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# Life & Viatical Settlements

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Viatical Settlements are not for every investor. They were created by wealthy investors looking for higher investment returns. Backed by large credit lines, they formed companies known as viatical funding firms. These firms buy directly from the sellers, and then open up the viaticals for investors.

So, exactly what is a viatical product? They are life insurance policies, but in this form of use, they become investments. Viatical settlements allow investors to invest in another person’s life through their life insurance policy. The investor might purchase the policy entirely or a part of it, with other investors also purchasing a portion of the same policy. When the insured dies the investors collect the death proceeds. The investor’s returns depend upon the insured’s life expectancy and the actual date he or she dies. If the insured lives longer than expected, the investor’s returns are lower; if the insured dies sooner than expected, the investor’s returns are higher (due to the length of time premiums and other expenses are paid). It is possible to lose part of the principle in viatical settlements if the insured individual lives much longer than expected since it is the investors that continue to pay the policy premiums.

Investors buy as low as possible and if all goes well collect high returns in the form of death benefits when the insured dies. One could say the investor is investing in the death of the terminally ill insured. Through this investment, the viatical firm provides cash to the terminally ill individual who has transferred (sold) his or her rights to receive the death benefits.

The policy owner who sells the policy is called the viator. The insured and the policy owner may not always be the same person; it is the policy owner who has the right to sell the policy, not necessarily
the insured. It is usually the policy owner who contacts the viatical funding firm as the result of an advertisement they or their family has seen. Viatical funding firms spend thousands of dollars advertising the availability of cash for the death benefits in life policies held by terminally ill policy owners. These advertisements appear in many locations, but especially in magazines that target elderly individuals and the gay community. You may also see advertisements in local papers announcing area seminars. These seminars have two purposes: to obtain life contracts from terminally ill people and to promote investments in the policies.

**How do Viatical Settlements Work?**

Most providers, provider representatives, and brokers will ask the policy owner (viator) to complete an application and medical release forms so the life or viatical firm can gather information from their life insurance company and doctors. All acquired information must be kept confidential and cannot be given to anyone without the insured’s written approval. If the insured individual qualifies, the provider will make an offer for your policy. The amount offered will be based on specific facts, such as how long the insured person is expected to live, the amount of the policy premiums, the rating of the issuing insurance company, and the policy’s provisions, such as waiver of premium clauses. If the policy owner accepts their offer, he or she will be asked to sign a viatical settlement contract.

**Purchasing Partial Policies**

While the entire policy is often purchased, that is not necessarily required. The policy owner can sell the entire policy face value or only a portion of it. If only a part of the policy is sold, the policy owner will be required to assign or transfer only the part being sold. The provider will become the new owner of the policy and the insured’s chosen beneficiary will retain the rights to the unsold portion of the policy.

**The Difference between a Broker and Provider**

There is a difference between a life or viatical settlement broker and provider. Although both a broker and a provider will help the viator
with the sale of their policy, there are important differences between the two. A broker works for the viator. A broker will check with several providers to find the best offer available for the policy. A provider represents the investors. A provider will only make one offer for the policy, based on their internal funding parameters. If the insured uses someone to help with the sale of their policy, he or she may want to ask whether the individual is a broker or provider. It is important to know!

Viatical Participant Confidentiality

All personal information should remain confidential, even from investors. Any financial, medical, or personal information obtained by a provider or broker, including names of family members, spouses, or other significant individuals, may not be shared with anyone unless the viator has given written approval for sharing information. Any written approval for the sharing of this information must show who may get the information and why it will be released.

When viatical settlements first originated in the 1980s, many of the terminally ill insured individuals were from the gay community. Battling AIDS was difficult enough; they certainly did not want their identity and private medical and financial information made available to others.

Regardless of the situation however, anyone who is ill does not need any additional stress. There were actually cases where investors began calling the viator to see if he or she was still alive. Many states now have legislation in place to protect the viator from loss of privacy.

While language will vary, such legislation will still be substantially similar in content. It will state that, except as otherwise allowed or required by law, the provider, broker, purchaser, insurance company, or any other involved person who has knowledge of the viator’s identity may not disclose it to any entity or person that does not have a legal basis for receiving it. An authorized person would not include anyone who has or may have a financial interest in the settlement contract (an investor).
Paying the Viator

Different companies may have different procedures for paying viators for their life insurance policies. Some providers use escrow agents or trustees to handle the money used to purchase life contracts. The escrow agents or trustees usually send the money to the viators within three business days of the date the insurance company confirms to the provider that the transfer of ownership has been completed.

Buyers Remorse

If the viator changes his or her mind about selling their policy, he or she can cancel their life settlement contract at any time up to the date allowed in the contract or by state statutes following receipt of the money from the provider. If the viatical contract is canceled, it is important to remember to make sure ownership of the policy was transferred back to the policy owner. Each state may have specific requirements when contracts are canceled. Usually the state insurance department can provide exact details.

When Death Occurs Soon After Selling a Life Contract

The exact amount of time will vary by state statute or by the policy itself (as long as it does not go against state requirements), but if the insured dies soon (usually within 15 to 30 days) after receiving the money from the provider, the settlement contract will automatically cancel. As a result of this automatic contract termination, the insured’s original beneficiaries will receive policy proceeds from the provider, less any money it already paid for the purchase of the policy and any premiums paid to the insurance company to keep the policy current.

Following Payment for the Life Policy

After the provider has paid the owner for the life insurance policy and transferred policy ownership, they may begin calling to check on the health status of the viator. In many states, the number of calls is limited, often to once per three month period, depending upon the stage of the viator’s health (how close he or she is to death).

If the viator does not want to be contacted about his or her health status, he or she may appoint an adult person or persons to be
contacted on their behalf. That person must be in regular contact with the viator. The viator must give the provider their representative’s name, address and phone number. Once this information is received by the provider, they may not contact the viator unless they have tried and been unable to reach the contact person for more than 30 days. The viator may change his or her contact person at any time by sending a written notice to the provider. It is important to remember, however, that contact for the purpose of health status is necessary in order to eventually file a claim with the insurer and pay the investors following the viator’s death.

The provider must give the viator the name, address, and phone number of the person who will be contacting them (or their designated contact person) about the insured’s health status. This allows the viator or their representative to be sure the call is from the proper person. If the viator’s life is expected to end in one year or less, contacts to check on health status are typically limited to once every 30 days, depending on individual state statutes. If the viator is expected to live for more than one year, contact is typically limited to once every three months.

**Checking Health Status through Physicians**

Some providers will use the viator’s signed medical release forms to obtain updates on their health status through their doctors. The medical release form tells doctors they are allowed to release the viator’s medical information to the provider, their broker, or provider representative. Viator’s have the right to withdraw their medical consent in accordance with law.

**Extra Policy Benefits**

Some policies may contain extra policy provisions, such as waiver of premiums, accidental death benefits, or disability provisions. Policy owners may contact their insurance company or agent to confirm additional policy provisions. If the policy includes additional benefits, they may or may not be included as part of the life or viatical settlement contract. Usually benefits for accidental death would not be included as part of the viator’s settlement since death by accidental means is unlikely (he or she is already terminally ill). The additional death benefit would remain payable to the insured’s listed beneficiaries.
or the estate. If the policy provides future increases in the death benefit, the viator may want to ask how much the provider is paying for the purchase of this benefit. If the life policy is a joint policy, or provides coverage on the lives of other family members or anyone other than the viator, there may be a possible loss of coverage for the other individuals. The viator should ask their agent about this possibility.

Other Available Options (Besides Selling the Policy)

Some life insurance policies offer options that may allow the insured to keep ownership of their policy and still meet their current financial needs. The insurance company may offer accelerated death benefits, for example, to help out with costs in some medical situations. The policy may also offer loans, and surrender of the policy for its cash value. Before entering into a viatical settlement, policy owners would be wise to contact their insurance company or agent to see what options are available.

What Every Policy Owner Should be Aware Of

Entering into a life or viatical settlement contract may affect other people or even the insured or policy owner adversely. The following list is not necessarily inclusive of all adverse effects.

- There may be a loss of life insurance coverage on the viator’s spouse or other family members, if the policy (or any riders attached to it) covers their lives;
- The amount of premiums due could change;
- Policy cash values or dividends, if provided for in the policy, could be lost;
- A loss of other rights or benefits, including conversion rights and waiver of premium benefits that may exist under the policy might occur;
- There could be adverse tax consequences;
- The viator’s ability to receive supplemental social security income, public assistance, and public medical services including Medicaid might be affected; and
• The money received for the viatical settlement could be taken away from the viator by creditors, personal representatives, trustees in bankruptcy, and receivers in state or federal court.

Because of the above, individuals should contact an attorney, accountant, estate planner, financial planning advisor, tax advisor, social services agency, the issuing insurance company, or agent to find out what effect selling the policy may have on the viator and their beneficiaries or co-insured.

**Viatical History**

The viatical name comes from the word “*viaticum,*” which means **provisions for a journey.** We see this word in some of our religious ceremonies today, but their meaning alludes to preparing spiritually, not financially.

In ancient Greece, family members placed a gold coin under the tongue of the deceased as payment for the ferryman who would transport the deceased across the river Styx to the underworld.

Although we no longer believe we must financially prepare for death, the name has lent itself to the viatical settlement investments. Since it is linked to an individual’s death, the name is appropriate.

Viatical companies determine profits on the difference between what they paid the insured for the death benefits and the full death benefits received. Obviously, the insured is not paid the entire death benefit, but rather is paid a percentage of the full death benefit. Exactly what the insured is paid will vary based on several factors, such as any existing policy loans, whether or not the policy is paid up, and so forth. The discounts are steep even under the best circumstances, but for the terminally ill patient the income provided by selling their policy is often a necessity. Life insurance cash values are often less than the amount received by selling their policy to a viatical firm, so the insured individuals do not mind receiving substantially less than the death benefits.

Although viaticals have existed in some form for some time, they were not known in the U.S. until the mid 1980’s. Today they have
become so popular that many states either already have or will draft consumer legislation to control how they are represented and sold. Although the item being sold is a life insurance contract it is not necessarily a licensed life agent that will represent viatical settlements. While life insurance agents may be involved, an insurance license is not required in most cases. Therefore, it could be a life insurance agent representing the product but it could also be the consumer’s postal carrier, or any other individual.

States are beginning to pass consumer legislation regarding viatical settlements because there has been so much incorrect information regarding these investments. While some of the wrong information may be intentional (to sell the product), much more has been unintentional because those promoting viaticals are often misinformed themselves.

Many viatical companies have offered finder’s fees. Even some surprising professions have cashed in on the referral fees, such as doctors and attorneys. In many cases these professionals were not looking at the referral fees; they were referring their clients because they realize it is the only avenue open to such individuals to obtain badly needed cash. In response to this, however, many states have banned referral fees to professionals whose primary role is advisor or caretaker to the viator.

Not every terminally ill person with a life insurance policy will find a buyer for their death proceeds. Screening viators begins with the application process, just as it does for a newly written insurance application. As with insurance, the viatical application will eliminate some applicants immediately since they do not meet the requirements stated in the application. Each viatical funding firm will have their own specifications, although all of them will have similarities. Simply being ill is not sufficient. The illness must be acceptable to the viatical funding firm, with a physician stating an anticipated time of death. Each company will set its own standards for anticipated times of death. One company may purchase contracts that have longer anticipated times of death while others will purchase only life contracts that are expected to pay out within six months.

Obviously, not all life insurance policies will be acceptable. Some contracts, for example, may contain restrictions that are not
acceptable. If the insured has policy loans out, that might also be unacceptable to the viatical funding company.

Viatical settlements utilize underwriting in order to analyze the risks involved with the investment. **There are two major areas of risk for the viatical funding firm: medical and insurance.** Each of these two elements will be individually underwritten. By analyzing the risks involved, the viatical funding firm will be able to put a cost on their risk, so they then know (1) if the risk is acceptable, and (2) what the investors must invest (pay) for their portion of the investment.

**Medical Underwriting**

Since the investment is based upon the death of the insured individual it is not surprising that there would be medical underwriting. The viatical funding firm must verify the expected time of death; this will require a written statement from the attending physician. In some cases, more than one doctor must submit their statement. The medical underwriting is stricter than that used for insurance applications. Insurance is estimating their potential costs from the opposite view. When a life insurance application is taken, the insurance underwriters are looking to see how long the individual might live. The longer he or she lives, the higher their profit margin since they are collecting premiums during the insured’s lifetime. Viatical funding companies come from the opposite view – they want to determine when the insured is likely to die since their profit margins come from an early death. While the general principles are the same, how the two are medically underwritten are not alike.

**Insurance Underwriting**

The life insurance policy itself must also be analyzed. Some contracts will be more profitable than others. Verification of coverage (VOC) is required to confirm that the policy is still in effect and that the ill individual is the insured individual. Never would the viatical funding company merely accept the insured’s word of such. The viatical firm must also confirm that the policy is beyond its contestable period. They would never take a chance of a rescinded policy due to nondisclosure of requested information or inaccurate information on the policy application. The life insurance policy must also be assignable at full face value. By “assignable”, we mean the terms of
the contract allow the policy to be transferred to another person or entity. The insured person would remain the same but the policy *ownership* would be transferred.

Obviously the policy owner would not receive full death values; that would eliminate any profit margin for the viatical funding firm. Purchase price is determined by several factors, primarily the medical and insurance underwriting conclusions. Some states have adopted model viatical law that was drafted by the National Association of Insurance Commissioners. It basically states that if life expectancy is “x”, the purchase price should be no lower than a certain percentage of the actual death benefit. Not all states have adopted these recommendations, but we are likely to see more of them doing so in the years to come.

While there may be varying opinions on the value of life insurance policies, industry professionals generally agree that the insured should receive no less than 50 percent of the death benefits. Of course, there are always exceptions, especially if there are policy loans that will reduce death proceeds. Many advisors recommend that viators search the market place, getting multiple offers before making a decision. When investor demand is high, the viator is likely to receive more than when demand is down.

In the last few years, the industry has experienced a new trend: policies purchased solely to sell in the secondary market, such as stranger-originated life insurance (STOLI). They may also be called stranger-owned life insurance policies. **Stranger-Originated Life Insurance** is a life insurance contract in which investors with no relationship to the insured initiate an insurance policy against their life and fund the premium payments for investment purposes.

There is a similar arrangement known as **Spin-Life**. Investors pay seniors to apply for life insurance and lend them the money required to buy the policies. They then sell these policies to speculators. STOLI transactions are defined as life insurance policies manufactured for the express purpose of selling them in the secondary market.

The NAIC has been looking at viatical settlements and related issues since May of 2006, with recommendations drafted regarding them, followed by occasional updates.
The terms viatical settlements and life settlements are often used interchangeably, but actually there is a distinction. Viatical settlements typically involve transactions that involve shorter life expectancies, whereas life settlements involve policy owners with possible longer life expectancies. These arrangements have been well received by many terminally ill individuals who have few financial resources in the last stages of their lives. Unfortunately, many of the viatical vehicles used were not presented in reputable style to either the ill individual or those who invested in them. That is partly why the National Association of Insurance Commissioners and the National Conference of Insurance Legislators (NCOIL) each developed model codes for viatical settlements.

Viatical settlements should not be confused with accelerated benefits that may be available in some life insurance contracts. Accelerated benefits may also be referred to as “living benefits.” These benefits are paid by the insurer directly to the insured, with the loans deducted from any death benefits paid upon his or her death. While accelerated benefits may be part of the policy, more often they are riders or policy attachments.

Policy Ownership Transfer

Once an offer has been made and accepted by the viator, transfer papers are sent out to the policy owner. All policy rights will be transferred to the viatical funding firm using an Absolute Assignment form. The beneficiary designation will also be changed since that is going to be the investment benefit portion of the viatical settlement. Instead of Aunt Mildred or daughter Cindy receiving any benefits upon the insured’s death, those who invest in the policy will receive the death proceeds. The viatical company’s Release of Liability form will also be sent to the insured, releasing the viatical funding firm from any liability resulting from policy transfer. The release form must be signed by all current beneficiaries. This release form may also be called a “Release of Beneficial Interest” since all beneficiaries are releasing their rights to any of the death proceeds. In most cases, this form must be notarized ensuring that all beneficiaries did actually sign off.
While all transfer forms are important, the Release of Liability form may be the most important. Once beneficiaries sign and have their signature notarized, they have no legal standing to sue the company or investors to recover their inheritance. Only if the entire transaction turned out to be illegal would they have any legal recourse.

All the required forms are returned to the viatical company, copied, and sent to the insurance company. The insurer must then return the forms showing the new policy owner and the newly listed beneficiaries. Investors will also receive copies to prove the legal work has been completed. If there is a sole owner of the policy (rather than multiple owners) he or she should receive the original insurance policy. Co-owners will receive copies of the documents.

**Policy Premium Payments**

If premiums continue to be required, the viatical funding company will pay them rather than the insured. Some policies have what is called a “disability waiver of premium” that states premiums are waived after the insured has been totally disabled for six consecutive months. Of course, this must be proven to the insurer with physician statements and medical evidence. A disability waiver may also be called a “premium waiver.”

While premium waivers may be part of the policy, more often it is a rider or attachment that was purchased by the insured, usually at the time of policy application. They are common to both group life policies and individually issued life insurance policies. Waivers of premium must be continually qualified, meaning the insured must reaffirm a continued disability at specified intervals, such as every six months. If the policy has been sold to a viatical company, such qualifications continue to apply. Once sold, the waivers will require signatures from both the viator and the treating physician, just as it did prior to the sale.

If the policy contains a waiver but it has not been activated for some reason, the viatical company is sure to have it activated as soon as possible. Often the insured individual has not read his or her policy sufficiently and is not even aware the rider exists. As a result the required documentation was not sent to the issuing insurance
company. It is also possible that the required length of time has not yet been satisfied.

For example:
Paul Policyowner was just diagnosed with terminal cancer. His cancer is already advanced and his doctor believes he only has three to five months left to live. His life insurance policy requires certified disability for a continuous six months. Paul will not be able to activate the premium waiver for six months. He is likely to die prior to the six month total disability requirement.

Some terminally ill individuals continue to work, if only part time. They probably need all the income available to them so working will provide this. If the insured is working, even part time, the premium waiver does not apply. Therefore, even if such a rider or attachment exists, the viatical settlement company may not be able to benefit from it.

Policies that do not contain a disability waiver of premium are likely to have premiums still due. Policies having the disability waiver of premium clause will have premiums due as well if the insured has not met their disability requirements. The viatical company or its escrow agent will apply to activate the waiver (if one exists) as soon as eligible, but in the meantime they cannot allow the policy to lapse due to nonpayment of premiums.

Although the viatical settlement firm sends in the premiums on the policy to ensure it does not lapse, in many cases it is still the insured that ends up paying for them. Many viatical settlement agreements require the cost of future premiums to be subtracted from the policy purchase price. Most states having laws on viaticals require viatical settlement offers to include a net offer, meaning the actual amount to be received after premiums have been deducted. The premiums that have been deducted are typically placed into an escrow or custody account.

If escrowed premiums are not totally used because the insured died sooner than expected, the remaining funds will normally be kept by the viatical company. Many viatical companies use excess premium
dollars from one account to apply to another where the insured is living longer than expected.

Each company will have its own formula for determining the amount of premiums that will be needed prior to the death of the insured. There may also be factors unique to the situation, such as the amount of premium, policy cash reserves, or other factors. Premium rates are also individual since they are based on the facts disclosed in the original policy application. An applicant having existing medical conditions at the time of application, for example, may have been charged a higher premium rate than another healthy individual buying the exact same contract.

Premiums on issued life insurance policies are affected by several factors, including:

- Age at the time of application;
- Whether the policy is a current age or renewable term contract (meaning premium rates change periodically, usually upon the policy anniversary date);
- Gender
- Type of insurance issued, such as term or whole life policy;
- Whether it is a group or individual contract;
- Policy rating at the time of application (existing medical conditions, lifestyle, or health rated issues); and
- Additional riders or attachments purchased that increased premium cost.

Certainly any investors in the policy should require confirmation of all premiums paid. If the policy is allowed to lapse, the investor will not receive the portion of death benefits owed to him or her. Every viatical investor should absolutely require premium payment confirmation each and every month premiums are due. States that have enacted viatical legislation have implemented investor safeguards, but the smart investor will still require some condition in the contract that ensures premiums are paid in a timely manner. A lapsed policy will mean the entire investment is lost, including principle in most cases.
If the premium changes due to the type of policy issued, the viatical company must keep abreast of such changes. Mistakes can happen, so the wise investor will take the time to make sure premiums are current and correctly paid.

If the viator lives longer than anticipated (a common occurrence) the investors must then pay to keep the policy in force in many cases. Again, if premiums were not paid the policy would then lapse and all investors would lose the amount invested. When there is only a single investor in the policy it is usually not difficult to make sure the policy stays effective through payment of premiums. It can be more difficult when there are multiple investors in a single policy. Viatical companies have gotten smarter at collecting when necessary, but multiple investors presents more work when premiums are prorated among them. Investors must know how one person’s failure to pay premiums will affect them.

Note: it is very important to know your state’s laws. This course is not offering legal advice. As a professional you must know what laws affect viatical settlements in your state. Laws change periodically, usually with consumer protection in mind.

Outstanding Policy Loans

Any policyholder might take out a policy loan against the contract’s cash values, but those with illness are especially likely to have done so. While this would have been reflected in the amount paid to the viator, it also affects the investors. A policy loan might affect expenses that are passed on the investors. For example, there may be annual loan costs that must be paid. Some contracts might charge the viator for these expenses, but it is something investors must be aware of in case it affects their investment.

Many policy loan costs will affect the viator rather than the investors. Such expenses might be collected along with the premiums that will come due and be placed in the escrow or premium reserve account. In many cases, how extra expenses are handled will depend on the contract the viatical company uses, meaning it can vary from contract to contract. Investors are most likely to incur these expenses if the viator lives longer than expected so that the loan expenses previously
collected are inadequate. Once the fund is exhausted, investors would then be expected to pay these costs as well as any premiums due.

**Additional Investment Fees**

Any contract can have investment fees; it is up to the investor to read any contract well before signing on the dotted line. In the past some viatical settlement contracts seemed to purposely avoid expense disclosure. Since these investments seldom (if ever) return the investment principle it is important to know what is involved before investing. Many types of investments have fees, but such fees should always be fully covered by the selling agent.

Some viatical contract fees may be called “policy servicing fees” or similar wording. This might include such simple things as paying the premium each month and routine paperwork. It could also include filing for disability premium waivers, converting a group policy over to an individual contract or distributing fees upon the death of the viator.

Additional fees may exist for an important part of the viatical contact process: tracking the viator (insured) through their illness. As the viator gets closer to death it is unlikely that he or she will be well enough to keep track of physician statements to maintain the disability waiver, for example. Waivers must include the viator’s signature so the viatical company must know where he or she is. Ill individuals do not always remain at the same address. As their illness progresses they may be moved to a hospital, hospice facility, or nursing home - all of which must be tracked.

Tracking viators is not necessarily difficult. It may be as simple as preprinted postcards that are given to the viators. These are filled out and mailed in periodically. However, it has been reported that as many as 30 percent\(^1\) of the viators move; postcards depend upon the viator following instructions and continuing to keep in contact.

Viatical firms may also utilize relatives or friends that agree to be a contact during the final months of the viator’s life. The viatical funding firm will contact these individuals periodically for updates, often on a monthly basis.

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\(^1\) Philip Loy, president of American Viatical Services (AVS)
While tracking the viator during their last months of life may sound cold hearted, it is vital to do so. The viatical company and their investors will not receive any death proceeds without a death certificate so maintaining contact is critical. As illness progresses, the insured are likely to move to be near their family or to a climate that makes their final days more comfortable. As they move, physicians change. Viatical companies could easily lose track of the insured if such arrangements were not in place.

