see *infra* Part III.

174. AMERICAN COUNCIL OF LIFE INS. & LIMRA INT'L, ACCELERATED DEATH BENEFITS: 1994 UPDATE 4 & fig. 1 (1994) [hereinafter ACCELERATED BENEFITS UPDATE] (on file with the *University of Michigan Journal of Law Reform*).

12 months.¹⁷⁵ Because most accelerated benefits options limit the amount the policyholder can accelerate to fifty percent or less of the policy's face value,¹⁷⁶ PWAs who accelerate may also be able to viaticate the portion of their policy that remains after acceleration. For example, a PWA possibly can receive by means of acceleration up to fifty percent of his policy's face value and still viaticate the remaining fifty percent. The availability of accelerated benefits thus does not signal the end of viatical settlements, even for those PWAs whose life expectancies are short enough to make acceleration possible.

Viatical company profits cannot be explained as a reward for innovation but can be explained partially as both a risk-reward and the result of a supply-demand lag. These partial explanations mandate considerable caution in setting the level of minimum price regulations, but they do not rule out such regulations. The possibility of a monopsonistic market structure argues in favor of minimum price regulation. When the possibilities for overreaching explored in the next section are considered, the case for minimum price regulations becomes stronger.

D. Overreaching

Even if the supply-demand lag in the viatical market is only temporary, the potential for supernormal profits still might exist once the supply of viatical settlements has caught up with demand. "Overreaching" by viatical companies in their dealings with vulnerable PWAs might support minimum payout regulation even if payouts will increase as more firms enter the viatical industry. Overreaching occurs when an unscrupulous viatical firm takes advantage of a PWA's compromised emotional state and desperate financial situation to gain a more favorable settlement for itself than it otherwise could obtain from a fully informed and rational decision maker, for whom obtaining money is not a matter of life or death.

To the extent that minimum payout regulations grow out of a desire to protect PWAs from overreaching, they are paternalistic, and paternalism seems to be an unsound foundation

175. See *infra* Part III.

176. See *infra* Part III.

for regulation. But what some dismiss as paternalism actually relates to concerns about the ability of certain consumers to make rational judgments.¹⁷⁷ H.L.A. Hart defended paternalism as an acknowledgment of "a great range of factors which diminish the significance to be attached to an apparently free choice."¹⁷⁸ Only if one believes that consumers *always* make rational judgments can one dismiss the concerns about overreaching that minimum payout regulations attempt to address.

All but the most stringent adherents to unrestrained competition recognize that there are situations in which interference with free market forces protects consumer interests and that consumers are not always rational economic decision makers.¹⁷⁹ Efficiency analysis presupposes that "[e]ach individual in the market is . . . the best judge of his own interests and [can] act rationally, maximising his utility."¹⁸⁰ This model of the rational economic decision maker may not be appropriate for some PWAs. PWAs who viaticate, by definition, have life expectancies of two years or less.¹⁸¹ In the face of such prospects, fully informed, rational economic decisions might not always be possible. If this happens in enough cases, the assumptions of the efficiency analysis fail, making a *prima facie* case for intervention in the market.¹⁸²

In his report on viatical settlements entitled *A System for the Exploitation of the Terminally Ill*, Joseph Belth noted that "persons who are terminally ill, and those close to them, probably are undergoing greater stress than they have ever experienced. Under those circumstances, they are easily confused and may be vulnerable to exploitation."¹⁸³ The exploitation of which Belth warned can occur in any number of ways.

177. According to Iain Ramsay, "the growth of the pejorative connotation of the term 'paternalism' is relatively recent." RAMSAY, *supra* note 33, at 55.

178. *Id.* (quoting H.L.A. Hart).

179. See, e.g., Ian Ayres & John Braithwaite, *Partial-Industry Regulation: A Monopsony Standard for Consumer Protection*, 80 CAL. L. REV. 13, 14 (1992) ("Laissez-faire policies that leave monopoly or oligopoly power unchecked in private hands might allow industry members to raise their prices above the competitive level."). But see MILTON FRIEDMAN & ROSE FRIEDMAN, *FREE TO CHOOSE: A PERSONAL STATEMENT* 222 (1980) (stating that "market competition, when it is permitted to work, protects the consumer better than do the alternative government mechanisms that have been increasingly superimposed on the market").