Viatical companies do sometimes lose contact with the viators. When contact is lost it has the potential of leaving investors with nothing if the individual cannot be located so that death can be verified with a death certificate.

Some companies contract with services that are established to track the viators. These companies have procedures in place designed to follow the ill individuals as they move from place to place or through the medical channels.

**Escrow Trust Accounts**

The very nature of viatical settlement contracts require escrow or premium reserve accounts. Whatever name is used, they are required to hold funds for coming premiums and other insurance contract costs. On the surface, they are used to keep funds safe until the insured viator dies and the death proceeds are dispersed. Unfortunately, not all escrow accounts are set up to protect the investors. There have been cases where the accounts were managed by persons or entities that have conflicts of interest.

Some escrow accounts have been set up in a person’s name. Even when intentions are good, this is dangerous for the investors. For example, let’s say the account is set up in the name of the attorney who drafts the viatical settlement contracts. The attorney then experiences legal problems; perhaps it is a messy divorce, bankruptcy, trouble with the IRS over taxes paid, or a lawsuit filed against the attorney. Whatever the case, the courts could decide the escrow account is part of the attorney’s assets and subject to settlement payments.
Viatical and Life Settlement Disclosures

Many states now have specific viatical and life settlement requirements. Generally providers and brokers must provide the viator with specified disclosures regarding the contract with each viatical settlement application. These disclosures must be provided in a separate document that is signed by the viator and the provider or broker. The disclosures may vary from state to state, but generally they include the following:

1. There are possible alternatives to contracts including accelerated death benefits or policy loans offered under the viator’s policy.

2. Some or all of the proceeds of the viatical settlement may be taxable under federal and state tax code. Assistance should be sought from a professional tax advisor.

3. Proceeds of the viatical settlement could be subject to the claims of creditors.

4. Receipt of the proceeds of a viatical settlement may adversely affect the viator’s eligibility for Medicaid or other government benefits or entitlements, and advice should be obtained from the appropriate government agencies.

5. The viator has the right to rescind a contract within a specified time period following receipt of the viatical settlement proceeds. If the insured dies during the rescission period, the settlement contract is rescinded subject to repayment of all viatical settlement proceeds and any premiums, loans and loan interest to the provider or purchaser.

6. Funds will generally be sent to the viator within three business days after the provider has received the insurer or group administrator’s acknowledgment that ownership of the policy or interest in the certificate has been transferred and the beneficiary has been designated. The time period may be based on state statutes so it is important for participants to know what their state has stipulated for the allowable payment time period.

7. Entering into a contract may cause other rights or benefits, including conversion rights and waiver of premium benefits, to
be forfeited by the viator. Assistance should be sought from a financial adviser.

8. Viators must be informed (usually by use of a brochure) of the viatical or life settlement process so they know what to expect.

9. The disclosure document must be similar to the following language in most states: "All medical, financial or personal information solicited or obtained by a provider or broker about an insured, including the insured’s identity or the identity of family members, a spouse or a significant other, may be disclosed as necessary to effect the viatical settlement between the viator and the provider. If you are asked to provide this information, you will be asked to consent to the disclosure. The information may be provided to someone who buys the policy or provides funds for the purchase. You may be asked to renew your permission to share information every two years."

10. The insured person may be contacted only by the provider, broker or its authorized representative for the purpose of determining the insured’s health status. This contact is limited to once every three months if the insured has a life expectancy of more than one year and no more than once per month if the insured has a life expectancy of one year or less. These time periods are typical, but since states can vary, again it is wise to know your own state’s requirements.

Generally, providers must provide the viator with any required disclosures no later than the date the contract is signed by all parties.

There are additional disclosures that must be conspicuously displayed in the contract or in a separate document signed by the viator and the provider or broker:

1) The affiliation, if any, between the provider and the issuer of the insurance policy to be viaticated including the name, address and telephone number of the provider.

2) A broker shall disclose to a prospective viator the amount and method of calculating the broker’s compensation. The term “compensation” includes anything of value paid or given to a broker for the placement of a policy.
3) If an insurance policy to be viaticated has been issued as a joint policy or involves family riders or any coverage of a life other than the insured under the policy to be viaticated, the viator shall be informed of the possible loss of coverage on the other lives under the policy and shall be advised to consult with his or her insurance producer or the insurer issuing the policy for advice on the proposed viatical settlement.

4) The dollar amount of the current death benefit payable to the provider under the policy. If known, the provider shall also disclose the availability of any additional guaranteed insurance benefits, the dollar amount of any accidental death and dismemberment benefits under the policy and the provider’s interest in those benefits.

5) The name, business address and telephone number of the independent third-party escrow agent and the fact that the viator or owner may inspect or receive copies of the relevant escrow or trust agreements or documents.
Life & Viatical Investing

Many professionals compare investing in a viatical settlement contract to buying a zero coupon bond with an uncertain maturity date. In the case of viaticals the return depends on the seller’s life expectancy and the date he or she actually dies.

Many investors might be surprised to learn that viatical settlements grew from the AIDS epidemic in the mid 1980s. The early victims of AIDS were mostly men and mostly unmarried. Even though they generally did not have families they did have life insurance policies. At the time mortality rates were high with life expectancies short (often due to the late stage diagnosis). As the AIDS victims grew sicker their ability to work decreased, often leading to loss of their jobs, followed by loss of medical coverage. Viatical settlements seemed like a way to help the dying as well as offering investors higher than average returns.

The result was a quick rise in popularity for viatical settlements contracts. Unfortunately for all concerned, there was little regulation that applied. Even though investors were investing in insurance contracts, the situation was unique enough that insurance regulators did not necessarily have jurisdiction.

Viators saw selling their life insurance contracts as a way of gaining badly needed cash and investors saw an unusual opportunity to make money. It should have been a winning combination. Since there was little regulation, viatical settlements ended up with a bad reputation in the investing community. Large sales commissions tempted the unethical salespeople to sell the contracts any way necessary. The honest salespeople were typically poorly trained, often making assumptions that simply were not true. Therefore, as a result of
greed, poor training, and inadequate knowledge many problems developed.

Although the early contracts saw many abuses, the basic concept can still be a win-win opportunity. The terminally ill can gain cash while investors gain earnings. In a 2002 study of hospice financial counselors having experience with viatical settlements, it was reported that many saw positive results for their patients. That doesn’t mean anyone should assume all such contracts are without risk; the opposite is true. There is indeed risk involved. One of the most famous viatical cases involved the Mutual Benefits Company headed by Peter Lombardi in Florida. He is now residing in prison as a result of his $1 billion Ponzi scheme.

Viatical Settlement Participants

As the various states enact legislation to control how viatical settlements are established and maintained they are likely to continue attracting investors. There are several parties involved in a viatical settlement:

1. The **viator**, who has been diagnosed with a terminal disease and is willing (often even eager) to sell ownership of his or her life insurance policy.

2. **Viatical settlement firms** that buy the policies. Although it is usually a company it does not necessarily have to be. An individual investor could buy the life insurance policy directly from the terminally ill individual. In that case, only the two parties would be involved. *Many informative brochures use “investor” to mean either the viatical settlement firm or individuals who invest funds in viatical settlement contracts.*

3. **Investors**, who invest through viatical settlement companies.

Most viators probably use brokers to help negotiate the process of selling their policy. Few people would be educated enough to correctly handle such a transaction on their own. Additionally, terminally ill individuals may not be up to the task of correctly maneuvering through this type of contract.
There have been some problems with purchasing life insurance policies solely for the purpose of selling them through viatical settlements. When this happens, terminally ill individuals attempt to cover up their illness in order to qualify for the policy. Since this could invalidate the policy when it comes time to disperse death benefits, viatical firms typically do their own medical and insurance investigations to circumvent this since “contestable clauses” would then apply. A contestable clause allows the issuing insurance company the right to refuse payment within two years of policy issue if underwriting was based on misinformation or omitted information.

Specifically, the incontestibility clause in life insurance policies is a provision setting forth the conditions under which benefits may be refused and the time period during which the insurer may contest or void the policy. After that time has passed (normally two years) the policy cannot be contested so benefits would be paid at the time of death. Some policies may still be contestible after two years for “material misrepresentation,” which would be fraud. Not all states nor all situations will allow funds to be withheld on those grounds, however. Viaticals have created an industry problem: some people are lying on life insurance applications for the express purpose of obtaining the contract, then selling it to viatical funding firms.

The Viatical Contract

Even a badly written viatical contract is still a legal document. Although the original viatical contracts were far less regulated than they are today, most transactions are still regulated to some degree by state and federal laws. As a result, most contracts include some standard provisions.

The early viatical agreements initially had no state or federal rules that applied specifically to viatical contracts. As a result each viatical funding firm used its own unique contract. Even the participating parties could be identified differently from contract to contract. This required the investor to be very attentive to all terms and provisions in the contract he or she participated in.

Contracts can be difficult to understand even when provisions are highly regulated, as they are for insurance policies. When there is no
regulation, they can be especially difficult to understand. Although the life insurance policies being sold are highly regulated, such regulation does not apply to viatical settlements. Some viatical contracts may be much more complicated than others. States are implementing viatical legislation to prevent some of the past experiences viators and investors have had.

Legitimate viatical companies use contracts that meet standard contract agreements and are usually multi-page in length. While each investor will develop their own viatical criteria through experience and preference, there is generally basic criteria that should be followed, including:

1. Length of time in the viatical settlement industry.
2. Whether or not they buy directly from the viator; most specialists feel it is best to buy directly from the viator.
3. Whether or not investors may buy directly from the viatical buyer; most specialists prefer to avoid going through marketing firms.
4. Licensing status; viatical funding firms should be licensed (or its parent company should be licensed) to do business in the state where the viatical contract is being sold to investors.
5. In some cases, securities compliance, meaning the company is registered with the state department in charge of securities. This is not necessarily required in all states.

Before investing, investors should be sure the viatical funding firm meets all the above requirements, not just some of them.

Consumers are often told to verify an entity’s licensing status, but few people actually do so. In this case, it is critical simply because there have been so many bad viatical contracts presented to investors. It is also important that the company be licensed in the state where the product is being sold. Viatical settlement contracts work best when they are ruled under the laws of the state where the investors live.

Many legitimate companies (as well as those not so legitimate) market viatical contracts under other names. For example, XYZ
company may form a sub-company to market its viatical investments, naming the sub-company something completely different. There are many reasons why a company would form a separate arm of the company to market viaticals or any other type of investment vehicle, including:

1. Administrative costs;
2. Potential future state or federal regulation; and
3. Existing regulations.

**Contract Standardization**

Investors and viators alike are likely to agree that the most difficult aspect of viatical and life settlements has been the lack of uniform standardization. States are changing this through legislation, however. Initially nothing about the contracts was standardized; not even the language and contract definitions.

All contracts are drafted for the protection of the contract writer. The early viatical contracts were no exception. While the majority of states now have laws that dictate many elements of the contract, it is still necessary for contract participants to be aware that the contract they sign is not necessarily written for their express benefit. Even so, most contracts have standard terms, clauses and conditions.

There are common elements to most viatical settlement contracts however, including:

1. Purchase price;
2. Policy requirements;
3. Viator health status requirements;
4. Independent medical evaluation requirements;
5. Current beneficiary waiver of interest requirements;
6. Escrow information;
7. Bank information (the bank that holds the escrow);
8. Applications
There may also be what is called a “hold harmless” clause in the contract, unless forbidden by the state of issue. This clause is used to reduce lawsuits. In effect, a “hold harmless” clause prevents the viator from blaming the viatical company or escrow agent for anything other than willful wrongdoing or gross negligence.

Beyond the listed eight items above, contracts vary widely. While all contracts must conform to federal and state laws, in many cases the language may still differ among contracts, so all participants must read them carefully prior to signing. Those who sell life and viatical settlements must also read the contracts they are representing. Unfortunately, individuals engaged in selling life and viatical contracts often fail to read the very product they represent.

The amount the viator will receive will depend upon the specific situation, such as his or her current health and the aging of the life policy.

**Viatical Settlement Terminology**

The following are viatical settlement contract terms all participants need to know:

**Beneficiary:**
The person or company who will receive the proceeds of the insurance policy once the insured or viator has died.

**Clean sheeting:**
Clean sheeting is a fraudulent practice that involves obtaining life insurance by submitting an application that hides adverse applicant information from the insurance company. When the policy is purchased with the intent of selling it, the facts hidden may include a known terminal or life-threatening illness or probability of illness.

**Contestability Period:**
Conditions set by an insurance company in which the company can contest the payment of a death benefit or cancel the policy should the insured die within a certain time period or under certain conditions, or should the policy have been obtained
fraudulently. Typically the time period in which an insurance company can contest an insurance policy is two years.

**Escrow Company:**
A company sometimes affiliated with or owned by the viatical settlement provider, which is set up to receive investment money from individuals for the purchase of viatical settlement contracts and which is to hold insurance policies purchased from viators. Often escrow companies pay the premiums on such policies and pay the proceeds to the investors upon death of the viator. It is important for the potential investor to investigate fully the credentials of the escrow company and any links which may exist between the escrow company and the viatical settlement provider. Recent apparent fraud has involved disappearances of such escrow companies or their personnel and the investors' funds.

**Face Value/Death Benefit:**
The death benefit, often called the policy’s face value, is the amount of money to be paid by the insurance company to the beneficiary upon the death of the insured.

**Fractional and Pool Interests:**
Some viatical settlement providers take a large life insurance policy and fractionalize its death benefits, selling the fractional pieces to multiple investors. They can also create a pool of viated policies and then sell fractional interests in the pool to investors.

**Viator:**
A person whose life is insured by a life insurance contract or certificate who wishes to sell or has sold the beneficial interest in his or her life insurance contract for a lump sum.

**Viatical Investor:**
A person who purchases the death benefit of a life insurance policy, or a fractional interest in such a death benefit, or an interest in a pool of such death benefits or fractional interests either directly from the viator or from a viatical settlement provider. More recently, such investments have been sold in the
form of interests in companies, such as limited-liability companies, formed for the purpose of buying viatics.

**Viatical Settlement Contract:**
An agreement between a viator and a viatical settlement provider or company [see below] to transfer the life insurance death benefit of the viator in exchange for money, typically for an amount of money less than the total death benefit of the policy.

**Viatical Settlement Provider/ Viatical Settlement Company:**
A person or company that buys or arranges purchases of the life policy’s death benefits from the policy owners for less than the expected death benefit amount, for the purpose of reselling them. Viatical settlement providers then sell the death benefits, at marked-up prices, as investments to individuals who expect to receive profits upon the deaths of the viators.

**"Wet Ink" Policy:**
“Wet ink” policies are a term generally associated with stranger-oriented life policies that are immediately sold within weeks of policy issuance, when the “ink is still wet” on the application. The newly issued life insurance policy should go through its two year policy contestability period before investors consider such viatics.

Individuals considering selling their life insurance policy for payment of a reduced face amount must realize that ownership of their policy will change. While this may seem obvious, there have been many instances where the policy owner did not seem to fully realize this. Policy “ownership” designates who the policy legally belongs to. It is the owner who has the right to change beneficiary designations.

When a viatical company or its agent is named policy owner, there is the additional risk that the policy will become subject to creditor's liens, including claims in a divorce or bankruptcy court. Obviously it becomes important for viatical and life settlement investors to be aware of this.

Some life insurance contracts have “irrevocable beneficiaries.” Irrevocable means the person or entity designated as the life...
insurance contract’s beneficiary cannot be changed without the written consent of the irrevocable beneficiary. A life insurance policy can have both an irrevocable and a revocable beneficiary simultaneously, if the insurer allows it. Investors are best served when they are designated as irrevocable beneficiaries. That does not necessarily mean the contract will always read that way. Sometimes the contract’s irrevocable beneficiary is the escrow trust. It may remain as the escrow trust or be transferred to the investors at the time of closing.

Generally viatical firms will only buy policies that are issued by solvent insurers; obviously the point is to receive payment upon the death of the insured. While states do generally have insurer guaranty funds, no company wants to deal with the procedures required to receive policy benefits under such circumstances. Many viatical firms also require the issuing insurer have a top financial rating, since they do not want to deal with companies that become insolvent at a later date. There may be firms that will accept policies that are issued by lower rated companies, however. Again this is something that participants should be aware of. If this information is not disclosed, it is important to inquire as to the company’s financial rating.

Each viatical firm will have specific requirements regarding the life insurance contracts they will buy. Such requirements will relate to life expectancy of the insured (viator), the age of the policy (for the incontestability clause), the insurer rating, and other elements the viatical firm considers important. The amount the policy owner may expect to receive for his or her policy will be directly related to the time the insured is expected to live and other relevant factors.

The escrow account and the manager of that account are important elements for the investor. Escrow agents/trustees are responsible for the safekeeping and disbursement of purchase funds, viaticum, and policy premiums. It is not their job to offer investment advice or make independent decisions. Their job is to keep records and write checks. If the escrow agent/trustee fails to pay policy premiums, the policy could lapse; obviously not what the investor wants to experience.

Escrow agents and trustees should not be allowed to share in the profits of the business. They should be third-party entities that are paid a fee for their services. Usually investors may see a profile of the escrow agents and trustees. Most professionals feel the escrow
account should not be set up in the name of an individual, law firm, or accounting firm. Doing so could mean the funds could be attached by the IRS, creditors, or individuals involved in a lawsuit against the person, or business firm. If the account became very large (some involve millions of dollars) there would also be great temptation to misuse the funds if they were controlled by a single individual or business firm.

Legitimate viatical companies use a nationally or federally chartered bank for escrow accounts. In some states, this is a requirement. While this does not guarantee legitimate business practices, it is a step in the right direction.

Some escrow trusts are interest-bearing accounts. If this is the case, investors should inquire as to whether or not they will share in the accumulated interest that is earned. Companies that keep all the interest earnings have less incentive to disperse investment funds quickly.

Many types of investments have administrative costs and fees, but investors must still make note of any in the viatical contract. Like so many types of investments, such fees can and will vary among contracts. While the purchase price may be all inclusive, this cannot be automatically assumed.

Some viatical contracts allow investors to do their own policy servicing and tracking. While this might initially seem like a good way to save money or simply follow the investment, some questions should be asked. If the investor initially wants to service the account themselves, what happens if he or she changes their mind? Is it possible to shift the job back to the viatical company? There have been many cases where the viator moved or contact was lost with them. It is important to keep contact with viators since it is their death that triggers insurance payment from the life insurance company holding the policy.

When a viator lives beyond their expected time of death investors must continue to support their investment in the form of paying policy premiums and any other expenses associated with the life insurance contract. This might include administrative costs of the viatical firm, such as tracking the insured individual and other administrative
functions. Some viatical and life settlement contracts may have a specified time in which additional funds must be supplied by investors. If the investor fails to pay the required additional funds for premiums or other costs, the viatical firm may use other legal means to collect them.

When a life insurance policy is owned by several investors, as is often the case, it could mean that some of the investors end up paying additional funds on a viator that lives beyond his or her expected lifespan, while other investors fail to pay. Most viatical and life settlement contracts expect this problem and have solutions in place to prevent the life policy from lapsing due to nonpayment of premiums. Solutions may vary, but often viatical firms take loans out against the policy cash values or dividends to pay the required premiums. They might also use excess in reserves from policies of other insured’s who died sooner than expected, leaving excess funds in the escrow accounts. Many viatical and life settlement firms keep the funds remaining in escrow when a viator dies sooner than estimated to cover such occurrences as this.

Since the length of time a life insurance policy must be supported determines the cost to investors, correctly evaluating the expected lifespan of a terminally or chronically ill viator is extremely important to the viatical participants. Viatical firms will request current medical records from policy owners to determine their investment risk. Like insurers, viatical firms review medical records prior to entering into a contract with the policy owner. Also like insurers, viatical firms employ analysts to make judgments on the likely lifespan of the terminally or chronically ill insured individual. However, there is no sure way to make judgments of this kind. The insured persons may die sooner or later than expected, and this is the risk investors accept. The risk can be minimized however, by using sound underwriting practices, including contacting attending physicians and considering new trends in medical treatments.

Unfortunately, investors may have no way to verify the viatical firm has correctly evaluated the viator’s medical information or that the information given to the investors is accurate. While we would like to assume that all viatical firms are honest, past experience has taught us that many will misrepresent the medical history of the viators in order to obtain investors. Due to privacy concerns, in most states
investors are not allowed to view or otherwise obtain the medical records of viators. Investors must rely on the past performance of the companies they deal with. A company that has been reliable in the past will generally continue to be reliable today and into the future, unless other factors change, such as management. If pertinent conditions change, investors may want to re-evaluate the viatical firm.

In states that have passed viatical and life settlement legislation, there is the right to cancel or rescind the purchase within a specified time period. The time period might be dictated by state statutes or by the contract itself. If the viator or investor has buyer’s remorse, he or she can cancel within the stipulated time period and receive a full refund, less any loans, charges, or other costs that are specified in the contract. In the case of a viator, he or she must return all money received when their policy was sold.

There may be rescission fees since companies acquire costs during the processing of a life insurance contract purchased from a viator. There may also be rescission fees for investors that cancel. Viatical firms take time to process orders, and it is reasonable to be compensated for their time and expenditures in doing so.

Most viatical and life contracts have risk disclosure forms. These may be just a paragraph or two long or they may be several pages long, depending on the company and the product concerned. Generally, they ask the participant to certify that he or she has read all disclosures, contracts, and relevant forms and have understood their content. They also usually suggest the participant seek the advice of council, whether that may be an attorney, financial advisor, tax specialist, or accountant. The participant has, upon signing the risk disclosure, confirmed that they are aware of and accept all risks associated with the viatical or life settlement contract. What risks are they referring to? There are several, including the following:

- There may be no established market that an investor could resell their viatical settlement contract to (although some viatical firms will buy back their investments);
- Medical developments or changes could extend the lives of some individuals with terminal illnesses (there are never dates-of-death guarantees);
• Fraudulent transactions of individuals cannot be completely eliminated even by those viatical firms that perform excellent due diligence on the contracts they buy.

There is another risk that may or may not be on disclosure forms (unless mandated by state statutes): if the insurer becomes insolvent, even in states with insurance guaranty programs, the investor may experience great delays in payment and the amount of payment will not be guaranteed since full death benefits may not always be paid.

Unless terminology is uniform by state statute, investors and viators will see some variance in terms used. The term “maturity risk” is often used when speaking of the viator’s predicted life expectancy. The term “cancellation risk” may be used when there is the risk that the investor will have no claim or only a partial claim to the total death benefit in a life insurance policy.

It is important to realize that viatical and life settlement investments do carry real risks for the investor. The maturity date is not guaranteed; the annual rate of return cannot be actually determined until the insured’s death; finally the viatical settlement is not a product of or guaranteed by any financial institution. Viatical and life settlement investments are subject to investment risk and possible loss of principal.

Investors are seldom aware that viatical firms will sell investors life insurance policies that were rejected for their own portfolios, due to risk factors. In fact, some life insurance policies may be accepted solely for the purpose of earning commissions from sales to investors. Therefore, it may be better to purchase viatical investments through a stockbroker or licensed insurance agent, since these individuals are more likely to be professionals that represent several viatical companies as well as other financial products.¹ Licensed professionals have a legal obligation to perform due diligence for their investors that may not legally exist for other individuals selling viatical settlement and life settlement investments.

¹ Viatical Settlements by Gloria Grening Wok, M.S.W.
Securities

Viatical settlement contracts are sometimes sold as securities. Investors should be aware of the risks involved, of course, and the differences between viatical settlements and other types of securities.

Most often the investor in a viatical settlement contract is dependent upon the viatical settlement provider (or another party selected by the viatical settlement provider) to see to it that the viatical settlement contract and the underlying life insurance policy is maintained. This involves anything from determining the life expectancy of the viator to maintenance of the life insurance policy, such as paying premiums and filing for the death benefit upon the death of the viator.

Most states require viatical settlement contracts that are sold or packaged as securities to be regulated as such. As with most securities, there are risks involved. Too often those risks are not adequately disclosed to the investor. Unfortunately, past experience has shown many instances of fraud in the viatical industry. While states either have or will address issues that lend to fraud, viatical and life settlement participants must still use sound judgment, independent of any state requirements.

As always, anyone considering investing money in any security should thoroughly research the product, the individual, and the company offering the security. A polished sales technique, high-pressure sales tactics, or promises of huge returns should not be a replacement for researching the investment and the person or company offering it.

All investors should be aware of several things prior to investing in a life or viatical settlement contract, in a pool of such contracts, or in any venture investing in life and viatical settlement contracts. Some of the important questions investors should ask themselves include:

- Have I thoroughly researched the viatical settlement provider or promoter offering the investment, and the agent offering to sell the investment? Are they rated by any rating services and what are their financial ratings? What are the backgrounds of the people who control the life or viatical settlement provider or company, including business history? Are there any complaints filed against them? If so, what are they?
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- Are the viatical settlement provider and their agent licensed to do business in my state? Contact the resident state to determine the answer.

- Is this investment suitable for my portfolio? Do I understand the risks involved and can I afford those risks?

- Does the viatical settlement provider permit early return of all or part of my investment in case of a personal financial emergency? If not, can I afford to have my money tied up longer in the event that the viator exceeds the projected life expectancy? Typically viatical settlement contracts are illiquid, meaning investors cannot get their money back until the viator dies. One of the major problems with viatical investments is that terminally ill viators often outlive their projected life expectancies due to medical advances and better care, thus radically reducing the investor’s anticipated profits (yield).

- What documentation have I received about the viators?

- Does the viatical settlement provider have viated policies in hand or contracts to purchase insurance policies? While state legislation has curbed many abuses, it is still important to know if the viatical company has life policies available. In some cases investors' money have sat in the promoters' bank accounts, earning no returns for their investors.

- Does the life insurance policy have any exclusion related to transference to third parties or is it contestable by the insurance company? Many states have mandated disclosure forms relating to incontestable periods, but if investors do not completely read their contracts they may miss this investment provision. So-called "wet-ink" policies have also been obtained by some viatical settlement providers that may have been obtained fraudulently by the viators. These investments must go through the two-year contestability period to avoid payment delays or even rescission of the policy if the insurer feels the policies were obtained fraudulently.

- If the insurance company detects illegal activities, the company will cancel or refuse to pay off the policy. The same is true for the sale of viaticals in which the policies were "clean sheeted,"
meaning they were obtained from the insurance companies without full disclosure of the viator’s existing medical conditions.

• **What are my fees and commissions charged by the viatical settlement provider and agent?** Specifically ask to receive all charges in writing.

• **How does the viatical settlement provider track and reports the status of my investment to me?** This refers to tracking and reporting the current medical condition of the viators. Who is responsible for filing death certificates and claims with the insurance company?

• **Who is responsible for paying the premiums of the life insurance policy or policies, and when are they due?** If it is the viatical settlement provider or a trustee, what is their background and business record? Failure to pay premiums could lapse the insurance policy and jeopardize the investment.

• **Who issued the life expectancy estimate?** Is he or she a licensed medical doctor? Did he or she actually examine the viator, or merely review a report? Were medical records confirmed by the listed physician?

• **Who becomes the beneficiary of the life insurance policy on the records of the insurance company - investors or the viatical settlement provider or trustee?** If it is the viatical settlement provider or a trustee, what is their background and business record? Is the beneficiary designation irrevocable?

• **Who actually receives the death benefit from the insurance company upon death of the viator – the investor, the viatical settlement provider, or a trustee?** How and when are death benefits paid to investors? Are any further costs or expenses to be deducted prior to payment?

• **Have I consulted with appropriate investment advisers, unaffiliated with the viatical settlement provider or the sales agent, regarding tax and other legal and practical implications of investing in a viatical settlement contract?**

Investors should not invest in any viatical-related investment until they have all viatical information in writing and feel they understand the information. If they do not understand any portion of it, investors
should consult with someone experienced in viatical settlements, but not associated with the viatical firm selling the settlement.

**It is Important to Remember**

- Life and viatical settlement contracts are relatively new, emerging in the 1980’s, and may not be as regulated as some other types of investments. Many states are now regulating life and viatical settlements, but investors should still know their rights before purchasing them.

- Be wary of any proclaimed “guarantees,” or “high return on investment” promises whether you are an individual considering representing life and viatical settlement contracts or an investor considering them for your portfolio.

- No one should feel pressured into acting as any participant in life or viatical settlement contracts until he or she understands them. Investors must understand the process in order to make an informed investment decision; individuals considering selling viaticals must understand them prior to representing them.

**Accelerated Benefits**

Some life insurance policies offer an accelerated death benefit option that allows the insured the option of receiving up to 80% of the death benefit at any time within the last year of their projected life. The remaining 20% is then paid to the insured's estate. Policies that offer this may circumvent the need to enter into a viatical settlement since it is unlikely the policy owner would receive 80% of the death benefit from a viatical settlement.

**Application Clean Sheeting**

The term *clean sheeting* came about because some agents presented a life or health application to the issuing insurer that did not contain all the facts necessary for appropriate underwriting of the risks involved. Since the application appeared “clean” of health problems or other underwriting issues, it became known as “clean sheeting” the application. Unscrupulous individuals in the viatical industry also use
"clean sheeting" by intentionally failing to disclose the applicant's status as being terminally or chronically ill. It was easy to do initially because most insurance companies avoided the added costs and invasiveness of medical exams and blood tests by relying on an industry honor system below a certain policy face value. Larger policies would be underwritten more extensively prior to issuance. This is changing as the viatical industry grows, with insurers beginning to underwrite even smaller policies more extensively.

Some viatical agents and brokers have assisted and encouraged viators to commit such fraud because it not only provided more policies than would be available though legitimate means, but it also provided a much higher rate of return due to the fact they can be bought from viators so cheaply under these conditions.

In legitimate transactions, ill policy owners usually receive 50%-70% of the face value of the policy. However, a "clean sheeted" policy viaticated during the contestable period may offer as little as 10% of the face value because it carries the high risk of rescission, or cancellation by the insurance company, due to fraud. States either have or will be addressing this issue through legislation.

**Wet Ink Policies**

It is best for viatical investors when the life policies they are investing in are at least two years old so that contestability periods have been satisfied. When a policy is purchased for viatical or life settlement immediately after the policy has been issued, it is called a wet ink policy, because the "ink has not had sufficient time to dry". After the policy is issued, the insured person sells his newly issued policy or even multiple policies from different insurance companies within weeks to a settlement provider using a broker.

Most people do not suddenly find out their life is terminal within weeks of purchasing a new life insurance policy. To see that happen repeatedly within a short period of time with the same broker or provider is strong evidence that they are both well aware that the policies have been "clean sheeted." Individuals involved in this practice use many practices (changing beneficiaries, policy assignment, and so forth) in an attempt to hide the activity.
Contestability Period

Some settlement providers delay reporting that the policy has been viaticated until the contestability period is over. Perhaps they falsely believe it is not a crime when they wait to report the viatical activity or perhaps they purposely intend to deceive the insurer and the viatical investors. Whatever the case, states are passing or have already passed required reporting procedures to halt this practice. If the parties attempt to hide the viatication of fraudulently obtained policies from the insurance company for as long as possible they obviously understand contestability issues.

Insurance companies have a contestability clause for two years after issuance, during which time it may be rescinded by the insurer for fraud in the application. After this period ends, the insurer is obligated to pay the death benefit, regardless of any fraud in the application. Because policies viaticated during the contestability period may be rescinded they bring a much lower price in the market.

Insured’s Life Expectancy

In a viatical or life settlement the maturity date of the investment is the date of the viator’s death, which releases the policy’s death benefits to the listed beneficiaries. To determine their rate of return investors rely on a report that projects the life expectancy of the insured. A reliable viatical firm will use only individuals who are skilled at making such projections. Investors should specifically ask about the skills of the analysts performing this job since an individual who is not sufficiently trained or experienced is likely to make the investment a poor choice.

Viatical investing is highly speculative and risky. Although the insured is terminally ill, predicting the insured’s time of death is far from an exact science. New drugs and treatments have compounded the risk for investors because they help policyholders live longer.

Viatical settlements are illegal under Canadian insurance legislation so Canadian investors should not be involved in viatical investments at all.
Cases of Fraud

One of the reasons the states have been passing viatical settlement legislation is due to the cases of fraud that have occurred. Financial Federated Title & Trust, and Asset Security Corporation pled guilty after being charged with conspiring to recruit insurance agents to defraud more than 3,000 investors while purchasing viaticated insurance policy investments over a three year period.

American Benefits Services was ordered to pay $129 million restitution on a corporate guilty plea where the company fleeced people with promises of high returns on purchases of life insurance policies from the terminally ill. Investors were told that their money would be used to purchase a beneficial interest in viaticated insurance policies, and that medical overviews were being performed on the insured persons whose policies were being bought.

Although at least $115 million in investor monies was taken in, the promoters used only $6 million of these funds to buy insurance policies whose total face value was just over $7 million. They used the balance of the money for purposes totally unrelated to the purchase of viaticated insurance policies, such as the purchase of twenty-five houses in Florida, Vermont, South Carolina, Massachusetts, Georgia, and Toronto, two helicopters, thirty-four luxury automobiles, three motorcycles, several jet skis and boats and a Fort Lauderdale burrito shop.

A company named Personal Choice Opportunities (PCO) misled investors when they sold viatical securities in the form of loan transactions. Investors lent money to PCO for them to purchase the benefits of life insurance policies from terminally ill individuals on the promise that they would receive a return on their investment of 21-25% per annum. However, the funds were not used to purchase life insurance policies but instead kept by the company. No evidence of any valid life insurance policies being purchased was ever discovered.
Repercussions for the Industry

Life insurance premiums are based on actuarial tables, but these tables are worthless in fraudulent applications. When the risk of issuing policies cannot be fairly calculated, it eventually affects the honest insurance-buying public. Insurance companies cannot afford to pay out large death benefits after collecting small premiums for only a few years. Even if they don't go bankrupt the added costs are eventually passed on to their other honest policyholders.

If the viatical industry as a whole cannot effectively police itself, states must then pass legislation to do so, and many states have. Investors will not invest if the industry is perceived to be dishonest. The industry could disappear by either being legislated out of existence or through lack of investor confidence.

Investor Risks

Investments have risk; there should be no surprise in that statement. Most people attribute Robert Worley, Jr. of New Mexico as having initiated the first viatical settlement investment. In the mid 1980s he brought together investors to fund the purchase of a terminally ill client’s life insurance policy. These investors formed a company called “Living Benefits.”

Viatical settlements present risk for their investors, just as other types of investments do. Investors pay a discounted amount for the life policy’s death benefit. The actual amount paid to purchase the rights to the death benefit will vary, based on local practices and any state requirements that may apply, but it is common for the seller to receive 50 to 60 percent of the actual death benefit (face value or face amount). Investors hope to see early returns while the insured obviously hopes to delay them (investor returns are triggered by the insured’s death). It is the deep discounts on the death benefits that provide the potential of high returns. However, it is important to remember that there are no guarantees in viatical settlements. Even the very sick may have an unanticipated return to health or delay in death.
The level of viatical risk varies based upon the life policy purchased. Most professionals give investors the following recommendations when considering investing in a life insurance policy:

1. Invest only in policies where the insured has a life expectancy of no more than three years (remembering that analysis of expected death is not an exact science).

2. Make sure the policy being purchased is from an insurer with a high rating; usually it is recommended that companies have at least an A rating (A.M. Best). Similar rating agencies may use different rating systems than Best uses, but whatever rating agency is used, be sure the company is financially stable.

3. Do not invest in policies that are still within the contestability period. As viaticals gain prominence it is likely that we will see increasing numbers of insurers looking at the cause of death during the contestability period.

4. Policies with a premium waiver provision are advantageous for the investor.

5. Make sure the life policy being purchased can be assignable, and the investor should be named as the beneficiary rather than the viatical company or some other entity or managerial person.

6. It should be verified that the insured was legally sane at the time he or she sold their life insurance policy.

7. The suicide exclusion time period should already be satisfied.

8. If the insured is still working and is selling his certificate of insurability through a group policy it is important to verify that the face value of the policy is maintained after he or she is no longer able to continue working.

9. If it is a group life insurance policy, the master contract must allow continued coverage even if the master policy is terminated by the employing company.

Although we did not list it, investors are also wise to know their own state laws regarding viatical settlement contracts. Most people would like to believe that agents and viatical companies know and follow their state’s laws, but no investor should automatically assume this will happen.
Viatical agents and representatives should certainly know their state’s laws. A salesperson might assume that the viatical company will know and follow applicable laws, but that cannot be assumed. By knowing and understanding state laws, viatical representatives will protect not only their clients, but themselves as well.

Following the nine recommendations provides valuable investment guidelines, but does not guarantee all will go well with the investment. Each listed item is more complex than one might realize. While many states require full disclosure, like all investments, loss of investment funds is always possible. Many viatical companies actually invest their own funds in viatical settlements, but that does not guarantee the outcome either. Since there are many variables, including a viator that gains their health unexpectedly, risk is always present.

An important term in the viatical industry is “maturity risk.” It refers to the possibility that the insured (viator) may not die as quickly as was predicted. Maturity risk is highest when the life policy paid more for the death benefits. For example, if the viator was paid 80% of the death benefits there is less room for profit if he or she lives beyond projections. If the viator was paid 50% for the same death benefits, longer life is less likely to result in investment loss. Each year of life beyond the initial projection results in reduced yields for investors. If the viator lives long enough, the investors will actually lose money because there will still be expenses, such as premiums and administrative costs.

There are many risks in all investments, but the viatical industry operated without restraint long enough to invent some new risks. While many of the previous risks may be minimized through legislation of viatical practices, no investor should think the risks totally evaporated.

It is generally the viatical company that selects the insured, evaluates his or her life expectancy, verifies the insurance coverage and assignability, and sets the policy purchase price. It is evident that the investor must fully trust the viatical company, so it is important to know who the investor is placing their trust with.
In the eighties and nineties there were plenty of viatical scams. While there were honest companies, there were also many dishonest ones. “Buyer beware” was the viatical theme. The maverick companies were hard to recognize since they used the same industry terms; investors had little tools available to distinguish between the companies that were trustworthy and those that weren’t. Viators also faced problems; viators signed over their life contracts without receiving adequate compensation for them. No one was surprised when the states began passing viatical legislation.

The National Association of Securities Administration Association (NASAA), a regulatory body, issued a public warning in 1985 about the many abuses in the viatical industry that were occurring. The viatical settlement can be very valuable to the viator needing cash during their terminal or chronic illness and there are many investors who have had good returns from viatical investments. The concept is one that should provide a win-win situation when performed ethically and honestly.

**Understand the Product**

When investors invest funds in a viatical settlement product they are buying a prediction of investment maturity. In other words, they are buying into a life insurance policy based on the prediction of the insured’s death. In order to invest wisely, the investor must know two primary things: how the prediction of death (investment maturity) was arrived at and secondly, how a life insurance policy functions. Obviously the investor must also feel certain they are dealing with a viatical firm that is legitimate, but for our purpose in this section, we will assume the firm has been evaluated and found to be trustworthy.

**Maturity Risk**

Analysts who measure risk, like any profession, can be excellent, average, or just plain bad at their job. Insurance companies cannot afford an analyst who is bad at their job since their industry is based on knowing their risk when they issue an insurance contract. That doesn’t mean insurers never have a bad analyst, but it is unlikely that one would remain employed in the insurance industry for long.
When viatical settlements first came out in the 1980s most companies did not employ seasoned risk analysts. There were little or no requirements of them to provide accurate estimates of maturity risk (dates of probable death) and little investor understanding of the necessity of doing so. It is important to again stress that investors are buying predictions when they invest in a viatical settlement contract. A poor prediction could mean more than just poor yields; it could also result in loss of investment funds.

When a life insurance policy is first issued, the life insurance company has determined risk based on longevity of the insured. The insurer wants the insured to live a long life. The majority of life insurance policies issued never pay out death benefits; most policies lapse prior to the insured’s death. Insurers traditionally did minimal underwriting, relying primarily on the agent, the policy application and the two year contestability period. Since most policies do not pay out benefits, this method has been reliable (although the viatical industry is causing many insurers to re-think their policy-issue position).

While the life insurance industry relies on their clients living a long full life, the viatical industry relies on their clients dying – the sooner the better. Both industries revolve around life insurance contracts but their focus is very different.

Since the viatical industry invests based on death expectancy versus life expectancy viatical firms spend more time looking at medical reviews, often obtaining medical records for the last two years (or more if the situation calls for it), laboratory data, any reports from specialists, and statistical information. Viatical analysts may talk with the attending physician since they often learn more from talking with the doctor than is written in the medical reports. A reliable viatical firm will want to talk with the doctor for another reason: to learn of any misleading or outright fraudulent medical information provided by the viator.

In the early years viatical firms did very little reliable evaluation since their priority was selling the contracts to investors. Predictions of the investment’s maturity (which is the date of the insured’s death) were based on flimsy information. With state legislation came more reliable predictions since companies were forced to disclose more information on how such maturity dates were determined.
Reliable viatical companies will use a combination of contract maturity prediction methods, including:

**Clinical**

Companies that hire medical specialists (usually individuals with a specialty in the disease) rely on their expertise, based on education and experience in the condition, to determine the predicted time of death. These individuals will review existing medical records to determine, based on their experience with the condition, how much longer the viator could be expected to live. Even though clinical evaluations use established statistical information and experienced personnel, it is always a prediction and never an exact science. Clinical evaluation may not consider current health studies of the disease or illness and may not necessarily include recent data that indicates those with the condition are living longer. For example, a new medication may be providing positive results regarding length of life that are not included in clinical evaluations. Some professionals believe clinical evaluations routinely understate life expectancies allowing investors to expect higher yields than would actually materialize.

**Statistical**

Statistical evaluations rely on past data. Each medical condition has an average life span. While that may be sufficient for some types of insurance, viatical settlement contracts work best when information is individualized. Statistical evaluations utilize the law of large numbers to arrive at a conclusion; general statistics do not take into consideration a person’s individual characteristics that can affect risk maturity. Additionally, past information will not take into account recent medical advances that can prolong life.

**Multi-Disciplinary**

Investors should prefer the multi-disciplinary viatical underwriting approach because it uses information from more than one source. The investor will receive the highest yields when maturity risk (the date the viator dies) is correctly calculated. This approach will use medical specialists, statistical information, physician communication, and current medical advances to determine maturity risk. Even drugs that
are not currently approved by the FDA may be included in their analysis since it may affect longevity if the viator is involved in clinical trials.

**Minimizing Investment Risk Through Knowledge**

If investors have underwriting information available to them, they are more likely to maximize their yields by selecting viatical settlement contracts that utilize broad analysis, thus providing accurate maturity risk estimations. It may be possible to request this information from the viatical firm. Companies should be willing to disclose their form of analysis even if an outside company performs the service.

It is generally best if evaluations are performed by contracted third parties, an entity not associated with the viatical firm. Such companies perform analysis for multiple companies and have no direct tie to any particular company. It is still important that the contracted party have past experience with viatical analysis since the criteria for evaluating longevity of life for viatical contracts is not the same as it would be for other entities, such as insurance companies. Those who provide this service, whether a contracted party or an individual that works directly for the viatical firm, must have the ability to understand the medical conditions associated with the terminal or chronic illness. Lack of understanding can mean poor analysis and projection of longevity of the viator. Those who make such judgments must understand the treatments that are likely to be used as well as any new medications or therapies that might be utilized.

Investors should never assume that the insured will not try new or additional care treatments after they sell their life insurance policy. In fact, the money they receive for their policy might actually be financing additional treatments, including organ transplants. Viatical companies understandably want the viators to be predictably terminal rather than unpredictably terminal, which is sometimes the case.

Evaluators may have different styles or arrive at different conclusions since this is not an exact science. Evaluators make *predictions* regarding the viator’s possible life expectancies. Of course, those who use as much information as possible in making viatical predictions are likely to be more accurate than those who use less; some will also be
better at their jobs than others. Therefore, it is also a good idea to look at past performance of the evaluating person or company.

Life expectancies of less than 30 months are considered short evaluations by most companies. While many factors will be considered most are based on actual disease progression.

It is not unusual for the life expectancy prediction to change. This might happen because a new drug is introduced that works well for the viator, or because the individual improves due to life style changes. It can be impossible to predict what new procedures or drugs may come in the future. Additionally not everyone follows what is considered “normal” disease progression.

Not every disease or illness is considered terminal. As every agent knows, some diseases, while unpleasant, do not necessarily end life sooner than normal. When viatical settlements were first written on AIDS victims it was thought that all would die young, but today that is no longer the case; what is normal today may not be tomorrow as new technology develops.

**A New Issue: Viator Fraud**

If there is money to be made, fraud will follow. Most people would not expect an individual to fraudulently claim they are terminal, but it happens. An individual who owns a life insurance policy contacts a viatical settlement company to sell their policy and presents false medical information indicating they are terminally ill. Only if the viatical company contacts the listed physician during the underwriting analysis would such fraud likely be discovered. If the fraud goes undetected investors end up investing in a policy that could go on for years, with the result being lost investment funds.

With current technology it is possible to both modify and create medical records. If the viatical underwriting departments do not make personal contact with physicians it is likely that such fraud will not only go undetected, but also grow. Unfortunately, the risk of fraudulent medical records falls on investors. It is seldom possible to receive compensation from the fraudulent viator.
Prior to viatical settlement opportunities, individuals who fraudulently obtained life insurance policies did so for their beneficiaries and usually the insured was genuinely ill and facing death. The insured had no personal stake in the policy since he or she would not benefit from the death proceeds. If the insured died within the two year contestability period his beneficiaries may not receive anything, but if he or she lived beyond the contestability period the insured’s heirs would receive the death benefits in most cases (though not necessarily in all cases).

For the viatical firm and their investors, fraudulently obtained policies present a huge risk. Many states now require full disclosure on contestability periods to help investors avoid the possibility of insurers refusing to pay death benefits due to misrepresentation on the policy application or omission of relative facts.

While most policies will pay death proceeds after the contestability period has passed, that is not always the case. Some states specifically recognize exceptions to the incontestability clause. It may also be possible that the state may grant an exception to an insurer’s request to refuse payment; insurers are most likely to seek this on very large policies.

Life insurance policies have included incontestability clauses for more than 100 years. It is mandated by state legislatures to circumvent legal battles over payment of death proceeds after the contestability period has passed. They allow insurance companies two years from the policy issue date to discover irregularities in the application. After two years, the insurer is not allowed to contest the coverage upon the insured’s death.

Incontestability clauses are not intended to permit fraud however. The intent is to establish time limits during which insurers must discover whether or not fraud exists. Therefore, an insurer that fails to seek out evidence of fraud through complete underwriting does so at its own peril. In the past, only basic underwriting was typically done since the risk of fraud was relatively small. Larger policies were understandably underwritten more extensively than smaller ones. With the advent of increasing fraud with the intent of selling the policies to viatical firms, insurers are likely to increase their level of underwriting to protect themselves.
Some life policies are applied for under one name, with another representing the insured in order to avoid effective underwriting. Their goal is to survive for two years (through the contestability period) so the insurer will pay the death proceeds. Several states allow the insurer to refuse payment where use of an imposter can be proven, despite the incontestability clause. There are strict and specific rules that apply to refusing to pay the death proceeds following the contestable period:

- The terminally ill person must have had an imposter sign the application for the life policy, and
- The imposter must have appeared for the mandatory medical examination.