180. RAMSAY, *supra* note 33, at 40.

181. See *supra* note 15 and accompanying text.

182. See *supra* note 41 and accompanying text.

183. Joseph A. Belth, *A System for the Exploitation of the Terminally Ill*, 16 INS. F. 11, 12 (1989) (relating conversation with James A. Neidhart, M.D., director, University of New Mexico Cancer Center).

The inequality of bargaining power inherent in viatical settlements is a particularly powerful source of exploitation. A PWA looking to sell his policy is approaching death and is often financially desperate. The ravages of AIDS may have required him to quit his job, resulting in loss of income and employer-provided health coverage. Expensive medications may have drained his bank account.¹⁸⁴ As a result, he may willingly accept an offer that would be unreasonable by an objective standard. Across the table from him sits a viatical company possessing detailed information about his health. By one estimate, each policy buyer has five policies from which to choose for every one it can buy,¹⁸⁵ so viatical companies can be quite selective about which policies, and which PWAs, they select.

Consider a hypothetical viatical settlement in which a PWA seeks cash for his \$100,000 life insurance policy. Assume that the policy has a cash surrender value of \$1500 at the time it is viaticated. Given a choice between viaticating or not viaticating his policy, the PWA may systematically underestimate its value. To the PWA in this position, any payment he receives above the cash value of the policy is a windfall, since that payment is unavailable to him during his lifetime without a viatical settlement. An offer of \$55,000 may appeal to this PWA because it is \$53,500 more than he could receive from the cash value of the policy. But an offer of \$55,000 is unfair in the sense that it is \$45,000 less than the value of the policy to the viatical company or to the PWA's prior beneficiaries. Thus, to the extent that the PWA can perceive the benefits of viaticating his policy as a windfall and the costs of viaticating his policy as falling on his prior beneficiaries, the PWA may be vulnerable to overreaching.

The undervaluing of policies which can occur in viatical settlements results from the fact that viatical settlements redefine how people should think about their life insurance. To most people, life insurance is an asset which they purchase for the benefit of others, not themselves. They have had no occasion to think of it as an asset that is available for their own use, other than at its cash surrender value. As one insurance company executive noted of the advent of accelerated benefits, "Up until now, life insurance has been really death

184. See Dean, *supra* note 1, at 124-25 (discussing the cost of AIDS medications).

185. Zicklin, *supra* note 110, at 17.

insurance.’”¹⁸⁶ The same could be said of viatical settlements. By making life insurance an asset available to the policyholder, viatical settlements require policyholders to adjust their attitudes toward their life insurance.

Policyholders must stop thinking of life insurance solely as later benefiting their spouse or partner, children, or other loved ones and start thinking of it as an asset that they can use for their own benefit during their lives. Until life insurance is widely recognized as an asset accessible to the living policyholder, people may not value it sufficiently. The insured’s discovery that he can get substantial sums of money from his own life insurance policy may be a pleasant surprise. By setting a floor below which the viatical payout cannot fall, minimum payout regulations prevent viatical providers from taking advantage of that pleasant surprise. Efforts to make people aware of the value of their life insurance *to them* by informing them of the possibilities of viatical settlement and accelerated benefits should be encouraged along with any system of minimum price regulation.

The incentive to obtain the maximum payout may vary with the PWA’s intended use of the money, as well as with his life expectancy. For example, a PWA with only two years to live need not be overly concerned that the money he receives for his policy will last three years or four years, as long as it suffices for two years. In addition, many PWAs viaticate not to pay medical bills or housing costs but to take deservedly extravagant vacations or to buy exotic cars.¹⁸⁷ A PWA who wants to take a trip to Europe may not care whether he receives enough money to fly first-class instead of coach, but a PWA who needs to finance his supply of zidovudine (AZT) likely will care whether he receives enough to finance another three months’ supply of the expensive medication. Much more is at stake in the latter case. In addition, because the company will offer to pay the viator less for his policy as his calculated life expectancy increases,¹⁸⁸ a viator may not want to bet against himself by seeking out a company that determines he has fewer months to live, even if it means that he will receive a higher payout. Receiving a low payout is in this sense good news, for

186. Armstrong, *supra* note 84, at 39 (quoting Prudential Insurance Company of America executive, Jim Longo).

187. LIFE BENEFACTORS, L.P., VIATICUM (promotional video tape) (on file with the University of Michigan Journal of Law Reform).

188. See *supra* Part II.B.1.

it means that the company's physicians have determined the viator's life expectancy to be relatively long.