**Viator Tracking**

Not all viators are sick enough to be hospitalized or confined to their home. It is common for viators to travel or move frequently based on a desire to see their children or grandchildren or due to the medical facilities available. Obviously it is necessary to know where viators are so dates of death will be known.

Some viatical firms employ outside firms to track the viators; others perform this duty themselves. Some tracking is done through the Social Security system, although that is a slower way of knowing when death occurs due to the time it takes the data to appear.

Most firms keep in periodic contact with viators and may require a third party person be assigned. This third party allows the viatical firm to track the viator’s health progress without making direct contact.

**Life Insurance Contracts**

Any person investing in a viatical settlement contract must understand how life insurance policies work. It is not necessary to become an expert on insurance, but basic understanding can make the difference between a bad investment and a good one.

A life insurance policy is a contract. The contract stipulates that for a financial payment (the premium) a specified party (the insurer) will pay another party
Life & Viatical Settlements

Chapter 2: Life & Viatical Investing

Life insurance is intended to protect those that would be financially affected by another’s death. The insured is typically the major wage earner in the family, but it may also be any other person of importance, such as the family caregiver. Companies often carry life insurance on key employees, since their death would adversely affect the company they work for.

Life insurance insures one’s life, not their death – although it is their death that triggers benefit payment. Life insurance, therefore, insures one’s life against death. Even that is over simplified since there are many forms of life insurance and many goals that might be met through life insurance contracts.

Basic Concepts

Life insurance is not necessarily complex but it does require some basic knowledge. Normally the questions considered involve “how much is enough?” and "how long will I need to keep this life insurance coverage?” When it applies to viatical settlements, the questions may be “when was this policy purchased?” and "is it beyond the two year incontestability clause?"

Insurance Companies Measure Risk

Every applicant represents a risk to the insurance company. Questions are asked on the application to help the insurer judge the risk involved. Sometimes a medical examination is also required. This might be as simple as a nurse coming to the applicant’s home for blood and urine samples or more complex if there is a higher potential risk involved.

Life insurance companies use actuaries to calculate the risk involved with issuing the policy. Mortality tables are used by the actuaries when determining the likelihood of the applicant dying prematurely. Besides the obvious attention to the applicant’s health status, the insurance company also looks at lifestyle with specific questions that might include:

- Does the applicant smoke or chew tobacco products?
- Does the applicant drink alcohol and, if so, how much and how often?
- Does the applicant have a regular exercise routine, such as walking or other type of activity?
• Is the applicant socially active (studies show people who interact regularly with others live longer)?

These are not the only lifestyle questions that may be asked but they demonstrate the types of questions that may be on an application. By looking at the characteristics shared by groups of people actuaries improve the accuracy of their predictions, which affects the benefits the insurance company is likely to pay.

Underwriters tally the information provided, adding points for unfavorable findings and subtracting points for favorable findings. The lower the applicant’s score, the better his or her rating will be. The final point score determines if the premium rate will be standard, substandard, or preferred. Those who pose the least risk will be the individuals who do not smoke or chew tobacco, are not overweight, and without a history of heart disease or other serious medical conditions. Not all life insurance companies offer a preferred premium rate for the very healthy individual, so it might be wise to search for a company that does offer lower rates for those who qualify. The vast majority of life insurance policies are issued at standard rates.

It is important to note that one insurer’s standard rate may cost more or less than another’s. Applicants and insurance producers should not assume that all companies charge the same rates.

The applicant has an obligation to tell the truth on their applications for insurance coverage and the writing agent has an obligation to disclose to the insurer all the information he or she received from the applicant. The agent should further disclose any indication that the applicant might not be disclosing their full medical history. For example, the agent sees an oxygen tank in the corner but the applicant does not mention needing oxygen. The agent should ask specifically if the applicant requires oxygen (this is true even if this question is also on the insurance application). In some states agents may not fill out the medical portion of the application on the applicant’s behalf; if this is the case it may be especially important to go over the questions with the applicant prior to the applicant completing the medical portion of the application. If the applicant lies or omits important medical information the insurance company can rescind the policy or deny a claim for the first two years following policy issuance.
Types of Life Insurance

There are different types of life insurance available. Many financial planners insist that only term life insurance should be purchased, but it really depends upon the goals of the insured. While term insurance certainly plays an important role in financial planning, especially for young adults who have limited resources, there are situations that call for other types of life insurance.

Once the amount of coverage necessary has been determined, the individual must decide upon the type of coverage they wish to purchase. There are two basic types of life insurance: permanent and term (although each category has subtypes).

**Permanent insurance**, as the name implies, covers the individual for their entire life; it is intended to be a permanent purchase. Upon death, benefits are paid and the policy ends.

**Term insurance** offers a predetermined “term” of coverage, such as one year, five years, ten years, or more. When the term ends, the coverage ends, although it may often be renewed at higher premium rates. Upon death, the policy also ends with payment of the death benefit.

Permanent insurance is typically used for a financial need that is continuous and often involves a goal beyond just death benefits. Often permanent insurance is used to supplement retirement income, for example. Term insurance is best suited to young adults that have not yet acquired a great deal financially. These consumers may be in the early years of marriage and child rearing, have a new mortgage, and multiple debts associated with establishing themselves in the community. They may be in the early stages of their career as well, when earning ability is relatively low. As time goes by their income will rise and their career will prosper but for now, they must have coverage that is effective but inexpensive.

What Will the Insurance Cost?

There are two parts to life insurance premiums: **mortality cost** and **policy expense cost**. The mortality cost is determined by the odds of the insured dying prematurely. Insurers are very good at determining the likelihood of premature death by gender, age, and occupation. Questions on the life
insurance application directly relate to how the insurer determines their mortality tables.

Policy expense costs relates to the costs of conducting business, such as staff, underwriting expenses, and agent commissions. Each life insurance policyholder contributes a share to these expenses through the premium costs they pay. Mortality costs increase each year as the insured ages (and risk of dying increases). Policy expenses can, of course, go up too but they tend to remain fairly steady.

Permanent policies that have level premiums average out the cost over the length of the policy. This means that the insured is actually overpaying their premiums in the early years of the policy in order to keep premiums the same in the later years when premiums would normally be higher. The overpayment in the early years is set aside in a reserve the insurer calls \textbf{cash value}. If the policy is canceled the insured receives the premium overpayment (cash value) back. In the first years of the policy there is additional expense of such things as underwriting and agent commissions, so there is not much cash value available.

Term insurance never has a cash value even when the premiums are leveled, with the insured paying higher premiums in the early years to make up for underpayments in the last contract years. Therefore no refund is available if the insured cancels the policy. As a result, many professionals feel that level term premiums are not always a good idea, although if the insured knows he or she plans to hold the policy long-term, they may find better pricing over time in level term policies. If the insured is not sure he or she will hold the contract for an extended period of time, then it gives the potential of overpaying in the first years with no guarantee of return of the extra premium if the policy is discontinued. Term insurance is the least expensive form of life insurance and it may be best to simply pay rising costs each year in an annually renewable policy. Usually income rises with time, so even though the term insurance policy will experience increased premium costs, they will still be relatively inexpensive compared to other forms of cash value life insurance policies.

**Term Insurance**

\textit{Term life insurance does not build cash reserves.} Term life insurance may be combined with other products, such as annuities or mutual fund accounts that do have cash reserves, but the actual term insurance contract has no cash reserves.
Under term insurance:

1. The insured must die before the term expires (the period of time during which the policy is effective) in order for the beneficiary to receive insurance benefits.

2. Upon the specified term’s expiration date the insurance ends. A new term may be started, however, depending upon the terms of the policy.

3. The cash outlay (premium) is relatively low, especially at younger ages. Costs do increase with acquired age.

Term life insurance has some variations based on the length of the insurance policy term, renewability options, price guarantees, and conversion options.

Even within the types of insurances, there can be sub-categories. Term insurance has basically four categories although there can be variations of each. The four types are:

1. **Annual renewable term** insurance, which is renewable each year regardless of the insured’s health. The premium will be higher each year due to increased age.

2. **Convertible term**, which allows the insured to exchange the policy without evidence of insurability. The exchange often means converting to a whole life policy or an endowment type of policy.

3. **Decreasing term**, which is often called Mortgage Insurance. The death benefit decreases over a specified period of time although the premium usually remains level.

4. **Level term insurance** generally has both a level death benefit and level premium cost for the entire term of the policy.

Annual renewable term comes up for renewal each year, as the name implies. As the term expires each year, the insured purchases a new annual term policy, with a higher price since the insured is now a year older. As one ages, risk of early death becomes more likely so cost is higher (mortality expenses raise). Annual renewable term is renewed for twelve month periods (annually).

Generally, annual renewable term is not underwritten each year; the insured merely has to pay another premium to renew the policy for an additional year. At some point, however, it is likely that this no longer becomes possible. Based on the contract language the policy will have a maximum renewal ability
specified in the policy. While it may be as little as ten years, it could also be as long as age 100.

Renewability is not the only thing that may be guaranteed. Premium levels may be guaranteed for some specified period of time as well. It would be unlikely that premiums would be guaranteed until age 100, but they may be guaranteed for five or ten years. Changes in health will not affect term policy pricing. In many cases, term life policies have conversion ability, meaning the insured can elect to exchange their term life policy for a permanent life insurance policy. Many policy owners choose to do this when their health deteriorates, although that may not necessarily affect the term policy renewability. Policy conversion will not require underwriting since it is guaranteed in their term life policy. No underwriting means no health questions are asked at the time of conversion.

Some term life insurance policies will have a fixed-rate level term feature. As we know, this means the amount of premium paid stays the same over a specified time period. The price may be locked in for as few as five years or as long as 30 years. Statistically, policy owners keep level term policies longer than annually renewable contracts so it is good for insurance companies to promote fixed-rate level term policies. Underwriting is expensive so it is not surprising that insurers want issued policies to stay on the books. Because insurers know the policies are more likely to stay active, competition often brings about pricing advantages that are not available with annual renewable term contracts.

Level term insurance policies are typically convertible to permanent insurance contracts without evidence of insurability. In other words, the insured will not have to prove their health status at the time of conversion because there will not be any underwriting for the new policy. Some policies may only have conversion privileges for a specified time period, such as ten or twenty years from when the policy is first issued. For example, if the level term policy allows conversion only within the first ten years of the policy, once that time period has passed, the insured would have to successfully complete underwriting requirements in order to convert over to a permanent life insurance policy. Since health conditions are more likely to develop with age, an individual who feels they may want permanent insurance would be wise to convert during the period of time when underwriting is not a concern.

Most professionals feel it is vital that the term policy have the option of converting to permanent insurance regardless of current health status. Since term contracts often have a maximum guarantee for renewability there may be a
point when the term policy cannot be renewed without evidence of insurability. Having a conversion option offers protection that can prove important if a health situation develops. No one can predict the future; it just makes sense to cover all possibilities.

**Reentry renewable level term** policies offer the lowest term rates, but there is a reason for that: renewal each policy term is priced based on current health status. In other words, the reentry annually renewable term policy continues to be low priced only if the insured remains healthy. If the insured’s health status declines, his or her renewal rates climb higher and quicker than any other type of term policy upon reentry to a new policy term. Only if the individual can reenter and reapply as very healthy do their rates remain at preferred levels (low). Insurance companies are not required to offer the lowest rates on reentry renewable level term contracts so the insured must continually shop the competition. To emphasize this vital point: rates on reentry renewable level term is very low for the healthy individual but potentially the most expensive in the marketplace if the insured is no longer in good health.

Reentry renewable level term policies should always have a conversion clause so that the insured can change to permanent insurance if his or her health declines. If coverage continues to be necessary, converting to permanent insurance may be the best option when illness occurs under the reentry renewable level term policy.

While it may seem that reentry level term insurance is never a good choice that is not really true. There are reasons that such insurance is a good choice. For example, a young family that needs a large amount of insurance but that has few dollars available would do well to purchase reentry level term insurance, but they should make sure it is renewable for at least five years (longer for some situations). Also be sure that there is the option to convert to a permanent life insurance policy. We cannot say it often enough: no person knows what the future may bring. If health status changes dramatically having a conversion option can mean the difference between leaving beneficiaries sufficiently supported or in poverty upon the death of the insured.

If there is the choice between reentry level term and traditional non-reentry term insurance select the non-reentry term. It is worth a little more money to keep preferred rates without having to qualify each time policy renewal comes around.
In all cases, agents should stay with financially high-rated companies. If A.M. Best is the standard being used, the companies should have an A rating or better. Represent only guaranteed renewable and convertible term products if possible. Although your clients may not realize it, you are doing them a favor by making sure they can renew their coverage and convert to a permanent contract if their health situation takes a turn for the worse.

Decreasing term insurance is a type that most consumers are familiar with, especially if they have a home mortgage. Under decreasing term insurance the coverage decreases annually but the premium remains level for the duration of the specified period in the contract. There are two types of decreasing term insurance:

1. Level decreasing term, and
2. Mortgage decreasing term.

**Level decreasing term insurance** reduces coverage a flat amount each year. The amount of decrease is often stated as a percentage per year.

Mortgage decreasing term insurance reduces coverage to correspond to the mortgage payoff amount. In the first few years, the reduction in coverage will be small since most of the mortgage payment goes to interest, not principal. In the later years of the mortgage the decrease will be more dramatic, to match principal payoff. The actual reduction of coverage is tied to the mortgage interest rate and the length of the mortgage, such as twenty or thirty years.

In most cases, the premium doesn’t change during the duration of the insurance term chosen. It is important to realize that near the end of the insured term there is very little insurance actually in place. The amount of coverage has steadily decreased along with the amount of money owed on the insured home. Seldom are these types of policies renewable either. If health conditions have developed, these policies are not designed to protect beneficiaries from an early death; they are merely designed to protect the mortgage. In many cases, the rates for mortgage decreasing term are not competitive when compared to other types of term insurance. It may be better to purchase a different type of term policy, with the intent of using it to pay off any mortgage balance. Only if such insurance is court ordered (as may happen in a divorce) should anyone buy a level decreasing term insurance policy. There are simply better options available.
When a person has a mortgage, the mortgage-holder may offer mortgage level
term coverage. The premium rates are seldom good. Most people can do better
in the open market unless their health is very poor or they have health factors
that would eliminate their eligibility for other life insurance policies. It is
important to remember that mortgage companies usually list themselves as the
beneficiary of the policy. If the insured dies the policy pays off the house
(making the mortgage company the beneficiary); family members will receive
nothing in most cases.

Many policies offered through mortgage companies, banks, and other
institutions cover only accidental deaths. Since even young people are more
likely to die from natural causes, accidental death policies are seldom a good
choice. No matter how inexpensive the policy is accidental death plans are not
likely to be a wise buy.

### Permanent Insurance

**Permanent Insurance** is coverage designed to last throughout the lifetime of
the policyowner. Although permanent insurance, such as universal life policies,
are nearly always sold by an insurance agent, there are some types that may be
purchased over the internet or through institutions, such as banks. However, it
is likely that an agent still is involved in some way, depending upon state
requirements.

The role of the agent should not be taken lightly. Since permanent insurance is
complex it is important that the selling agent be well versed in the products.
Buying term insurance is relatively easy since there are no cash values and it is
pure death protection; it is the least complex type of insurance. Permanent
insurance, on the other hand, is complex. Using an agent to purchase any type
of insurance, including term insurance, doesn’t cost the consumer any higher
premiums, so individuals may as well utilize the expertise of an agent regardless
of the type of coverage being purchased. A good agent will help determine the
right amount of coverage and make suggestions that the average consumer is
unlikely to consider. A professional agent can mean the difference between
being poorly insured and adequately insured. In addition, if the applicant has
health issues an agent may be essential in finding a company that will accept the
risk. Using an agent doesn’t necessarily mean meeting with an agent face-to-
face since many companies utilize agents online or over the telephone with
similar results. As long as the agent is able to adequately and professionally
complete the transaction with the consumer’s needs and goals in mind, the end result is likely to be satisfactory.

There are many types of agents, from the career agent specializing in life insurance products to the guy who sells one or two policies a year as a sideline. Most professionals feel the full-time professional agent is the best avenue.

Unfortunately, insurance agents have been unfairly represented as individuals who take advantage of the average consumer. Most agents realize that their livelihood is based on referrals and therefore they strive to provide good efficient service to their clients. An experienced life insurance salesperson is an advantage for the consumer since the agent will steer them to the right products and help them maneuver through the vast amount of choices available in permanent life insurance options.

Some life insurance may be available through work but the rates are not always a good buy, especially if the worker is young. Group rates are priced on the medium of the group as a whole. If the workplace has a high percentage of older ages the cost may be higher than necessary. Additionally, since younger workers may change jobs it is important to know if the coverage ends when the job ends or if conversion to private insurance is possible.

Perhaps the largest failing of permanent insurance is purchasing less than necessary to keep premium costs down. While some life insurance may be better than none at all, being underinsured is not an advantage for the beneficiaries. If the individual cannot afford sufficient permanent insurance it should be subsidized with term insurance. Permanent insurance is more expensive than term insurance. Some consumers may want permanent insurance for the cash values they acquire but being under-insured is a major financial planning error. While there are valid reasons for buying permanent insurance, it should never be purchased unless sufficient death benefits exist in the policy. The primary reason for buying life insurance is to insure against premature death; if that goal is not met, then the reason for buying it has not been met either.

Surprisingly, many people buy multiple small life insurance policies rather than one with sufficient death benefits. This seldom makes sense from a cost perspective. Buying multiple smaller policies is typically more expensive than purchasing one comprehensive life insurance policy. It probably happens because each small policy does not seem very expensive so consumers impulse-
buy rather than actually taking the time to analyze their needs and buying one good contract.

Many small inexpensive policies have a major flaw: they pay only for accidental deaths. These may even be free through banking institutions and membership organizations. Statistically even young adults are much more likely to die from natural causes, not accidents.

Many consumers would say they have not purchased multiple smaller policies when in fact they have. The reason they don’t realize it is simple: they weren’t purchased from agents. Maybe they have a policy through their credit cards, one with their credit union, another from their bank, and yet another from their mortgage company. Some of these may be free, but if they cost a dime, the coverage has been purchased. Many of these will be accidental death plans, which are typically a waste of money. Policies that are “free” are nearly always accidental death plans. The money spent on these small policies could be banded together and used to purchase one adequate policy.

All insurance decreases one’s financial risks, even the policies that are never collected on (such as fire insurance on our homes). No one buys insurance because they know for certain that a loss would occur; they buy insurance because there is the possibility of loss. Life insurance is perhaps the one sure thing since all of us will eventually die. For any parent, life insurance should be one of their top priorities. Since no laws require the parent to protect their child in the same way companies and states require drivers to insure their cars or potential liability, life insurance can be overlooked when it is actually extremely important.

Those with sufficient cash flow (to afford the premiums) and who will need coverage for at least fifteen to twenty years will want to consider permanent cash value coverage, such as a universal life insurance policy. As an individual ages term insurance can become very expensive, making permanent life products seem more reasonably priced considering the cash value portion that will eventually be available.

A cash value policy is similar to a term policy with a built-in savings component. Many call this an investment, but the cash values should not be considered an investment since there are so many better ways to invest for the future. The accumulating cash is a savings component rather than an investment. This may seem like a minor distinction but it is important that consumers not consider cash value life insurance policies similar to mutual funds or annuities. Basically, a
cash value policy is simply a convenient way to pay for a lifetime of term insurance coverage. In the year it is purchased it will cost much more than term insurance because overpayment is occurring in level priced policies. The early over-payments are used to defray the higher cost of coverage at older ages (later on in the policy) and reduce the amount of coverage needed; if cash values exist less coverage is then needed.

For example, Ted bought $100,000 in benefits in a permanent life insurance contract. Twenty years later there is $20,000 in cash values; if he still needs $100,000 available he can actually insure his life for just $80,000 at this point, relying on the cash values to make up the difference.

Cash values earn interest. The insured can take some or all of the accumulated dollars even if they terminate the insurance policy. Even if the policy is kept active, the insured can take a policy loan against the cash values. A loan will reduce the death benefit so this should not be done without due consideration of the impact a sudden death might have on the family’s financial situation if there is a reduced death benefit.

When a permanent policy is purchased certain levels of death benefits and cash values are guaranteed by the issuing company. The insurer usually projects higher levels of death benefits and cash values, but even if minimum levels are met, there are certain guarantees. While premiums are higher due to the cash values that accrue, if the insured will need the protection for many years, it is generally worth the added cost. Those who want or need coverage for their entire life most certainly would want to purchase cash value products rather than term insurance.

We sometimes hear that it is better to “buy term insurance and invest the difference” in premium, but this is seldom practical, unless it is for a short-term need and even then it is unlikely to happen. Why? Few people actually invest the difference. Over a long period of time, buying term and investing the difference may not even be prudent. If the policy will be held for 20 or 30 years or more, buying cash-value insurance is usually a better deal than term due to the rising cost of insurance as the individual ages. Especially if the policy is allowed to lapse or surrendered, the cash values on a long-held policy will actually return the premiums that have been paid. The insured may end up with more cash upon surrendering a cash-value policy after a couple of decades that he or she would have paid for term insurance. Part of the reason for this is the income-tax advantages held by cash-value life insurance policies. The policy
values are not taxed until the policy is surrendered and the cash values taken. They escape income taxation entirely if the policy is held until death.

The largest disadvantage to a cash value policy, as we previously said, is the tendency by those who buy them to purchase a too low death benefit. Because the cost is higher than term insurance, people often reduce the amount of protection they purchase to bring the premiums to the level they desire. Maybe they intend to eventually purchase larger death benefits; maybe they just don’t really believe they will die prematurely. Whatever the reason buying too little life insurance is a big financial planning mistake.

Permanent insurance has several characteristics:

1. The **premium remains level** throughout the policy's lifetime.

2. The **contract builds up cash reserves** in the early years, which allows the company to maintain level premiums even though the insured becomes older which would normally trigger higher premiums. These reserves also bring about a "cash value" that may be borrowed by the policyholder or may be taken as surrender proceeds if the policy is canceled.

3. A whole life contract, by definition, can be kept at the **same premium level** for the lifetime of the insured.

There are several types of permanent insurance. Whole life is the old standard and is still sold by many agents. It has the highest annual charges but also the strongest guarantees for the buyer. For those who want flexibility, however, it is hard to overlook the universal life insurance policy.

**Universal Life Insurance Policies**

Many consumers are aware of the term "universal life," but have only a vague idea of what it actually is. A *universal life insurance policy is a life insurance policy in which the investment, expense and mortality elements are separately and specifically defined.* The policy-owner selects a specified death benefit, which typically remains level. The death benefit may, however, be one that increases over time, coinciding with the increased cash value of the policy (death benefit Option II), or, alternatively, the death benefit can remain level regardless of the underlying value changes (death benefit Option I). A *load* is deducted by the insurance company from the premium amount paid by the policyholder for defined insurer expenses. The premium remaining is then credited towards the contract owner’s policy cash values. Mortality charges are next deducted. Interest earned on the remaining cash is credited at whatever percentage
current rates happen to be. Since specific policy details do vary from company to company, variations will occur. Increased expenses or "loads" and/or increased mortality rates will also result in lower cash values. Just like annuities, there is usually a minimum contractual guarantee on the interest rate earned; typically around 4 or 4.5 percent. Mortality costs also generally have a guaranteed maximum premium charge for the pure cost of the death benefit. Most insurance companies do not charge that maximum rate, however. Typically, the rate actually charged is lower.

Many consumers assume there is a "standard" universal life insurance policy that is somewhat uniform from company to company. Actually, there is no such thing as a "standard" universal life policy. The level of premium paid, the amount of the death benefit, and the length of time over which premiums are paid are variable. While the first policy year may have a stated minimum premium due, following that first year, the contract owner may usually vary all factors: the premium amount, the payment date, and the frequency of the payments. These features are what make this type of policy favored by consumers. These features are sometimes called "stop-and-go features" or options. The ability to discontinue payments and then resume them at a later date does not require reinstatement of the policy. As long as there are enough cash values within the policy to pay the required expenses and mortality rates, the policy will remain in force. The policy will terminate if the cash values are not adequate, although there is usually a grace period allowed of up to 60 days.

Universal life is similar to whole life in that it allows the insured to build up a cash value within their policy. While whole life does not typically disclose what the insured receives for their money, universal life does allow the insured to see what portion of the premiums went toward covering company expenses and how much was used for the insurance protection, and how much made up the savings component. Initially, universal life was fairly easy to understand, even for nonprofessionals. As time went by, however, many observed that universal life policies became more difficult to understand.

**Universal Life Policies Compared to Traditional Plans**

The combination of traditional life insurance forms and annuities is not as simple as it might appear. The most important difference is the addition of cash values that build up in the life portion at variable interest rates (based on current interest rates) rather than in predetermined and guaranteed long-term cash values as one would see in whole life insurance contracts. Universal life policies have guaranteed interest rate minimums that were originally near 4% in the
1980s. Excess rates (the amount actually credited) were determined by money market rates or sometimes by external indexes that were usually stated in the contracts. Each year the insured paid a flexible premium, which was sometimes called a “contribution” since the amount was voluntary above certain specified minimums. After deducting expenses and a risk charge for the term insurance protection from the contribution, each month the insurer credited the remainder to the cash value of the contract.

Universal life policies are also different from traditional insurance in how the potential use of cash values is allowed. Traditional life insurance only permits full cash-value withdrawal when the policy is surrendered or allows loans up to the cash-value amount. The universal life insurance policy adds the option of partial withdrawals, sometimes with extra fees charged. These withdrawals are not considered loans, but they do reduce the policy’s face and cash values just as traditional policies do. The general purpose of the cash value buildup is not intended for sporadic emergency withdrawals at younger ages however, since these values are needed for paying the increasing cost of the term protection in the policy (term life costs more as the insured ages). Universal life does expect to see some withdrawals as the insured ages since one-time expenses might happen for various reasons, such as a child going to college or to fund a nursing home confinement for an elderly parent.

Another difference from traditional life products is the universal life insurance policy’s adjustable death benefits. Initially, policyholders will select one of two basic forms: the fixed face value or a face value that pays the face value purchased plus the accumulated cash values.

At any time following the initial selection the policyholder may decrease the face value to specified minimum amounts or he can increase it with evidence of insurability without rewriting the contract. It is important to note that insurability must be proven in order to increase the death benefit.

How do these differences apply to the general policyholder? They may make universal life insurance products advantageous, depending upon the insured’s personal situation, which always must be taken into account. As always, one of the most important considerations is adequate levels of life insurance. If the individual cannot afford the universal life policy’s premiums, he or she may need to remain with term insurance protection until universal life products become affordable. If the universal life product is affordable at sufficient insurance levels, the advantages include:

1. Flexibility in premiums, benefits, and withdrawals, and
2. Cash-value increases that reflect current interest earnings and mortality rates.

As with all insurance, there may also be disadvantages to purchasing universal life insurance products. Flexibility, while usually a good element, may also have a pitfall. Not all policyholders will use common sense when considering withdrawal of cash values. Those who understand how the policy best performs will only make changes when they are necessary by real needs or economic adversity. Universal life allows the insured to make even bad changes to their policies, so agents are likely to see some changes that appear foolish (and indeed are foolish). Too much flexibility is often a disadvantage since consumers do not exercise careful thought to the changes they have the ability to initiate. Part of preventing foolish choices is providing proper information and education regarding the universal life product they have purchased. Once provided, however, it is still the insured’s right to make any changes the contract allows.

Another possible disadvantage is a false sense of what the universal life product will produce in cash values. While there is a guaranteed rate specified in the policy, usually the amount actually credited is higher. In severe economic downturns the minimum guaranteed rate is a safety net; unlike stocks this product will not lose value. In most cases, the insurance policy will credit higher values than the guaranteed rate. However, no policyholder should believe that their policy will always pay rates high enough to be a substantial financial investment – it is life insurance, not an investment.

The insurance industry did actually experience agents selling universal life products with projected interest rates far higher than would actually be paid. Since the software supplied by insurance companies allowed the selling agent to enter any interest rate they wanted, some agents entered unrealistic figures selling products on the basis of unrealistic projections for future earnings. Most states took steps against those agents and hopefully this problem has primarily been solved. Interest rates, even properly projected rates, do not apply to the entire premium paid; they are calculated only on what is left after expenses and term insurance coverage is subtracted. As the insured ages, the amount it takes to buy the term coverage increases so the amount of remaining premium earning interest is reduced. The policy may refer to "gross rates of return" and "net rates of return" to reflect this important point.

When universal life contracts first appeared in the marketplace in the 1980s, interest rates were very high, encouraging this type of product development. Agents could present very favorable outlooks using universal life products that
combined the advantages of cash-value life insurance with higher yields possible through the “invest-the-difference” philosophy. As interest rates came down it became more difficult to do that with most types of cash value life insurance products. Increased yields on money market funds, corporate and government bonds, and other types of investments during high interest periods hurt any type of cash value life product, encouraging a return to purchase of term policies. Products like universal life were the insurance industry’s answer to this problem.

**Universal life** is a trade name, not a specific policy type. Insurers may use various names for policies that meet the universal life definition. If the policy has similar characteristics it may be a universal life insurance policy, even though it has a different name. Universal life plans divide death protection and cash-value accumulations into separate components. This division distinguishes them from the traditional cash-value policy that is an indivisible contract with unified death protection and cash value accumulations. Universal life is able to guarantee more competitive rates of return from year to year than can traditional cash-value products. Flexibility is achieved by adjusting the amounts of savings and protection to meet the needs of the individual policyowner.

Flexibility can be very important to a policyowner. As we go through life there are times when we have more cash than other times. When children are young there may be emergencies that take all available cash, temporarily leaving no dollars for insurance premiums. Times of unemployment may also require premium payments to be skipped until the insured is able to return to work. Cash values will keep the policy active even though the insured cannot pay premiums during difficult financial times. As children grow, becoming financially independent, more premium dollars are probably available. As the cash-value fund grows in the policy it will eventually help supply retirement income.

All types of life events can affect a person’s ability to continue paying their premiums. Such things as divorce, deaths in the family, births, remarriages, and responsibilities relating to disabled children or parents, or any number of other events can affect the insured’s ability to pay premiums on a regular basis. A universal life policy is able to keep the policy in force during difficult times by dipping into cash reserves to pay premiums that are due.

**Premiums**

Insurance contracts have premiums; a **premium** is the payment the insured makes for his or her insurance coverage. The premium due date will be listed on
the policy. The insured has the option of paying premiums monthly (usually through a bank draft), quarterly, semi-annually, or annually. Annual premiums may be less than quarterly or semi-annual payments. If the insured pays their premiums monthly through a bank draft costs are likely to be less than monthly payments the insured must manually mail in.

Policies have grace periods for payments. This is the amount of time allowed past the premium due date to pay the premiums without lapsing the policy or providing proof of insurability. If the premium is not paid within the grace period the policy will lapse and the life insurance coverage ends (except in policies that have provisions to pay the premium from cash values). Reinstatement may require proof of insurability.

Policy Options

Cash value or participating insurance policies offer three sets of options: nonforfeiture, dividend, and settlement options.

Nonforfeiture Options

Nonforfeiture options provide an avenue of premium refund. If the owner discontinues paying premiums the insured may:

1. Surrender the policy for its cash value, if any;
2. Convert the policy to a paid-up contract of the same type but with a reduced face amount; or
3. Convert to a paid-up term policy for its full face amount for a period usually shorter than the original policy. This is called extended term insurance.

If the policy is participating the insurance under the reduced-paid-up option continues as participating. Insurance under the extended term option often becomes non-participating. Some companies might continue the extended term as participating but at higher rates.

Policies commonly have provisions that automatically convert to extended term insurance if the owner discontinues payments and fails to elect one of the other available options.
Dividend Options

Dividends are paid on insurance policies participating in the insurance company’s earnings. It is usually expressed as “par” for participating and “non-par” for non-participating insurers. Mutual insurers are commonly companies that issue dividends to their policy owners. Stock insurers may issue both non-par and par policies, but most stock insurers issue only non-par policies.

A par company generally pays dividends in cash, but typically no money is actually transferred unless the policy is paid up (all premiums have been paid). The insurer applies the cash dividend towards the next premium that comes due.

Dividends may be “accumulated as interest.” The insurance company retains the dividends in this situation and accumulates them at not less (and usually more) than the interest rate specified in the policy.

Dividends may also be used to buy paid-up additions to the policy at net rates. This is an opportunity to acquire low cost insurance since these additions are purchased at net rates. In other words, the insurance is purchased without the expense allowance. This can be especially important if the insured has experienced declining health since this additional coverage is purchased without regard to current health or even occupation (some occupations are considered high risk) when the dividend is paid. Paid-up additions must be the same type as the policy the dividend is paid on. Paid-up additions may be selected for current dividends at any time without proof of insurability.

Another dividend option is one-year term insurance. Under this option the amount of insurance that can be purchased by the dividend is often limited to the cash value of the policy. If the dividends exceed the amount required to purchase the maximum term insurance the policyowner may elect to use the excess for a different option available under the policy.

If the policyowner wants additional death protection either the paid-up insurance or the one-year term dividend option is a good choice. If the insured is more interested in saving money for retirement the accumulate-at-interest dividend option could be chosen. Interest paid on dividend accumulations is taxable income but annual increases in the cash value of paid-up additions are not generally subject to current income taxation. As always, it is important to consult with a tax expert.
Settlement Options

The generally accepted method of paying proceeds from a life insurance policy is by lump sum distribution. However, two alternative methods offer periodic payments:

1. The interest-only option, and
2. The annuity options.

If the annuity options is elected there are several choices available, including lifetime income options, installments for a specified time period (such as twenty years), and installments of a fixed amount of money each month or each year. The amount of income available and the time over which income is available is directly related to the amount of money deposited into the distribution vehicle (the annuity). Obviously the more money deposited the more income one will receive.

The word "annuity" means "a payment of money." The insurance industry designed them to do just that. Choosing an annuity payout option requires understanding of how payout options work.

There tends to be some standard options offered:

1. **Lifetime Option (Single Life):** For as long as the annuitant lives he or she will receive a check each month for a specified sum of money. The payment amount received each month will never change. This option will pay the maximum amount in comparison to other available annuity payout options. Selecting the lifetime option is a gamble. If the annuitant lives a long time, he or she could collect handsomely over time. If their life is cut short, the insurance company will keep any balance left unpaid. No leftover funds will be distributed to any heirs.

2. **Joint-and-Survivor (Two or More Lives):** Under this option, the insurance company will make monthly payments for as long as either of two named people lives. In some cases, it could involve more than two lives, but usually there are just two people involved as annuitants. This option is often utilized by married couples. However, the couple need not be married. Any two people named will be honored by the insurance company.
3. **Life and Installments Certain:** The key word here is CERTAIN. The "certain" period of time is usually either ten or twenty years, but may be another time period also. This option states that should the annuitant die prior to the stated "certain" time period, payments would then continue to the beneficiary until that specified number of years had been met. On the other hand, the annuitant may receive payments longer than the "certain" period stated. That is where the "life" part comes in.

4. **Cash Refund Annuity:** If the annuitant dies before the amount invested has been paid out by the insurance company, then the remainder of the invested money (plus interest) will be paid out in monthly installments or in a lump sum to the named beneficiary or beneficiaries.

In each of these options, the insurance company pays nothing beyond the agreed period of time:

1. **Single Life** = nothing after the death of the annuitant (no beneficiary designated money);

2. **Joint and Survivor** = nothing after BOTH named people have died (no beneficiary designated money);

3. **Life and Installment Certain** = nothing after the death of the annuitant or until the stated time period; whichever comes last (so a named beneficiary could receive something if the annuitant died prematurely).

4. **Cash Refund** = nothing after the full account has been paid out whether to the annuitant or a beneficiary.

A lifetime option will mean a higher monthly payment to the insured but the insured is gambling that he or she will live long enough to receive more than they deposited into the annuity. If the annuitant dies before they receive the amount deposited the insurance company keeps any remaining money; heirs receive nothing. However, when considering retirement financial security is the first consideration, not potential beneficiaries.

Under the interest-only option the insurer retains policy proceeds paying interest to the beneficiary. A minimum interest rate is guaranteed with the actual interest payment determined by the amount the insurer earns. Although there are minimum guarantees, the amount actually paid has traditionally been higher.
State Required Provisions

Each state will have specific state requirements. While these may vary from state to state (so we are not quoting any specific state’s provisions) there does tend to be some basic requirements in all states. There will be some provisions mandated by the state, some provisions allowed by the state and provisions the insurer feels are necessary. Some provisions are included to protect the insurer from excessive claims although that is more likely to occur in health contracts than in life contracts.

Generally all states have specific items they feel are necessary for consumer protection, which may include incontestability, misstatement of age (sometimes even misstatement of sex), deferment, nonforfeiture, loan values, grace periods and reinstatement provisions. It is always important to know one’s own state laws; as an insurance professional this is an agent’s duty and moral obligation to his or her clients. It is also an obligation the agent has to the companies they license with.

Incontestability

The incontestability provision prevents the insurer, following a specifically stated period of time, from rescinding (contesting) the policy on the basis of misstatements made or omission of facts on the original application. While the applicant may not have intended to leave out information or state the facts incorrectly, during the initial period following policy issuance the insurer could rescind the policy for such occurrences. States want that period of time to be reasonable so they impose incontestability requirements.

Exact wording will vary based on state requirements but the incontestability statement may be similar to the following:

“This policy shall be incontestable after it has been in force during the lifetime of the insured for a period of two years from the date of issuance, except for nonpayment of premiums.”

If premiums are not paid in a timely manner, the policy will lapse independent of any omission or misstatement of application facts. The courts have interpreted the clause in favor of consumers, allowing it to become an agreement to disregard consumer fraud. It makes sense to do so since it would be impractical to gather enough evidence or find sufficient witnesses to prove
the applicant intended to defraud the insurance company. The insurers also realize that misstatements and omissions in the application sometimes result from agents who wish to receive a commission. In other words, the applicant claims he or she did in fact disclose the information to the agent, but the agent failed to disclose them to the insuring company.

One advantage of incontestability clauses that agents and policy owners alike may not be aware of is how it affects beneficiaries. The clause is valuable to them because it prevents delayed settlements resulting from long and costly court action if the policy has been in force for more than two years.

**Misstatements in the Application**

Generally misstatements concern the applicant’s age, but it can involve the stated gender as well. The incontestability clause does not excuse the misstatement of age or sex since they are primary life insurance rating factors. Obviously the older an individual is the greater the risk to the insuring company. The gender is also a factor since women generally live longer than men. However, such misstatements would seldom cause the policy to be rescinded although the insurer is allowed to adjust premium rates and back charge to the inception of the policy for any additions that are owed in premium. If the insured is deceased, an adjustment would be made in the face amount of the policy to correctly reflect the premiums that were paid. In other words, the beneficiary is paid the amount of proceeds the premiums would have purchased if the age and sex had been correctly stated.

The author is not aware of any adjustments stated in policies for surgical sex changes. Generally issues of this nature must experience a court case before it becomes legally addressed in policies. However, even in surgical sex changes it is likely that insuring factors would be based on the gender at birth since all those attributes (risk factors based on age and gender) would still exist.

**Deferment Clause**

In the 1930’s insurance companies experienced multiple policyholders withdrawing or borrowing cash values from their policies simultaneously. This forced insurers to sell assets at depressed prices, causing the companies substantial financial losses that would not otherwise have occurred. Since then life insurance companies have been required to include a clause giving them the right to defer payment of cash or loan values in policies for a period not to exceed six months, unless the loan is for renewal of premiums.
The deferment clause does not apply to death proceeds when the insured dies, although it may apply to lump-sum withdrawals of proceeds left with the company under the interest-only option or the prepayment of any guarantees under an installment or life income option.

**Nonforfeiture**

Since cash-value contracts contain nonforfeiture provisions, the cash-value rights in a policy are not forfeited if the policy is discontinued.

**Loan Values**

Many types of life insurance policies develop cash values. Term insurance never develops cash values, so this would apply to the various forms of permanent life insurance. Some term policies are coupled with such things as annuities but only the non-term portion would acquire cash values.

If the policyowner wants to keep his or her life insurance policy in force while still acquiring cash he or she can arrange a loan from the insurer up to the cash value in the policy. The insurer lends the money at the guaranteed policy rate; the rate varies so it is necessary to consult the policy and policy attachments.

Some policy owners may feel it is unfair to charge interest when they withdraw their own policy values but there is a valid reason for doing so. Insurance companies take into consideration the investment income of the cash values when computing premium. Therefore, if the policyowner withdraws the cash values the insurer must be compensated for the investment income they lose.

Originally the purpose of policy loans was to provide a source of funds for policyowner emergencies but people soon realized they could use the money for any purpose – not just emergencies. Savvy investors pulled their cash values through policy loans and invested them in short-term vehicles at higher rates to earn a profit. For example, a policyowner earning 5 percent on his cash values might withdraw the money and invest in short-term financial paper at 8 percent, earning a higher rate than he could have in his life insurance policy. This became a widespread occurrence and it put insurance companies at a competitive disadvantage.

The National Association of Insurance Commissioners, partially as a result of this problem, approved a model bill permitting a policy loan provision for new
polices that allowed periodic adjustments of the policy loan rate. The adjustments are based on specified indexes of long-term corporate bond yields. The maximum loan rate for each policy must be determined at regular intervals, at least once a year but not more often than once in any three-month period. The rate charged may be increased if the increase would be 0.5 percent per annum. It must be decreased if the decrease would amount to 0.5 percent per annum. The NAIC model bill permits a fixed policy loan interest rate of 8 percent in place of the variable rate.

**Grace Periods and Reinstatement**

Insurance contracts provide a grace period during which the insured may pay their premiums without losing insurability. While it is never wise to pay premiums late, the grace period does allow policy owners to maintain their policies even if premiums are paid late, as long as they are paid within the grace period allowed. Grace periods are 30 or 31 days following the premium due date. If late premiums are paid within this time period the policy remains in effect, as though premiums had been paid on time.

If premiums are not paid by the end of the grace period policies without cash value will terminate. Those with cash values will be placed on the appropriate nonforfeiture option. If death occurs during the grace period any unpaid premium will be deducted from the life proceeds the beneficiary receives.

Policyholders may reinstate their lapsed policy within specified time periods. He or she will be required to pay all back premiums prior to reinstatement and provide proof of insurability. The length of reinstatement varies but usually the time is three to five years. If reinstatement is sought by the insured within a short time of lapse proof of insurability may be no more than a simple statement made by the policyholder. For longer periods of lapse the insurer may require a medical examination similar to what a new application would require.

**Allowed Policy Provisions**

Some policy provisions are allowed since they do not violate state or federal requirements. State laws generally allow insurers to include restrictions for such things as suicide, aviation, and war, for example.
Suicide

If an individual was suicidal it would be logical to first buy a life insurance policy naming loved ones as beneficiaries. This would be considered “adverse selection.” Obviously it would not benefit insurers to have very many people buy a policy and then commit suicide. Therefore, there is a restriction in life insurance policies restricting benefits when death is the result of suicide. Policies will not pay benefits for suicide within two years from the date of issuance (a few restrict payment for one year). Insurers must still return all premiums that have been paid but no death benefit is due.

Aviation

Aviation restriction provisions are usually limited to planes flown by nonprofessionals and the insured individual. Flight in commercial airlines would not be restricted. Usually the provision states exclusion “for aviation deaths, except those of fare-paying passengers on regularly scheduled airlines.” Military aircraft is typically excluded since that would imply active duty in the military, which would be covered by military life insurance. Military exclusions may read similar to: “exclusion of deaths in military aircrafts only; exclusion of pilots, crew members, or student pilots and aviation death while on military maneuvers.” There was a time when only policies issued during periods of war would include these clauses but today, with America involved in non-declared war conflicts, these are more likely to appear in contracts.

War

War clauses vary widely so it is always important to review the actual policy for details. Some policies will totally prohibit payment for deaths resulting from war in any capacity while others will prohibit payment only for specific situations. If the death occurred while the insured was in the military, for example, but the death itself was not related to war activities the policy might still pay benefits to the beneficiary. The insurer will refund any premiums that were paid or an amount equal to the policy reserve.

General Provisions

Insurance companies certainly underwrite and create policies with profits in mind. It would actually be unethical for them to do otherwise since they must remain in business if they are to pay out benefits to those that deserve them.
Life & Viatical Settlements

Chapter 2: Life & Viatical Investing

Even state and federal laws recognize that insurers must remain profitable. With that goal in mind, there are general provisions designed for the protection of the insurer, which in turn protects policy owners.

**Deduction of Indebtedness and Premium Refund**

Indebtedness to the insurer from a policy loan will be deducted from any proceeds payable to a beneficiary at death, or from cash values upon surrender of the policy. Insurers may refund unused premiums if the insured dies with an insured term paid for, but this is not generally required by law.

*For example:* Ivan Insured mails a quarterly life insurance premium payment to his insurance company on December 15th for the policy term from January 1 through March 31. On December 28th he unexpectedly dies from injuries incurred in an automobile accident. His insurer may or may not automatically refund his quarterly payment to his estate, depending upon company practice.

His insurance company is not required to return his premium but may do so if it is their normal practice to do so. Even when an insurance company does not ordinarily return unused premium, they may do so upon request. Therefore, estate administrators typically do request refund of unused premiums as a matter of standard estate settlement practices.

**Change of Beneficiary**

When an application is taken for life insurance coverage the agent requests a primary beneficiary listing. The beneficiary may be a single person or multiple people. When multiple people are named the application will request a listing of each beneficiary percentage of proceeds upon the insured’s death. *For example, it may state:* Mary Maxwell: 50% and James Higgins: 50%. If the agent is wise, he or she will also request a contingent beneficiary in case the first named beneficiary or beneficiaries predeceases the insured.

In most policies the applicant reserves the right to change the primary and contingent beneficiary designations. In many cases change of beneficiary is merely a matter of filling out a new beneficiary designation form, but some companies may require the original policy be returned along with the completed form.
Assignment

In property insurance contracts the consent of the insurer is needed to assign benefits to another, but this is not typically the case for life insurance contracts. However, the life insurance company is likely to require notice of assignment be filed with their home office. This is usually considered a consumer protection measure.

Beneficiary Designations

While it is not mandatory, the wise policyowner will always name an individual or individuals as policy beneficiaries. Seldom would entering “estate” on the beneficiary line be wise. Policy benefits bypass probate proceedings when a person is the listed beneficiary. The designation may be either revocable or irrevocable. Most people would always choose a revocable designation, meaning the insured can change his or her named beneficiary any time they wish to, and usually as often as they wish.

If the beneficiary designation is irrevocable all policy rights are vested in the beneficiary and the policyowner may not assign the policy or borrow on it without first getting the beneficiary’s permission. An irrevocable beneficiary designation may be either reversionary or absolute. In reversionary designations the policy rights revert to the policyowner if the beneficiary dies first. In absolute designations the value of the policy is included in the beneficiary’s estate for the beneficiary’s heirs.