None of this concern with undervaluation, and the overreaching that it allows, means that all or even most PWAs are desperate, irrational, and incapable of driving a hard bargain for their policies. There is a good deal of truth in the National Viatical Association's statement that "[t]erminally ill persons are just that, terminally ill; they are not incompetent."¹⁸⁹ But protecting PWAs from overreaching does not deem them inherently incompetent: it only recognizes that they are often in circumstances which make their exploitation more possible. Minimum price regulation would make that overreaching impossible.

III. THE ACCELERATED BENEFITS OPTION

The limits of viatical settlements in providing money to PWAs and other viators have resulted in a new life insurance product that purports to make viatical settlements obsolete. The insurance industry and many commentators have trumpeted these "accelerated benefits" provisions in life insurance policies as the solution to the money problems of the financially strapped terminally ill, and the white knight to save the PWAs from the supposed exploitation and greed of viatical settlement companies.¹⁹⁰ Although accelerated benefits are preferable to viatical settlements in most circumstances, they are not, for reasons to be explored in this Part, a total replacement for viatical settlements.

Accelerated benefits are life insurance policy proceeds paid by the life insurance company to the policyholder before the policyholder dies.¹⁹¹ For accelerated benefits to be available to the policyholder, his policy either must already have an accelerated benefits option written into it, or his insurer must

189. NVA INFORMATION BOOKLET, *supra* note 32, at 13.

190. See, e.g., Nick Ravo, *Companies That Buy Life Policies Under Scrutiny*, CHI. TRIB., July 1, 1994, at C3 (quoting a New York financial planner as stating that "accelerated benefits from insurers [are] 'almost always' a better deal than payouts from viaticals").

191. CRAWFORD, *supra* note 68, at 184.

make the option available through a rider.¹⁹² Most accelerated benefits provisions allow the policyholder to accelerate benefits under a number of different conditions, the most common of which is the "diagnosis of a terminal illness for which death is likely to occur within a specified number of months."¹⁹³ AIDS is obviously one such condition.

First introduced in the late 1980s, accelerated benefits since have exploded in availability. Although only 215 of 446 companies surveyed by the American Council of Life Insurance and LIMRA International offered accelerated benefits in 1994, those 215 companies included most of the largest companies, holding approximately seventy percent of life insurance in force in the United States.¹⁹⁴ Over eighteen million people were covered by policies with accelerated benefits provisions in 1994, and that number is considered to be a substantial undercount.¹⁹⁵

The chief advantage of accelerated benefits is that, unlike viatical settlements, they cost the policyholder very little money. In fact, thirty-two percent of companies offering accelerated benefits in group policies do not charge the policyholder anything to accelerate.¹⁹⁶ Other group policy companies either charge the policyholder an additional premium (12%), take the fee out of the accelerated benefit paid to the policyholder (20%), or treat the payout as a lien and charge interest on the amount accelerated (20%).¹⁹⁷ For policyholders with individual policies, fewer companies charge nothing (25%), and more companies have adopted the additional premium (25%), discounted benefit (25%), or lien (23%) approaches.¹⁹⁸ Even when the insurer charges the policyholder for accelerating benefits, however, the

192. ACCELERATED BENEFITS UPDATE, *supra* note 174, at 7. In 1994, 84% of accelerated benefits were offered through riders that can be added to existing policies, while only 11% were built into the policies themselves. *Id.* at 7 & tbl. 5.

193. *Id.* at 3. Eighty-three percent of accelerated benefits "products" can be activated for terminal illness, 12% for a "dread disease," 11% when a need for long-term care arises, and 10% for conditions which result in a need for permanent home confinement (total exceeds 100% because some products can be activated by more than one condition). *Id.* at 5 & tbl. 2. AIDS, at least in its latter stages, could satisfy all of these conditions.

194. *Id.* at 4-5.

195. *Id.* at 15 & fig. 3. The undercount resulted from the fact that many of the companies offering accelerated death benefits could not provide information as to the number of policyholders covered by accelerated benefits provisions. *Id.* Note that those 18 million people own only .5% of all life insurance policies in force. Quint, *supra* note 11, at D1.

196. ACCELERATED BENEFITS UPDATE, *supra* note 174, at 13 & tbl. 17.

197. *Id.*

198. *Id.* at 8-9 & tbl. 8.

charge is insignificant when compared to the cost of viatical settlement. The Prudential Insurance Company, for example, deducts approximately four percent as its charge for acceleration, allowing a policyholder with a \$100,000 policy to retain \$96,000 for himself and his beneficiaries.¹⁹⁹

Obviously, a world in which all terminally ill people had life insurance with the option to accelerate benefits for no charge would be a great improvement over the current state of affairs. The limited availability of accelerated benefits, and limitations on exercising the acceleration option when it is available, however, leave intact the market for viatical settlements. Even if a PWA owns a policy with an acceleration option, strict life expectancy and amount limitations may make the option unavailable or financially unattractive.