It is important to be precise when listing beneficiary designations. An agent is unlikely to allow his or her client to simply list “Granddaughter Nancy” for example. While there may currently be only one granddaughter named Nancy there is no way to know what the future may bring. It is important to list full names so there is no doubt as to who the intended beneficiary is. If available, listing the beneficiary’s Social Security number is also advisable.

Policy forms allow both a primary and secondary beneficiary listing. The secondary beneficiary is often referred to as the contingent beneficiary designation. The contingent beneficiary would receive the life insurance proceeds if the primary beneficiary had died prior to the insured individual.

Some third party rights do exist in life insurance contracts. Beneficiary rights are determined by the type of beneficiary designation and by the ownership of
the policy. In some cases the beneficiary is both the beneficiary and the policy owner; certainly he or she can then exercise all policy rights by virtue of contract ownership. The owner may exercise all policy rights including policy loans and assignments regardless of the type of beneficiary designation.

If the beneficiary is not also the owner but is revocably designated as beneficiary he or she has a **contingent interest** in the policy. This is an interest that is contingent upon the subject dying prior to the named beneficiary and prior to revoking that person in favor of another. A revocable designation may be changed to someone else if the insured wishes to.

A person named as an irrevocable beneficiary has a **vested interest** in the policy. He or she can deny the owner permission for policy loans, assignment and any other action relating to the policy that would affect the proceeds the irrevocable beneficiary would receive, assuming he or she outlives the insured.

Creditors’ rights to the insured’s cash values and life insurance proceeds are generally restricted by common law, federal statutes, and state statutes. Sometimes creditors’ rights depend to some degree on how the beneficiary designation is stated. If the insured dies and the beneficiary designation listed “estate” it will likely make the funds available to creditors. It may be possible to legally attach a life insurance policy but the availability of any cash reserves or values would depend on the policy’s provisions. If removing the cash values will not cancel out the policy, the courts may allow it. Even so, if the right to collect is a policy option to be exercised by the insured, the insurance company is not obligated to pay the cash value until the insured elects that option, so creditors may not be able to actually receive the cash values. Creditors do not have the right of election and the courts will not typically force election on the insured. Creditors can claim cash values only through formal bankruptcy proceedings.

In the case of death, the courts have ruled that policy proceeds then belong to the named beneficiaries, as long as “estate” was not listed rather than an actual person. As a result proceeds are not subject to the insured’s creditors because they now belong to the third party beneficiaries. If the insured owes taxes, usually collection is limited to cash values, not death proceeds.

Two federal statutes concern creditor’s rights to life insurance: federal tax liens and bankruptcy. The federal government can collect its tax claims directly from the insured’s insurance company, although it is limited to the policy’s cash values. If the insured dies prior to paying the taxes he or she owes the tax claim is collected the tax limit is the cash values immediately prior to death.
When a policyowner files bankruptcy the Federal Bankruptcy Act determines how life insurance policies are treated.

State statutes have generally exempted life insurance from creditor’s claims, although each state will have variances. State statutes take precedence over the Federal Bankruptcy Act. Crossman Co. v. Ranch in New York stated exemptions on life insurance proceeds were enacted for "the humane purpose of preserving to the unfortunate or improvident debtor or family the means of obtaining a livelihood and preventing them from becoming a charge upon the public."

In many states the exemption extends only to policies payable to the insured’s spouse and children. In some states it extends the protection to any person that was dependent upon the insured, which could even include aged parents. Some states extend this creditor protection to any listed beneficiary (that is not the estate). In most states this protection includes not only the death proceeds but also any cash values. A few states provide protection from creditors to the beneficiaries as well as the insured. If the statute is not applicable to the beneficiary’s creditors the insured may provide this protection by including a spendthrift trust clause in the policy settlement agreement. This clause gives the beneficiary protection from their personal creditors. A spendthrift trust clause requires the policyowner to elect an installment settlement option. Only the proceeds held by the insurer for the benefit of the beneficiary are protected; any money the beneficiary receives is then available to creditors.

Every time an application for life insurance is made the applicant has several decisions to make. These decisions concern beneficiary designations as well as ownership and policy options. All decisions are important.

**Policy Payments**

Policyholders and beneficiaries may receive payments under the terms of their life insurance policy. The payment amount depends upon a variety of factors relating to the policy. Obviously a term insurance policy would not have any cash values whereas a universal life insurance policy might. Even in a permanent policy, such as universal life, payments would depend upon how many and how long premiums have been paid. It would also depend how the insurance carrier handles policy costs.
Cash Values

All forms of permanent insurance, such as universal life, have cash values if sufficient premiums have been paid. The policy will state the amount of cash value available each year the policy remains in force. A cash value policy is expensive if the insured does not keep the policy active for a sufficient length of time; short term life insurance needs are best suited to term coverage (with no cash values). Experts recommend cash value policies be kept for no less than ten years. For those that do select cash value products and keep them long enough to make the cost worthwhile cash values can be effective in supplying retirement income or emergency cash.

Cash values may be accessed at any time at the policy owner’s request. However, there are other options besides just withdrawing the funds. These options include:

1. **Borrowing against the policy.** Once money is borrowed, if the insured dies prior to repaying the loan, the amount borrowed will be subtracted from the benefits that are payable to the listed beneficiaries.

2. **Buying reduced coverage.** If the insured finds he or she is not able to pay the premiums but still wants to keep the coverage, it is possible to get reduced permanent life insurance. The cash value is used to buy a smaller policy that is paid in full.

3. **Changing to term insurance.** If it becomes difficult to manage the premiums in a cash value life insurance policy, the insured could elect to reduce the cost by using cash values to purchase a paid-up term life policy, assuming sufficient cash values exist to do this. When the term contract ends, coverage also ends. This may be referred to as extended term life insurance.

Dividends

For insurance purposes, dividends are refunds of premiums for those who have participating policies. A participating policy (called a **par policy**) is one that has a premium fixed at an amount higher than the insurance company believes will be needed to cover the costs of providing protection. The extra payment is returned to the policyholder as a dividend after the actual insurance costs are determined. The policyowner is guaranteed not to have to pay higher premiums than those stated in the policy. The dividends can be used to pay the lower premiums, buy additional insurance, or earn interest if left in the policy cash values.
Nonparticipating policies, referred to as non-par policies, have premiums fixed as close as possible to the actual cost of providing the coverage. As a result, there would not be any dividends paid to the policyowner.

**Proceeds**

Proceeds are paid to a listed beneficiary when the insured individual dies. To receive the proceeds, the beneficiary must file a claim with the insuring company. Once the proper filing has been made, the individual will receive the face amount of the policy, called the **proceeds**. Proceeds can be received in one of several ways, called **settlement options**. The settlement options include:

1. **Lump-sum option**, which allows the beneficiary to receive the entire amount in cash.
2. **Amount option**, which allows the beneficiary to take a certain amount each month until the money and interest run out.
3. **Time option**, which allows the beneficiary to take the money plus interest paid out over a specified period of time (such as ten or twenty years) on a monthly installment basis.
4. **Interest option**, in which the cash values are left on deposit with the insurance company to earn interest indefinitely. The recipient simply withdraws the interest earning periodically as the need for cash arises.
5. **Lifetime income option**, in which the individual receives a guaranteed income for their lifetime. The payments consist of interest only so they can never run out.

**Special Clauses**

While all contracts can be intimidating, some of the most difficult contract language is found in insurance policies that have special clauses. Special clauses may do multiple things, depending upon the insurer’s intent. These clauses might limit the insured’s rights or grant the policyowner important privileges. Agents must understand and be able to communicate the options or limitations special clauses contain.

Nearly all policies have clauses of some sort. They might include:

1. **Incontestable clauses**, which state that the insured has a “temporary” policy for a specified length of time; incontestability of the coverage is
typically two years. If the insurer finds the insured has lied or misrepresented the facts on their application for the specified period of time the company may refuse to pay a claim or even rescind (take back) the coverage entirely. Of course a life insurance policy would end anyway upon the death of the insured, so rescission is not really an issue if the insured has died.

2. **Waiver-of-premiums clause**, which waives premium payments after a stated period of qualified disability, often six months. The length of time the clause will pay premiums depends upon the contract. This provision is particularly important when the insured becomes disabled, sick, or injured and cannot work for a period of time. Without this provision failure to pay the premiums, even if it is due to a disabling injury, will mean lapse of coverage. Some policies will pay the premiums on the insured’s behalf up to the age of sixty-five, so this provision is a significant benefit to the insured individual and his or her family.

3. **Automatic premium loan**, which will pay the premium on behalf of the insured if he or she fails to do so. The premiums are charged against the policy as an automatic premium loan so the policy does no lapse. Interest will be charged on the loan.

4. **Accidental death benefit**, which might also be called an **indemnity**. An indemnity clause promises the policy will pay an extra amount if the insured dies as a result of an accident rather than natural causes. We sometimes hear this referred to as a “double indemnity clause” when the insurer will pay double the face value when death results from an accident. It can be more than a double indemnity, depending upon contract terms; it could be triple indemnity or even quadruple indemnity. There are often some identifying requirements for indemnity payment; for example, the insured may have to die within 90 days of the accident to receive these additional proceeds. If he or she lives longer than the requirement, it would not be treated as death by accident, but instead it would be considered death by natural causes (so no indemnity payment would be available). Most policies do charge an additional premium for the accidental death benefit, but it is typically very low since accidental death is not as likely as natural death. The actual premium will depend upon risk factors for the insured.

5. **Assignment clause**; if the insured has kept the right to change his or her life insurance beneficiary, the policy can be assigned to another party to serve as security for a debt or loan. Some banks will lend money on a life insurance policy if it can be assigned to them, for example. If the
insured does not have the legal right to assign the life insurance policy, then the beneficiary would have to give permission to do so.

6. **Non-cancelable clause**, which allows the insured to continue an insurance policy for as long as the premiums are paid. It cannot be canceled for any reason other than nonpayment of premium. This becomes very important if the insured develops a medical condition that renders him or her uninsurable.

7. **Guaranteed insurability option**, which allows the policyowner to buy additional insurance at some point without proving his or her current insurability. Like the non-cancelable clause this becomes important if health status changes, making the insured uninsurable. Typically, this option is available to new applicants who are under the age of forty who are buying a whole-life, universal life, or endowment policy. Although the availability of buying additional insurance depends upon contract language, often additional insurance is available every few years until the age of forty. The amount of additional insurance available may be limited so it is important to read the policy carefully.

8. **Exclusions**: some policies exclude certain situations entirely from coverage. For example, non-fare airplane flight is often completely excluded under the policy exclusions. Exclusions tend to be similar in all policies but since there may be some variance the buyer should shop around if a particular exclusion applies that he or she would like covered by their life insurance policy. In many cases, if death results from an exclusion companies will return premiums if the death occurs within the first two policy years.
Traditionally, life insurance policy owners were limited to just two options when they wanted to get out of their insurance policy:

- They could allow their policy to lapse, often receiving nothing, or
- They could surrender their policy receiving its net cash value.¹

In the past few years, however, secondary markets for life insurance policies have created another option for terminally ill life insurance policyholders: viatical settlements (sometimes also referred to as “life settlements” or “senior settlements”). Life or viatical settlements allow life insurance policyholders to obtain substantially more than they might ordinarily have received under the two previous options.

An informal secondary market in life insurance policies has actually existed for a long time in the sense that it was not uncommon for terminally ill policyholders to borrow money from relatives or friends, using their life insurance policies as collateral on the loan. In some cases, policies were even sold outright to third parties with no insurable interest. No one in authority took notice since it was not done frequently enough to be considered dangerous to the industry.

This secondary market became significantly more formalized with the development of the viatical settlement industry in the late 1980s, at a time when the Acquired Immune Deficiency Syndrome (AIDS) outbreak seemed to be quickly approaching epidemic proportions. At that time, some AIDS victims found themselves in a situation where they had very high medical costs, very few assets other than a life insurance policy, and a very short life expectancy. In response to the

financial needs of this particular population, viatical settlement companies stepped forward and offered some financial relief when no other industry was willing to.

In late 1996 researchers at the World AIDS Conference presented information showing that the use of protease inhibitors and other modern pharmaceutical medications were having a significant impact on the ability to prolong the lives of many AIDS patients. As a result, viatical settlement investors soon began focusing on life insurance policyholders who were terminally or chronically ill with other deadly diseases, such as heart disease, cancer, Alzheimer’s disease, stroke, and sometimes just plain old age. This changed the focus of life and viatical settlement contracts, eventually leading to state regulation when viatical abuses became significant.

Today, the viatical settlement industry has grown considerably. Between 1991 and 2000 viatical settlement contracts increased from $90 million to approximately $1 billion. According to a May 2006 Bernstein Research report titled “Life Insurance – Life Settlement Update – What a difference a year can make”, the life settlement market is expected to become an estimated $160 billion industry. In 2004 the viatical market produced $5 billion in transactions, with that doubling to $10 billion in 2005. It seems to be one of the fastest growing industries.

**About the Viatical Industry**

It is important that viatical representatives understand the product prior to representing viaticals, just as it is important that policy owners understand what to expect when selling their life insurance policies. Just as we must read contracts prior to signing them, participants in the viatical industry must do the same.

The viatical industry has three participating groups: viators, viatical brokers and viatical providers. Viators (policy owners) deal with the viatical brokers and viatical providers.

Viatical brokers handle all aspects of viatical transactions. Since brokers represent the policy owner, they usually remain in contact with the policy owner throughout the viatical purchase process.
Viatical brokers generally provide multiple offers so viators are not burdened with personally having to seek them.

Viatical providers are the companies that represent the institutional funding groups. It is the providers that determine monetary offers and manage the life insurance policy after it is sold and ownership has been transferred.

**Tax Issues**

We always hesitate to provide any tax-related information since tax laws change and some laws apply only under specific conditions. Therefore, the reader assumes all responsibility for staying abreast of tax laws; this course is not intended to provide any tax or legal advice. Nor should this course be used in any financial planning capacity. Each person must know their personal state’s laws.

Since proceeds from viatical settlements are considered personal income, another issue that certainly needs to be addressed is the related tax implications. Originally proceeds from viatical settlements were treated as ordinary income and taxed accordingly. However, in the mid-1990’s, Congress changed that.

The federal Health Insurance Portability and Accountability Act (HIPAA), which passed in 1996, allow individuals to exclude most viatical settlement proceeds from gross income. Proceeds from viatical settlements are treated as income received by reason of the insured’s death. **However, the exclusion is available only to individuals who are terminally ill from a medical condition that could reasonably lead to their death in 24 months or less.** Furthermore, the terminal nature of the condition must be certified by a physician. Likewise, chronically ill individuals also may be able to receive a tax break under HIPAA. A "chronically ill individual" is defined in the Internal Revenue Code as:

1. Being unable to perform at least two activities of daily living (eating, toileting, transferring, bathing, dressing, and continence) for a period of at least 90 days;
2. Having a certain level of disability as prescribed in the federal rules by the Secretary of Treasury, in consultation with the Secretary of Health and Human Services; or

3. Requiring substantial supervision due to severe cognitive impairment. Unlike those who are terminally ill, the health status of the chronically ill individual need only be certified by a licensed health care practitioner (as opposed to a physician).

Conflicts of interest can develop, so it is important that the viator consider all who might be affected prior to considering the sale of their policy. In the beginning, one of the most commonly seen issues in the viatical settlement industry involved health care professionals who worked directly with the viatical settlement companies. Whenever a caregiver becomes financially linked to the viatical settlement industry, there is a concern that a conflict of interest will occur, putting the investor at a disadvantage. Full disclosure of the potential for these types of conflicts of interest is essential in enabling the potential investor to make informed investment decisions. Of course, such relationships could also affect the confidentiality of the insured, since the caretaker would know his or her patient’s identity, medical, and financial situation.

Viators with Less than Two Year Life Expectancy

_This course is not intended and does not offer any tax advice. We strongly urge anyone participating in a viatical settlement to seek their personal tax advice from a tax expert. Tax laws may change at any time._ Generally, however, any viator who is estimated to have a life expectancy of less than two years receive their viatical settlement proceeds _federal_ tax free. Life expectancy is determined by third party underwriters companies use to determine the insured’s estimated mortality. In many states, such as New Jersey, New York, and California, there are also no state taxes due. Again, the best advice is to seek a tax advisor in the state of domicile to gain information on the specific state requirements and tax laws.

The following example of a viatical settlement shows a typical case:

- **Death Benefits:** $250,000
- **Cash Surrender Value:** None (term policy)
- **Premiums Paid:** $5,000
Settlement Amount: $122,500

Our example policy has no cash values since it is a term life policy so the policy owner would not receive any cash values by surrendering it. The owner received $122,500 instead of letting the life insurance policy lapse. Even if it was a cash value policy, however, the values in the policy may have been less than what could be received by selling the death values and transferring policy ownership. In this case, the entire settlement is received tax free. However, we are not saying that this will always be the case. Each person must know their own state laws.

Two to Five Year Life Expectancy Estimate

There is usually capital gain taxes involved in viatical settlements when the insured individual is estimated to live longer than two years. Since the time of death (policy maturity) is estimated, of course there is no way to guarantee life expectancies, but viatical firms using sound underwriting will come fairly close.

In this example, the cash surrender is less than the premiums paid on the policy. In other words, the insured already paid more into the policy than he or she will receive if the policy is surrendered and the cash values taken. Even though the settlement amount is well below the death benefit, for individuals needing cash and terminally or chronically ill, the amount is likely to be considered as fair.

<table>
<thead>
<tr>
<th>Death Benefits:</th>
<th>$250,000</th>
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</thead>
<tbody>
<tr>
<td>Cash Surrender Value:</td>
<td>$10,000</td>
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<tr>
<td>Premiums Paid:</td>
<td>$23,000</td>
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<tr>
<td><strong>Settlement Amount</strong></td>
<td><strong>$60,000</strong></td>
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<tr>
<td>Settlement Amount:</td>
<td>$60,000</td>
</tr>
<tr>
<td>Premiums Paid:</td>
<td>$23,000</td>
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**Taxable Amount:** $37,000 Capital Gain

Although $37,000 of the settlement will be taxed, the policy owner still receives money he or she would not have otherwise had.
Life and Viatical Settlements

While it is very important that viatical and life settlement participants understand the risk involved, these contracts can be beneficial, as AIDS patients discovered in the 1980s.

Many professionals have recommended life and viatical settlements to seniors who apply the transaction proceeds to their financial planning strategies. Selling unwanted and often unneeded life insurance policies have allowed our senior citizens to give to charities, purchase more suitable life insurance coverage (if an insurance need still exists) and pay for specific medical needs, such as nursing home care.

We often think of the terminally ill profiting primarily from life and viatical settlements, but businesses are also using them by selling company-owned life insurance policies. This was previously an untapped market. The policies that are sold are usually ones that were placed on key employees no longer working for the company, due to their advanced age or medical situation. Since life insurance policies often carry a low surrender value, selling the policies typically brings in more immediate cash than would otherwise be available from the policy.

If not terminally ill, life and viatical settlement contracts are not realistic for every policy owner. They are generally most suitable for well-to-do people who are at least 65 years old. So far, the policies have been primarily written on men, with those 72 and older most likely to be the contract sellers. When women sell their policies, they are most likely to be at least 75 years old. Of course, those who are terminally ill may be any age.

Although it depends on the viatical company, the minimum face value that will be accepted is often as high as $250,000. The average policy sold is closer to $2 million. However, viatical companies are increasingly accepting policies with lower face values, perhaps as low as $50,000. Although smaller policies are now being purchased, professionals often feel policy owners receive greater benefits when the face values are higher.
Universal life policies are the most common type of policy that is settled, but all types can be sold. Variable life policies are expected to enter the viatical settlement market in greater numbers as more broker-dealers open life settlements to their security-registered representatives.

While companies vary, most viatical and life settlement firms prefer policies from only highly rated insurance carriers. Each company will have its own guidelines and investors will be wise to check the issuers rating before investing in a life policy. Individuals selling viatical settlements should also know the rating of the company in order to fairly represent the product to investors.

Since viatical settlements developed a bad reputation in the investing community in the 1990s, states have generally adopted some form of regulation for viatical settlements. Now they are also adopting regulation for stranger-owned life insurance, as that form of investing gains substantial growth. Even so, a 2002 study showed that among hospice financial counselors who had experience with viatical settlements, most thought it was a positive experience. There is obviously a place for these contracts as long as they are bought and sold in an appropriate manner. Sellers receive more than the policy’s cash surrender value, so they are generally happy. Buyers pay less than the actual death benefit so they are also happy. Investors may or may not be happy, depending upon the outcome of the investment.

Life or viatical settlements provide a liquidity that would not normally exist on a life insurance policy. Policy owners might otherwise have allowed their policy to lapse, receiving only what cash values happen to exist in their contract.

**Client Qualifications**

While there may be differences among companies, the basics tend to be universal. Generally all types of life insurance qualify, including term policies. Any person or business who owns a policy can request an appraisal with the goal of selling the contract, as long as they are the legal owner. It is important to note that usually only the policy owner may sell it. There are basically three general requirements that
need to be met in order to receive a policy appraisal, which determines whether or not the viatical firm will purchase the life policy.

**Requirement #1:**

The life insurance policy must have been purchased no less than two years ago before it can be used in a viatical settlement. That is because insurance companies put a two year contestability period on all life insurance policies. Any reputable funding source in the viatical industry will not purchase a policy during this contestability period. Doing so would put the viatical settlement investors at risk, since the insurer could refuse to pay death proceeds with cause.

**Requirement #2:**

The life insurance policy must have a face amount that meets the viatical firm’s size requirement. Many are accepting smaller policies, such as $20,000, but it should not be assumed that all companies will do so. The face value is the amount that will be paid by the insurance company upon the insured’s death (the death benefit). There is generally no maximum face value that can be purchased. Viatical funding companies have pricing models fit around fixed returns on purchasing policies.

**Requirement #3:**

The insured must have some type of life threatening illness, such as AIDS or cancer, or be owned by an individual with advanced age. If the insured has no life threatening illnesses or is still young, the viatical firms cannot determine how many premiums might be needed to have an estimate of when the policy will mature. In viatical settlements the “maturity date” is the date of the insured’s death. This date is vital to obtaining investors.

**Illness Creates a Need for Cash**

Viatical settlements were initially created to meet the financial need of AIDS victims, but any type of terminal illness may apply to viatical settlement contracts. Generally the policy owner takes part in a viatical settlement because he or she wants to pay medical or other
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bills, eliminate debt, enjoy the final months or years of their life, or simply enhance the quality of their remaining life.

How does a terminally or chronically ill person learn of viatical settlement opportunities? In the past health care workers, or even the individual’s attorney, may have informed the insured of their existence. Today, it is likely an advertisement will be the instrument alerting the policy owner to viatical companies.

Once a policy owner becomes interested in viatical settlements, he or she will likely call the company sponsoring the advertisement. The states and other professionals highly recommend individuals interested in participating in a viatical settlement check with multiple companies prior to signing over their life insurance policy. The insured will get a percentage of the death benefit soon after the policy ownership is transferred. While the percentage is less than his or her beneficiaries would have received upon his or her death, at this point the policy owner is more interested in receiving cash than leaving an inheritance. The amount received is typically more than the policy’s surrender value so policy owners are satisfied with the reduced death benefit they receive.

A viatical settlement might be compared to selling an asset that would normally be considered illiquid. Instead of selling their home or car the policy owner sells his or her life insurance policy. Doing so also reduces household expenses by the amount of the premium since the viatical company will take over that cost.

There are more news articles against viatical settlements than for them, but that does not necessarily mean viatical settlements are a poor choice. However, it is important to investigate the quality of those selling the product, underwriting them, and handling the investments. The states either have or soon will be implementing legislation because of past viatical and life settlement abuses.
The National Association of Insurance Commissioners adopted their recommendations for viatical settlement agreements and copyrighted them in 2007. Viatical settlements may also be referred to as life settlements. Whether a state uses the term viatical settlement or life settlement, they are essentially the same.

States are not obligated to use the NAIC model when drafting viatical legislation, but they often do draw some aspects from them. Called the **Viatical Settlements Act**, the NAIC viatical settlement model act created recommended legislation for:

1. Viatical related definitions;
2. State licensing procedures, including a recommendation for 15 hours of biennial continuing education on viatical procedures and contracts;
3. Rules for license revocation or denial if circumstances warrant it;
4. State specified contract and disclosure forms;
5. Reporting requirements on an annual basis of contracts written and death proceeds that have been paid;
6. Rules of investigation following complaints, and establishment of retention requirements;
7. Adoption of viator disclosure forms;
8. Adoption of insurer disclosure forms;
9. Establish general rules that apply to viatical settlement procedures and contracts;
10. Adoption and clarification of prohibited practices and conflicts of interest;
11. Adoption of advertising regulations;
12. Fraud prevention and control;
13. Injunctions, civil remedies and cease-and-desist orders;
14. Establishing the state commissioner’s ability to act and promote legislation.

The NAIC adopted amendments to the Viatical Settlement Model Act during a summer meeting in San Francisco on June 4, 2007. The NAIC originally began to look at viatical legislation in May of 2006.

Definitions

Business of Viatical Settlements
An activity involving but not necessarily limited to, the offering, soliciting, negotiating, procuring, effectuating, purchasing, investing, financing, monitoring, tracking, underwriting, selling, transferring, assigning, pledging, hypothecating, or in any other manner, acquiring an interest in a life insurance policy by means of a viatical settlement contract.

Chronically Ill
1. Being unable to perform at least two activities of daily living, such as eating, toileting, transferring from beds to chairs, bathing, dressing or continence.
2. Requiring substantial supervision to protect the individual from threats to health and safety due to severe cognitive impairments; or
3. Having a level of disability similar to that described by the Secretary of Health and Human Services.

Policy
A policy is an individual or group policy, group certificate, insurance contract, or legal arrangement of life insurance usually issued by an insurance company to a resident of the state.

Related Provider Trust
A viatical provider trust may have various names, but whatever the name it is a titling trust or other trust established by a licensed viatical settlement provider or a financing entity for the sole purpose of
holding the ownership or beneficial interest in purchased policies in connection with a financing transaction. They typically have a written agreement with the licensed viatical settlement provider under which the licensed viatical settlement provider is responsible for ensuring compliance with statutory and regulatory requirements.

Many states will have legal requirements of viatical trusts, which they must follow in order to operate within that state.

**Special Purpose Entity**
A special purpose entity is a corporation, partnership, trust, limited liability company or similar entities formed solely to provide either directly or indirectly access to institutional capital markets.

**Terminally Ill**
An individual having an illness or sickness that can reasonably be expected to result in his or her death within twenty-four months or less.

**Viatical Settlement Broker**
A person who works exclusively on behalf of a viator and receives a fee, commission, or other valuable consideration for offering or negotiating viatical settlement contracts between the viator and one or more viatical settlement providers or one or more viatical settlement brokers. A broker, despite receiving compensation from the viator, is considered to represent only the viator – not the insurer or viatical settlement provider. The broker owes the viator a fiduciary duty to act according to the viator’s instructions and in the best interest of the viator. A viatical settlement broker would not include an attorney, certified public accountant or a financial planner accredited by a nationally recognized accreditation agency who is retained to represent the viator and whose compensation is not paid directly or indirectly by the viatical settlement provider or purchaser.

**Viatical Settlement Contract**
A written agreement between a viator and a viatical settlement provider or any affiliate of the viatical settlement provider establishing the terms under which compensation or anything of value is or will be paid. The compensation will be less than the expected death benefits of the policy; in return the viator will give his or her present or future assignment, transfer, sale, devise or bequest of the death benefits or
ownership of any portion of the insurance policy or certificate of insurance.

A viatical settlement contract includes a premium finance loan made for a life insurance policy by a lender to a viator on, before, or after the date of issuance of the policy where the viator or insured receives on the date of the premium finance loan a guarantee of a future viatical settlement value of the policy or they agree on the date of the premium finance loan to sell the policy or any portion of its death benefits on any date following the issuance of the policy.

A viatical settlement contract would not include a policy loan or accelerated death benefits made by the insurer according to the policy terms.

**Viatical Settlement Provider**
A viatical settlement provider is a person, other than the viator, that enters into or effectuates a viatical settlement contract with a viator.

**Viatical Settlement Purchase Agreement**
This is a contract or agreement entered into by a viatical settlement purchaser, to which the viator is not a party, to purchase a life insurance policy or an interest in a life insurance policy, for the purpose of deriving economic benefits.

**Viator**
A viator is the owner of an individual life insurance policy or certificate holder under a group policy who resides in the state and enters or seeks to enter into a viatical settlement contract. If there is more than one owner of the policy and the viators are residents of different states, the transaction will be governed by the laws of the state in which the viator having the largest percentage of ownership resides. If the viators hold equal ownership, the viators may agree in writing to use the state of residence of one viator.

**License and Bond Requirements**
Those wishing to act as a viatical settlement provider or broker must obtain a license from the state he or she resides in. Since each state may have specific licensing requirements, of course the provider or
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broker must meet all their state’s licensing qualifications, including continuing education if appropriate.

A person wishing to become a viatical settlement investment agent must first obtain a license from the commissioner of the state of residence of the viatical settlement purchaser. If there is more than one purchaser on a single policy, residing in different states, the viatical settlement purchase agreement must be governed by the laws of the state in which the purchaser having the largest percentage of ownership lives or the state that is agreed upon in writing by all purchasers.

Under the NAIC model laws, life insurance producers who are licensed as a resident insurance producer with a life line of authority for at least one year is deemed to have met the licensing requirements to operate as a viatical settlement broker. Within 30 days of first operating as a viatical settlement broker, the life insurance producer must notify the commissioner that he or she is acting as a viatical settlement broker, using the form prescribed by his or her state. This notification will probably include an acknowledgement that the agent will act within the laws of his or her state. There is likely to be a licensing fee payable at the same time.

Some states may require insurance producers to obtain separate licensing. Therefore, the agent may not necessarily meet the licensing requirements to operate as a viatical settlement broker merely because he or she has been a licensed agent for at least a year. As always, it is vital that insurance producers know the laws of their particular state.

The insurance company issuing the life insurance policy is not responsible for any act or omission of a viatical settlement broker or provider resulting from their connection with the viatical settlement transaction, unless compensation is received by the insurer.

An individual licensed as an attorney, certified public accountant or financial planner (accredited by a nationally recognized accreditation agency) who is retained to represent the viator may negotiate viatical settlement contracts on the viator’s behalf without having to obtain a viatical settlement broker’s license, as long as compensation is not paid directly or indirectly by the viatical settlement provider.
Viatical licenses are renewable each year on the anniversary date. There will be annual fees specified by each state that must be paid at the time of license renewal. Of course, if the fees are not paid, the license will lapse for nonpayment.

Applicants must provide information on forms that are specified by the individual state insurance departments. The commissioners have the authority, at any time, to require the applicants to fully disclose the identities of all stockholders, partners, officers, members and employees. If the commissioner is not satisfied with any one of these individuals or if that person is deemed to have influence over the applicant’s conduct, the commissioner may refuse to issue or renew a license.

A license issued to a legal entity authorizes all partners, officers, members, and designated employees to act as viatical settlement providers, viatical settlement brokers, or viatical settlement investment agents. All individuals that will act as providers, brokers, or investment agents must be named in the application and on any supplements to the application.

Upon filing the application and paying any applicable fees, the commissioner will investigate each applicant and issue a license if the commissioner determines the applicant:

1. For viatical settlement providers, has provided a detailed plan of operation;
2. Is competent and trustworthy and will act in good faith in the capacity of the license type issued;
3. Has a good business reputation and has had experience, training, or education qualifying him or her in the business for which the license applies;
4. For viatical settlement providers and brokers, has demonstrated evidence of financial responsibility in a format prescribed by the state’s commissioner through either a surety bond executed and issued by an insurer authorized to issue them or a deposit of cash, certificates of deposit, or securities or any combination thereof in the amount of $250,000.
Surety bonds are to be issued in favor of the state and will specifically authorize recovery by the commissioner on behalf of any person who sustained damages due to erroneous acts, failure to act, conviction of fraud, or conviction of unfair practices against the viatical settlement provider or broker.

The commissioner may ask for evidence of financial responsibility any time it appears necessary to do so.

If a viatical settlement provider or broker experiences change in the officers, stockholders holding 10% or more of the stock, partners, directors, members or designated employees, the provider must notify the commissioner of the change within 30 days.

The NAIC Model Act recommends that states adopt a continuing education requirement of fifteen (15) hours of training related to viatical settlements and viatical settlement transactions. Assuming the state has adopted the NAIC recommendation, an individual that fails to obtain the required education for his or her viatical settlement broker license would lapse due to noncompliance.

**License Revocation and Denial**

The state commissioner, under the NAIC Model Act, could refuse to issue, suspend, revoke or refuse to renew the license of a viatical settlement provider or broker if the commissioner finds that:

1. There was any material misrepresentation in the license application;

2. The licensee or any officer, partner, member or key management personnel has been convicted of fraud or dishonest practices, or is otherwise proven to be incompetent or untrustworthy;

3. The viatical settlement provider has demonstrated a pattern of unreasonable payments to viators;

4. The licensee or any officer, partner, member or key management personnel has been found guilty of or pleaded guilty to any felony or misdemeanor involving fraud or moral
turpitude, regardless of whether a conviction has been entered by the courts;

5. The viatical settlement provider has entered into any viatical settlement contract that has not been approved under the laws of the Model Act, if adopted by the state.

6. The viatical settlement provider has failed to honor contractual obligations specified in the contract or purchase agreement;

7. The licensee no longer meets the requirements for initial licensure;

8. The viatical settlement provider has assigned, transferred or pledged a viatical policy to a person other than a viatical settlement provider licensed in the state, viatical settlement purchaser, an accredited investor or qualified institutional buyer; or

9. The licensee or any officer, partner, member or key management personnel has violated any provision of the Model Act, as adopted by the state.

The commissioner may suspend, revoke or refuse to renew the license of a viatical settlement broker or producer if the commissioner finds the individual has not followed state requirements or engaged in bad faith with one or more viators.

If the commissioner denies a license application or suspends, revokes, or refuses to renew a license of a viatical settlement provider, broker, or life insurance producer operating as a viatical settlement broker, the commissioner will conduct a hearing according to the state’s administrative procedure act.

Viatical Settlement Contracts and Disclosure Statements

All viatical contracts and disclosure statements must be approved by the state’s insurance commissioner prior to use. If the forms fail to meet all requirements, are unreasonable, contrary to the interests of the public, or in any way misleading or unfair to the viator, they will be
disapproved. If the commissioner feels it necessary, he or she may also require the submission of advertising material for approval.

**Reporting Requirements and Privacy**

Each viatical settlement provider must file an annual statement on or before March 1 of each year with the commissioner relating to all transactions for viators that are residents of the state. The report must contain all information required by that state’s regulations. Any individual data that could compromise the insured’s or viator’s privacy of personal, financial, or health information will be filed with the commissioner on a confidential basis.

Except as allowed or required by law, no party may disclose the identity of the insured, his or her financial or medical information to any other person, unless the disclosure:

1. Is necessary to effect a viatical settlement between the viator and a viatical settlement provider and the viator and insured have given prior written consent to do so;

2. Is necessary to effect a viatical settlement purchase agreement between the viatical settlement purchaser and a viatical settlement provider and the viator and insured have given prior written consent to do so;

3. Is provided in response to an inquiry by the state’s commissioner, any other governmental officer or agency, or under mandatory reporting requirements of fraudulent viatical settlement acts;

4. Is a term of or condition to the transfer of a policy by one viatical settlement provider to another viatical settlement provider;

5. Is necessary to permit a financing entity, related provider trust, or special purpose entity to finance the purchase of policies by a viatical settlement provider and the viator and inured have provided prior written consent to do so.
6. Is necessary to allow the viatical settlement provider or broker, or their authorized representative, to make contacts for the purpose of determining health status; or

7. Is required to purchase stop loss insurance coverage or financial guaranty insurance.

As states consider adoption of the NAIC Model Act, they have the chore of protecting the privacy of those involved in viatical settlements while still keeping the legal language broad enough to allow licensed entities to notify the commissioner’s office of unlicensed viatical activity. Insurers must also be able to make necessary disclosures without violating privacy laws.

**Examination or Investigations**

The Model Act says: "The commissioner may conduct an examination under this Act of a licensee as often as the commissioner in his or her discretion deems appropriate after considering the factors set forth in this paragraph."¹

When a state commissioner or the commissioner’s representative is considering conducting an examination he or she will consider consumer complaints, results of any financial statement analyses and ratios, changes in company management or ownership, actuarial opinions, independent CPA reports, and other relevant criteria. The commissioner may examine or investigate any person or business entity that is material to the licensee. If the licensee is not a resident of the state, the commissioner may accept an examination from the licensee’s domicile state or port-of-entry state. Investigations will be made in cooperation, as far as practical, with the insurance supervisory officials of other states where the licensee transacts business.

Those licensed to work in the viatical settlement industry must retain copies for five years of all paperwork associated with the viatical settlement contracts or proposals of contracts. This would include proposed, offered or executed contracts, purchase agreements, underwriting documents, policy forms, and applications. They must,

¹ NAIC Model Act Section 7, subparagraph A(1)(a)
as stated, be kept for five years from the date of the proposal, offer, or execution of the contract or purchase agreement, whichever is later.

All checks, drafts, or other evidence and documentation related to the payment transfer, deposit or release of funds from the date of transaction must also be kept, as well as all other records and documents related to viatical settlements. In short, anything related to viatical settlement business should be kept for five years. It is better to keep more than necessary rather than less. If in doubt, keep it. Even after the five year period, if the commissioner requests these documents and the individual still has the material, he or she is obligated to turn them over.

All records must be legible and complete. Records may be kept in a paper format, by photograph, micro-process, magnetic, mechanical, or electronic media. Any process that accurately keeps the records and allows reproduction of them is acceptable.

When it is determined that an examination is prudent, the commissioner will issue an examination warrant appointing one or more examiners to perform it and instruct them as to the scope of the examination. The examiners will observe the guidelines and procedures in the Examiners Handbook adopted by the National Association of Insurance Commissioners (NAIC), unless the state has adopted different procedures or the commissioner feels other guidelines are appropriate.

All individuals working in the viatical field that are contacted during the investigation must provide requested information in a timely and convenient manner. There must be free access at the individual’s office to requested information at all reasonable hours. This would include access to books, records, accounts, papers, documents, assets, and computer recordings related to the licensee being investigated. The refusal of a licensee, his or her officers, directors, employees, or agents to submit to examination or to comply with reasonable written requests will be grounds for suspension or refusal of, or non-renewal of any license or authority to continue in the viatical settlement business or any business subject to the insurance commissioner’s jurisdiction.
The commissioner has the power to issue subpoenas to any person, to administer oaths, and examine under oath any individual on any matter pertinent to the examination. If an individual refuses to obey a subpoena the commissioner may petition a court of competent jurisdiction and, with proper showing, the Court may enter an order compelling the person to appear and testify or produce requested evidence. Should the individual fail to obey the court order, he or she will be punished under contempt of court statutes.

The commissioner may retain attorneys, appraisers, independent actuaries, independent certified public accounts, or other professionals as examiners. The reasonable cost of these individuals must be paid by the licensee being examined. Findings of fact and conclusions made as a result of the examination will be *prima facie* evidence in any legal or regulatory action. The commissioner may terminate or suspend an examination in order to pursue other legal or regulatory actions that would apply to the state’s insurance laws. The commissioner may also use and, if appropriate, make public any final or preliminary examination report or other documents as he or she considers appropriate for the situation, unless the state has confidential statutes in place that would prevent such actions.

Examination reports are comprised of only facts gathered from books, records, or other documents of the licensee, its agents, or other persons connected to the investigation. Only conclusions and recommendations the examiners find to be reasonably warranted by the facts will be included.

The examiner in charge will file a verified written report under oath with the commissioner within sixty days following completion of the examination. The insurance commissioner will then transmit the report to the licensee, with a notice providing a reasonable opportunity of up to thirty days to make a written submission or rebuttal with respect to any matters in the examination report. If the commissioner feels regulatory action is appropriate for the situation, he or she may initiate any proceedings or actions allowed by state law.

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2 *prima facie*: Latin for “as it first appears”
Confidentiality of Examination Information

Names and identifying information of all viators must be considered private and confidential information. They may not be disclosed by the commissioner, unless required by law. All examination reports and other documents related to the licensee’s investigation are confidential and generally are not subject to subpoena. Such information would not be subject to discovery or admissible in evidence in any private civil action.

Documents or other information in the possession or control of the NAIC and its affiliates and subsidiaries are confidential by law and privileged, not subject to subpoena, and not subject to discovery or admissible in evidence in any private civil action if they are:

1. Created, produced, or obtained by or disclosed to the NAIC and its affiliates and subsidiaries in the course of assisting an examination or assisting a commissioner in the analysis or investigation of the financial condition or market conduct of a licensee; or
2. Disclosed to the NAIC and its affiliates and subsidiaries by a commissioner.

None of the individuals connected to the examination, including the NAIC and its affiliates and subsidiaries, are permitted to testify in any private civil action concerning any confidential documents, materials or information obtained during the investigation. The commissioner may share documents and other information, including confidential and privileged documents, with other state, federal, international regulatory agencies and authorities, and the NAIC as long as they agree to maintain the confidentiality and privileged status of all information.

The commissioner may receive communications, including confidential and privileged documents, from the NAIC and from regulatory and law enforcement officials of other jurisdictions. The commissioner will maintain all material and information as confidential or privileged, as long as its confidential or privileged status was communicated.
Conflict of Interest

The commissioner may not assign any individual as an examiner if he or she has either a direct or indirect conflict of interest. A person who is affiliated with the management of or owns a pecuniary interest in any person subject to examination would constitute a conflict of interest. This does not necessarily mean an examiner could not also be a viator, an insured in a viaticated insurance policy, or a beneficiary in a policy that was viaticated.

Immunity from Liability

The commissioner, his or her authorized representatives, and any authorized examiner are immune from liability for statements made or conduct performed associated with his or her duties during an investigation as long as they acted in good faith. Nor is any person or company liable that communicated or delivered information or data to the commissioner, per his or her request, due to an examination as long as the service was performed in good faith and without fraudulent intent.

Despite the immunity afforded, a person who is still named as a party in a civil cause action for libel or slander is entitled to an award of attorney’s fees and costs incurring as a result of that action in most cases.

Disclosure to Viator

With each application for a viatical settlement, under the NAIC Model Act, by the time the contract is signed, the viatical settlement provider or broker must provide the viator with at least the following disclosures:

1. There are possible alternatives to viatical settlement contracts including any accelerated death benefits or policy loans offered under the viator’s life insurance policy;

2. That a viatical settlement broker represents exclusively the viator – not the insurer or viatical settlement provider. He or she owes a fiduciary duty to the viator, including a duty to act
according to the viator’s instructions and in the best interest of the viator.

3. Some or all of the proceeds of the viatical settlement may be taxable under federal income tax and state franchise and income taxes. It may be wise to get assistance from a professional tax advisor.

4. Proceeds of the viatical settlement could be subject to the claims of creditors.

5. Receipt of the proceeds of a viatical settlement may adversely affect the viator’s eligibility for Medicaid or other government benefits or entitlements. It would be wise to seek advice from the appropriate government agencies.

6. The viator has the right to rescind a viatical settlement contract before the earlier of sixty (60) calendar days after the date upon which the viatical settlement contract is executed by all parties or thirty (30) calendar days after the viatical settlement proceeds have been paid to the viator. Rescission, if exercised by the viator, is effective only if both notice of the rescission is given and the viator repays all proceeds and any premiums, loans and loan interest paid on behalf of the viatical settlement within the rescission period. If the insured dies during the rescission period, the viatical settlement contract will be considered rescinded, subject to repayment of all viatical settlement proceeds including any premiums, loans and loan interest that was paid on the viator’s behalf. These funds must be repaid within sixty days of the insured’s death.

7. Funds will be sent to the viator within three business days after the viatical settlement provider has received the insurer or group administrator’s written acknowledgment that ownership of the policy or interest in the group certificate has been transferred and the beneficiary has been designated.

8. Entering into a viatical settlement contract may cause other rights or benefits, including conversion rights and waiver of premium, to be forfeited by the viator. It may be wise to consult with a financial adviser.

9. The viator must receive a brochure describing the process of viatical settlements. The NAIC’s form for the brochure will be
used unless another form is developed or approved by the state’s commissioner.

10. The disclosure document will contain the following language: "All medical, financial or personal information solicited or obtained by a viatical settlement provider or viatical settlement broker about an insured, including the insured’s identity or the identity of family members, a spouse or a significant other may be disclosed as necessary to effect the viatical settlement between the viator and the viatical settlement provider. If you are asked to provide this information, you will be asked to consent to the disclosure. The information may be provided to someone who buys the policy or provides funds for the purchase. You may be asked to renew your permission to share information every two years.”

11. Following execution of a viatical contract, the insured may be contacted for the purpose of determining the insured’s health status and to confirm the insured’s residential or business street address and telephone number. This contact will be limited to once every three months if the insured has a life expectancy of more than one year. The insured may be contacted no more than once per month if the insured has a life expectancy of one year or less. All such contact must be made only by a viatical settlement provider licensed in the state in which the viator resides at the time of the viatical settlement or by the provider’s authorized representative.

A viatical settlement provider must give the viator at least the following disclosures no later than the date the viatical settlement contract is signed by all parties. The disclosure must be conspicuously displayed in the viatical settlement contract or in a separate document signed by the viator and provide the following information:

1. The affiliation, if any, between the viatical settlement provider and the issuer of the insurance policy that will be viaticated;

2. The name, business address and telephone number of the viatical settlement provider;

3. Any affiliations or contractual arrangements between the viatical settlement provider and the viatical settlement purchaser;
4. If a life insurance policy has been issued as a joint policy or involves family riders that cover the life of anyone else other than the terminally ill individual, the viator must be informed of the possible loss of coverage on the other lives under the policy and he or she must be advised to consult with his or her insurance producer or the issuing insurer for advice on the proposed viatical settlement.

5. It must state the dollar amount of the current death benefit payable to the viatical settlement provider under the policy or certificate. If known, the viatical settlement provider must also disclose the availability of any additional guaranteed insurance benefits, the dollar amount of any accidental death and dismemberment benefits under the policy or certificate and the extent to which the viator’s interest in those benefits will be transferred as a result of the viatical settlement contract; and

6. State whether the funds will be escrowed with an independent third party during the transfer process. If so, it must state the name, business address, and telephone number of the independent third party escrow agent and the fact that the viator or owner may inspect or receive copies of the relevant escrow or trust agreements or documents.

A viatical settlement broker must provide the viator with at least the following disclosure by the time the viatical settlement contract is signed by all parties. It must be conspicuously displayed in the viatical settlement contract or in a separate document signed by the viator and provide the following information:

1. The name, business address and telephone number of the viatical settlement broker;

2. A full, complete and accurate description of all offers, counter-offers, acceptances and rejections relating to the proposed viatical settlement contract;

3. A written disclosure of any affiliations or contractual arrangements between the viatical settlement broker and any person making an offer in connection with the proposed viatical settlement contracts;
4. The amount and method of calculating the broker’s compensation. The term “compensation” includes anything of value paid or given to a viatical settlement broker for the placement of a policy; and

5. If any portion of the viatical settlement broker’s compensation is taken from a proposed viatical settlement offer, the broker must disclose the total amount of the offer and the percentage that will be the broker’s compensation.