For example, sixty-seven percent of companies offering accelerated benefits require that the policyholder have a life expectancy of less than one year in order to accelerate benefits.²⁰⁰ Thirty percent allow acceleration only by policyholders with life expectancies of less than six months.²⁰¹ This means that even PWAs who own policies with accelerated benefit provisions must sometimes wait for months, while their health deteriorates and their bills pile up, to exercise the option. In contrast, almost all viatical settlement companies accept policies of PWAs with life expectancies of up to two years, with some companies accepting those with life expectancies up to three years.²⁰²

In addition to these time limitations, most insurance companies offering accelerated benefit options restrict the percentage of the policy's face value which can be accelerated. Fifty-nine percent of companies offering acceleration limit the accelerated portion to no more than fifty percent of the policy's face value.²⁰³ Only twenty-five percent of companies impose no limit on the percentage of face value which can be accelerated, and only thirteen percent allow more than fifty percent (but less than 100%) of face value to be accelerated.²⁰⁴

199. Ian Brodie, *Delicate Issue Blooms into \$300m a Year Industry*, THE TIMES (London), July 19, 1994, at Business.

200. ACCELERATED BENEFITS UPDATE, *supra* note 174, at 6 & tbl. 4.

201. *Id.*

202. *See supra* note 112.

203. ACCELERATED BENEFITS UPDATE, *supra* note 174, at 9 & tbl. 9.

204. *Id.*

One significant advantage of accelerated benefits over viatical settlements is that the unaccelerated remainder of the policy, less any fee, goes to the policyholder's named beneficiaries upon his death.²⁰⁵ But that remainder to the beneficiaries is not always an advantage, especially if the policyholder's financial needs exceed the amount which the insurer allows him to accelerate. For example, if only twenty-five percent of face value is available through acceleration, that amount will be substantially less than the amount offered by even a low viatical settlement in a market without minimum price regulation, notwithstanding the fact that under an acceleration option, most if not all of the remaining seventy-five percent will go to the policyholder's beneficiaries upon his death. To a PWA strapped for cash and without children for whom to provide a death benefit, the amount offered by a viatical company may be more attractive than that offered by the acceleration option.

For many PWAs, however, acceleration will provide, at low or no cost, ample cash for their needs, while leaving intact a payout to their beneficiaries. Where both viatication and acceleration are available options, and where the terminally-ill person's policy allows him to accelerate a sum sufficient to meet his needs, accelerated benefits are superior to viatical settlements.

Because accelerated benefits are a new product, however, few people know of their availability. All state viatical settlement acts and the NAIC's Model Act therefore require that viatical settlement companies inform prospective viators of the possibility of accelerated benefits.²⁰⁶ This requirement seeks to avoid a major source of inefficiency in the viaticals market by preventing viators from accepting viatical settlements when acceleration would have provided them with more cash.

Accelerated benefits, while in many ways preferable to viatical settlements, are only preferable under quite narrow conditions: the policyholder must have purchased life insurance from a company that provides the option of acceleration, he must have less than one year to live, and his financial needs must be satisfiable by whatever fraction of his policy's face value acceleration will provide. If those conditions are met,

205. See CRAWFORD, *supra* note 68, at 184 (explaining that an accelerated benefits provision may allow payout of part of the death benefit and that the face amount and cash value of the policy will be reduced accordingly).

206. See *supra* note 51 and accompanying text.

acceleration is vastly superior to viatical settlement. If one of those conditions is absent, however, a viatical settlement might be a more attractive option.

CONCLUSION

Rather than a "ghoulish" practice that ought to be banned outright, viatical settlements can be a freeing and empowering option for PWAs and other terminally ill people. At present, however, that freedom can come at too high a price. Licensing requirements help to ensure high standards for viatical companies in a business which by its nature requires the highest ethical standards. Disclosure regulations help to ensure that PWAs are aware of accelerated benefit options and know the financial downsides of viatication. Minimum payout regulations will ensure that viators receive fair payouts for their policies, while still allowing viatical investors a reasonable return commensurate with the actual risks and costs of the viatical business.