If the viatical settlement provider transfers ownership or changes the beneficiary of the insurance policy, the provider must notify the insured of the change in writing within twenty days after the change.

A viatical settlement provider or its investment agent must provide the viatical settlement purchaser with at least the following disclosures prior to the date the purchase agreement is signed by all parties. The disclosures must be conspicuously displayed in any viatical purchase contract or in a separate document signed by the viatical settlement purchaser and viatical settlement provider or investment agent and must make the following disclosure to the viatical settlement purchaser:

1. The purchaser will receive no returns, such as dividends and interest, until the insured dies and a death claim payment is made.

2. The actual annual rate of return on a viatical settlement contract is dependent upon an accurate projection of the insured’s life expectancy, and the actual date of the insured’s death. An annual “guaranteed” rate of return cannot be determined.

3. The viatical life insurance contract should not be considered a liquid asset. It is not possible to predict the exact timing of its maturity; funds are not usually available until the death of the insured. There is no established secondary market for resale of such products, so there may be no possibility of selling the purchase to another.

4. The purchaser may lose all benefits or may receive substantially reduced benefits if the insurer goes out of business during the term of the viatical investment.
5. The purchaser is responsible for payment of the insurance premium or other costs related to the policy, if required by the terms of the purchase agreement. These costs may reduce the purchaser’s return. If a party other than the purchaser is responsible for the payment, the name and address of that party must be disclosed.

6. The purchaser is responsible for payment of the insurance premiums and other costs related to the policy if the insured returns to health. The amount of the premiums must be disclosed, if applicable.

7. State the name, business address and telephone number of the independent third party providing escrow services and the relationship to the broker.

8. The amount of any trust fees or other expenses to be charged to the viatical settlement purchaser must be disclosed.

9. State whether the purchaser is entitled to a refund of all or part of his or her investment under the settlement contract if the policy is later determined to be null and void.

10. Disclose that group policies may contain limitations or caps in the conversion rights, additional premiums may have to be paid if the policy is converted, and name the party that would be responsible for payments of additional premiums. If a group policy is terminated and replaced by another group contract, state that there may be no right to convert the original coverage.

11. Disclose the risks associated with policy contestability including, but not limited to, the risk that the purchaser will have no claim or only a partial claim to death benefits if the insurer rescinds the policy within the contestability period.

12. Disclose whether the purchaser will be the owner of the policy in addition to being the beneficiary. If the purchaser is only the beneficiary (not also the owner) disclose the special risks associated with that status, including the risk that the beneficiary may be changed or the premium may not be paid.

13. Describe the experience and qualifications of the person who determines the life expectancy of the insured, such as
independent physicians or specialty firms that weigh medical and actuarial data, the information this projection is based on, and the relationship of the projection maker to the viatical settlement provider, if any.

14. Disclosure to an investor must include distribution of a brochure describing the process of investment in viatical settlements. The NAIC’s form for the brochure may be used unless one has been developed by the state.

At the time of an assignment, transfer, or sale of an insurance policy, in part or whole, the viatical settlement provider or its investment agent must provide the purchaser with at least the following disclosures no later than the time of the transaction. The disclosures must be contained in a document signed by the viatical settlement purchaser and provider, or the provider’s agent.

1. It must disclose all the life expectancy certifications obtained by the provider in the process of determining the price paid to the viator.

2. It must state whether premium payments or other costs related to the policy have been escrowed, and if so, the date upon which the escrowed funds will be depleted. It must further state whether the purchaser will be responsible for premium payments and other policy costs after the funds have been depleted. If he or she will be responsible, the amount of premiums and other costs must be stated.

3. If the policy premiums and other costs have been waived, it must state whether the investor will be responsible for premium payments if the issuing insurer terminates the waiver. The amount of the premiums must also be stated.

4. It must disclose the type of life insurance policy being sold, such as whole life, term, universal or a group policy certificate. It must also state any additional benefits that are in the policy and the policy’s current status.

5. If the policy is a term life insurance policy (having no cash values) it must disclose the policy’s special risks, including the purchaser’s responsibility for higher premiums if the viator continues the term policy at the end of the current term (many
term policies increase in cost at each policy renewal anniversary).

6. It must state whether the policy is contestable. Policies still in the contestable time period contain additional risk for the purchaser.

7. It must state whether the policy’s issuing insurance company has any rights that could negatively affect or extinguish the purchaser’s rights under the viatical settlement contract, what those rights are, and under what conditions the insurer’s rights could be activated.

8. It must state the name and address of the person responsible for monitoring the insured’s condition. It should describe how often contact is made with the insured and how the date of death is determined. It should also state how and when this information will be relayed to the purchaser of the life insurance policy.

Under the NAIC Model Act, the viatical settlement purchaser has three days from the time the disclosures are received to void the purchase agreement. During these three days, the purchaser should completely read the disclosures and seek council if any of them are not fully understood.

**Disclosure to Insurer**

Viatical settlement providers and brokers must fully disclose their plans, transactions, or series of transactions to the policy’s issuing insurer before initiation of the viatical settlement during the first five years of the policy. As always, if the state has mandated different time periods or procedures it is the responsibility of the provider or broker to know and follow their state’s laws and regulations.

**General Rules**

When a viatical settlement provider enters into a viatical settlement contract, he or she must first obtain a written statement from the viator’s licensed attending physician that the viator is of sound mind and under no constraint or undue influence to enter into the contract.
The provider must also obtain a document from the insured releasing their medical records to the licensed viatical settlement provider, broker, and life policy’s issuing insurance company.

Within 20 days after the viator executes the documents required to transfer rights under the insurance policy or within 20 days of entering any agreement, option, promise, or any other form of understanding, whether expressed or implied, to viaticated the life insurance policy, the viatical settlement provider must give written notice to the issuing insurer that the policy has or will become a viaticated policy, along with a request for verification of coverage. A copy of the insured’s medical release and a copy of the viator’s application for a viatical settlement should be included. The NAIC’s form for verification of coverage would be used, unless the state has developed its own form.

The insurer must respond to the verification of coverage request within 30 calendar days of the date the request was received. The company would indicate whether, based on medical evidence and documents provided, the insurer intends to pursue an investigation at this time regarding the validity of the insurance contract or possible fraud. The insurer must accept a request for verification of coverage made on an NAIC form or any form approved by the state’s commissioner. The request (on the proper form) may be made by facsimile (fax), email (electronic copy) or by mailing the original to the insurer, accompanied by the viator’s signed authorization.

Prior to, or at the time of execution of the viatical settlement contract, the viatical settlement provider must obtain a witnessed document in which the viator consents to the contract, represents that the viator has a full and complete understanding of the viatical settlement contract, has full and complete understanding of the benefits of the life insurance policy, acknowledges that he or she is entering into the contract freely and voluntarily and, where applicable, acknowledges that the insured has a terminal or chronic illness, which was diagnosed after the life insurance policy was issued.

If the viatical settlement broker performs any of these activities that are required of the provider, it is not necessary for the provider to also complete them. All medical information obtained by any licensee is subject to all applicable provisions relating to confidentiality.
All viatical settlement contracts, under the NAIC Model Act, must allow the viator the absolute right to rescind the contract before the earliest of *sixty calendar days* following the date the contract was executed by all parties, or *thirty calendar days* after the viatical settlement proceeds have been sent to the viator. The viator may be required to give notice and repay the viatical settlement provider all proceeds, including any premiums, loans and loan interest that were paid on his or her behalf.

If the insured dies during the rescission period the viatical settlement contract will be deemed rescinded. The viatical settlement provider or purchaser will be reimbursed for any proceeds, premiums, loans, or loan interest that he or she paid on behalf of the insured within 60 calendar days of the insured’s death.

If a viatical settlement contract is rescinded, any commissions or other compensation that was paid to a viatical settlement broker must be refunded to the viatical settlement provider within five business days following receipt of written demand from the provider. The viator’s notice of rescission or notice of the insured’s death (if rescinded due to death within the applicable rescission period) must be sent with the repayment demand.

The viatical settlement purchaser has the right to rescind a viatical settlement contract within three days after the disclosures have been received.

The viatical settlement provider must instruct the viator to send the required executed documents necessary to change policy ownership, assignment, or beneficiary designation directly to the independent escrow agent. Within three business days from the date the provider or escrow agent receives them the provider must pay or transfer the proceeds of the viatical settlement into an escrow or trust account maintained in a state or federally-chartered financial institution whose deposits are insured by the Federal Deposit Insurance Corporation (FDIC). When the settlement proceeds have been paid into the escrow account, the escrow agent must deliver the original change in ownership, assignment, or beneficiary change forms to the viatical settlement provider or related provider trust or other designated representative of the provider. Upon receipt of the acknowledgement...
of transfer, the escrow agent will pay the settlement proceeds to the viator.

If payment is not made to the viator for the viatical settlement contract within the time requirements, the viator may void the contract for lack of payment. Once payment is made the contract may be accepted by the viator and reactivated. Funds are considered to be paid as of the date the escrow agent either releases funds to the viator through wire transfer or sends a check to the viator through the US postal service or some other nationally recognized delivery service.

Periodically contact will be made with the insured for the purpose of determining current health status. Such contact may only be made by the viatical settlement provider or broker licensed in the state. Contact for the purpose of checking health status is limited to once every three months for insured’s having a life expectancy of more than one year and no more than once per month for those with a life expectancy of less than a year. The provider or broker must explain contact procedures at the time the contract is entered into. Contact for reasons other than determining current health is not limited and may be made as often as necessary in the process of conducting business. Viatical settlement providers and brokers are responsible for their authorized representatives; if such representatives contact viators more often than allowed for health status purposes they will be held accountable.

Prohibited Practices

It is a violation, under the NAIC’s Model Viatical Act, to enter into a viatical settlement contract prior to the application or issuance of a life insurance policy that will be used for the contract. It is also a violation to do so within a five-year period beginning with the date of issuance of the policy or certificate, unless the viator certifies to the settlement provider that one or more of the following conditions have been met within that five-year period:

1. The policy was issued upon the viator’s exercise of conversion rights from a group or individual policy, provided the total time covered under the conversion plus the time covered under the prior policy was at least 60 months (thus meeting the five year
requirement). Group policies will be calculated without regard to any change in insurance carriers, provided the coverage was continuous and under the same group sponsorship.

2. The viator submits independent evidence to the viatical settlement provider that one or more of the following conditions were met within the five year period:
   a. The viator or insured is terminally or chronically ill;
   b. The viator’s spouse died;
   c. The viator divorced;
   d. The viator retired from full-time employment;
   e. The viator is not able to maintain full-time employment due to a physical or mental disability, confirmed by a physician;
   f. A final order, judgment or decree is entered by a court of competent jurisdiction, on the viator’s application of a creditor, adjudicating the viator bankrupt or insolvent, or approving a petition seeking the viator’s reorganization or appointing a receiver, trustee or liquidator to all or a substantial part of the viator’s assets.

3. The viator enters into a viatical settlement contract more than two years following the policy’s issuance date and meets the following conditions:
   a. Policy premiums were exclusively funded with unencumbered assets;
   b. There is no agreement or understanding with any other person to guarantee liability or to purchase the policy, including forgiveness of a loan; and
   c. Neither the insured nor the policy has been evaluated for settlement.

All required evidence must be submitted to the insurer with a request for verification of insurance. The copies must be accompanied by a letter of attestation from the viatical settlement provider that the copies are true and correct. The copies sent to the issuing insurer will be deemed to conclusively establish that the viatical settlement contract meets legal requirements and the insurer must timely respond to the request.

In responding to the request for verification of coverage, the issuing insurance company may require the viator, insured, viatical settlement
provider or broker to sign any forms, disclosures, consent or waiver forms that have not been expressly approved by the state’s commissioner for use in connection with viatical settlement contracts. Upon receipt of a properly completed request for change of ownership or beneficiary designation, the insurer must respond in writing within 30 calendar days with written acknowledgement confirming the requested changes have been made or stating reasons why they cannot be completed. Insurers may not unreasonably delay making changes in ownership or beneficiary designations or in any way interfere with lawful viatical settlement contracts.

**Prohibited Practices and Conflicts of Interest**

Viatical settlement brokers may not solicit an offer from, effectuate a viatical settlement with or make a sale to any viatical settlement provider, purchaser, investment agent, financing entity, or related provider trust if he or she has current control, previous control, or common control with them. This refers only to viatical settlement contracts or insurance policies.

Viatical settlement providers may not knowingly enter into a viatical settlement contract with a viator if, in connection with the contract, anything of value will be paid to the viatical settlement broker that is controlling, controlled by, or under common control with that provider, purchaser, investment agent, financing entity, or related provider trust. If either a viatical settlement broker or provider does so, it will be deemed a fraudulent viatical settlement act.

Viatical settlement providers may not enter into a contract unless the viatical settlement promotional, advertising and marketing materials have been previously filed with the state’s insurance commissioner’s office. Under the NAIC Model Act, at no time may any marketing materials state or make any reference to the insurance being “free” for any period of time. The inclusion of any reference in the marketing materials that might cause a viator to reasonably believe the insurance is free for any time period is considered a violation of the NAIC Act.

Unless it is provided in the life insurance policy, no life insurance producer, insurance company, investment agent, viatical settlement broker, or provider, may make any statement or representation to the
applicant or policyholder in connection with the sale or financing of a life insurance policy to the effect that the insurance is free or without cost to the policyholder.

**Advertising for Viatical Settlements and Purchase Agreements**

This section of the NAIC Model Act is designed to provide prospective viators and viatical settlement purchasers with clear, understandable statements in the viatical settlement advertisements and to assure the clear, truthful and adequate disclosure of benefits, risks, limitations, and exclusions of viatical settlement contracts or viatical settlement purchase agreements that are bought or sold. They intend to accomplish this by establishing guidelines and standards of permissible and impermissible conduct when advertising viatical settlements to assure that product descriptions are presented in a way that prevents unfair, deceptive or misleading advertising and lends to providing accurate presentation and description of viatical settlements.

These rules apply to any viatical settlement contract advertising and to any related products or services intended for dissemination in the state, including Internet advertising viewed by people located in the state. If there are federal regulations that apply these requirements would not minimize or diminish them, but rather are designed to minimize or eliminate conflict.

Every viatical settlement licensee must establish and maintain a system of control over the content, form, and method of dissemination of all advertisements of its viatical contracts, products and services. Regardless of who writes, creates, designs, or presents the advertisements responsibility rests on the viatical settlement licensees, along with the individual who created or presented the advertisement. A system of control must include regular notification of existing requirements at least once each year to agents and others authorized to produce advertising. They should also be reminded routinely that advertisements must be approved by the commissioner, if that is the case in their state.

Advertising must be truthful; there should not be any misleading facts or implications. The form and content of an advertisement for
viatical settlement contracts, viatical settlement purchase agreements, products, or services must be sufficiently complete and clear to avoid deception or misunderstandings. It should not have the capacity or tendency to mislead or deceive, which will be determined by the state’s commissioner from the overall impression left by the advertisement based on a person of average education or intelligence within the population segment the ad targets.

Certain viatical settlement advertisements are considered false and misleading on their face and are prohibited. False and misleading viatical settlement advertisements include, but are not necessarily limited to, the following representations:

1. Words such as “guaranteed,” “fully secured,” “100 percent secured,” “secure,” “fully insured,” “safe,” “backed by rated insurance companies,” “backed by federal law,” “backed by state law,” “backed by state guaranty funds,” or similar representations;

2. Phrases such as “no risk,” “minimal risk,” “low risk,” no speculation,” “no fluctuation,” or similar representations;

3. Representations such as “qualified or approved for individual retirement accounts, Roth IRAs, 401(k) plans, simplified employee pension plans, 403(b), Keogh plans, TSA, other retirement account rollovers,” “tax deferred,” or similar representations;

4. Utilization of the word “guaranteed” to describe the fixed return, annual return, principal, earnings, profits, investment, or similar representations;

5. Statements like “No sales charges or fees” or similar representations;

6. “High yield,” “superior return,” “excellent return,” “high return,” “quick profit,” or similar representations; and

7. Purported favorable representations or testimonials about the benefits of viatical settlement contracts or purchase agreements as an investment that has been taken out of context from newspapers, trade papers, journals, radio and television programs, and all other forms of print or electronic media, such as the internet.
Information that is required to be disclosed should not be minimized, rendered obscure, or presented in an ambiguous fashion or intermingled with the text of the advertising so as to be confusing or misleading.\(^3\)

Advertisements may not omit material information or use words, phrases, statements, references or illustrations if the omission or use has the possibility of misleading or deceiving viators or contract purchasers. The fact that viators and contract purchasers have the ability to inspect the contract prior to the sale, may have a “free look” period, or receive a refund if not satisfied does not remove the legal requirements regarding truthful advertising. An advertisement may not use the name or title of a life insurance company or policy unless the advertisement has been approved by the insurer.

An advertisement may not say that premium payments will not be required in order to maintain the policy of a viatical settlement contract or purchase agreement, unless that is the actual fact. Advertisements may not state or imply that interest charged on an accelerated death benefit or a policy loan is unfair, inequitable or in any manner incorrect or an improper practice.

The words “free,” “no cost,” “without cost,” “no additional cost,” “at no extra cost,” or words of similar text may not be used with respect to any benefit or service, unless true. Advertisements may specify the charge for a benefit or service or may state that a charge is included in the payment or use other appropriate wordage.

Testimonials, appraisals or analysis used in advertisements must be genuine, represent the current opinion of the author, and be applicable to the viatical settlement contract or purchase agreement, product or service advertised. It must be accurately stated with sufficient completeness to avoid misleading or deceiving prospective viators or purchasers as to the nature or scope of the testimonials, appraisals, analysis or endorsements. When testimonials, appraisals or analysis are used, even though they may have originated with another person, the licensee is responsible for them, and the statements are subject to all provisions. When an endorsement refers to benefits received under

\(^3\) Nothing in this education course should ever be used in advertising or for the purpose of making a sale.
a viatical settlement contract or purchase agreement, all pertinent information must be retained for five years following its use.

If the person making the testimonial, appraisal, analysis or endorsement has a financial interest in the party making use of them through a related entity, that fact must be prominently disclosed in the advertisement. Advertisements may not state or imply that any organization or entity has given their endorsement, unless that is the fact; the relationship between the organization and the viatical settlement licensee must be disclosed.

Information used in advertisements must accurately reflect recent and relevant facts. The source of all statistics must be stated in the ad. The name of the viatical settlement licensee must be clearly identified in all ads about the licensee or its viatical settlement contract or purchase agreement, products or services. Contracts must be identified by form number or some other appropriate description.

Advertisements are not allowed to disparage insurers, viatical settlement providers, brokers, investment agents, insurance producers, policies, services or methods of marketing.

If an application is part of an advertisement, the name of the viatical settlement provider must be shown on the application. Ads may not use names that might mislead or deceive readers of the true identity of the licensee or create the impression that a company other than the viatical settlement licensee would have any responsibility for the financial obligation.

Advertisements may not use symbols, colors, or materials that would lead a prospective viator or purchaser to assume it was connected in some manner to a government program or agency. Nor may the ad suggest or create the impression that viatical contracts are recommended or endorsed by any government entity. The ad may state that the licensee is licensed in the state where the advertisement appears, as long as it does not exaggerate that fact or suggest that competitors are not licensed. The ad may suggest the reader consult the licensee’s web site or the department of insurance to find out if the state requires licensing and confirm their licensed status.
The name of the actual licensee must be stated in all of its advertisements. They may not use trade names, group designations, names of any affiliates or controlling entities, service marks, slogans, symbols or other devices that would be misleading or deceptive to the reader as to the ad’s sponsor.

If the advertiser emphasizes the speed with which the viatication will occur, the ad 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. If the ad emphasizes dollar amounts payable to viators, it must state the average purchase price as a percent of the policy face values obtained by viators contracting with the licensee during the past six months. All of this is designed to prevent false assumptions by viators and purchasers.

**Fraud Prevention and Control**

It should be no surprise that the NAIC Viatical Model Act prohibits fraudulent viatical settlement activity. Additionally, individuals may not knowingly or intentionally interfere with the enforcement of the provisions of the Model Act or investigations of suspected or actual violations of it. An individual in the business of viatical settlements may not knowingly or intentionally hire, contract with, or permit any person convicted of a felony involving dishonesty or breach of trust to participate in the business of viatical settlements.

**Fraud Warnings**

Contracts, purchase agreement forms, and applications for viatical settlements, regardless of the form of transmission, must contain the following statement or a substantially similar statement:

> "Any person who knowingly presents false information in an application for insurance or viatical settlement contract or a viatical settlement purchase agreement is guilty of a crime and may be subject to fines and confinement in prison."

The actual statement will vary based on its reference. For example, there will be a difference between a viatical settlement contract and a purchase agreement.
Individuals are required to report any suspected fraudulent viatical settlement activity to the state commissioner. This is certainly true of those working in the viatical settlement industry, but it is also required of those outside the industry.

**Immunity from Liability**

A person who reports suspected fraudulent viatical settlement activity does not have civil liability for doing so as long as the suspicion is reported to the state’s insurance commissioner. It is important, in maintaining immunity, to follow required procedures. Calling the newspaper rather than the commissioner could cause liability, for example. Immunity would also not exist for those who made statements with actual malice.

Immunity will exist for reporting suspicion of fraudulent viatical acts if the information is provided to or received from:

1. The insurance commissioner, his or her employees, agents, or representatives;
2. Federal, state, or local law enforcement or regulatory officials or their employees, agents, or representatives;
3. An individual involved in the prevention and detection of fraudulent viatical settlement acts or that person’s agents, employees or representatives.
4. The National Association of Insurance Commissioners (NAIC), National Association of Securities Dealers (NASD), the North American Securities Administrators Association (NASAA), or their employees, agents or representatives, or other regulatory bodies that oversee life insurance, viatical settlements, securities or investment fraud; or
5. The life policy’s issuing life insurance company.

If suit is brought against an individual who followed correct procedures in reporting suspected fraudulent viatical activity, he or she is entitled to an award of attorney’s fees and costs if he or she is the prevailing party in a civil cause of action for libel, slander, or any other relevant tort coming from reporting their suspicions.
Confidentiality

Any information given to the commissioner or other authorized party regarding suspected fraudulent viatical acts is privileged and confidential; it will not be made part of any public record. Information obtained in an investigation will not be subject to discovery or subpoena in a civil or criminal action. This does not prohibit release by the commissioner of documents and evidence obtained in an investigation or actual fraudulent viatical settlement acts:

1. In administrative or judicial proceedings to enforce laws administered by the commissioner.

2. To federal, state, or local law enforcement or regulatory agencies, to an organization established for the purpose of detecting and preventing fraudulent viatical settlements acts or to the NAIC.

3. At the discretion of the commissioner he or she may give information to a person in the business of viatical settlements that is aggrieved by a fraudulent viatical settlement act.

The NAIC Model Act does not preempt the authority or relieve the duty of other law enforcement or regulatory agencies to investigate, examine and prosecute suspected violations of law.

Viatical Settlement Antifraud Initiatives

Viatical settlement providers and brokers must have antifraud initiatives in place that can reasonably be expected to detect, or prevent fraudulent viatical settlement acts. The commissioner may order modifications that could reasonably be expected to prevent or detect fraud.

Antifraud initiates include:

1. Fraud investigators, who may be employees or contractors of the provider or broker or

2. An antifraud plan that must be submitted to the commissioner.
An antifraud plan should include, but is not limited to:

1. A description of the procedures for detecting and investigating possible fraudulent viatical settlement acts and procedures to resolve material inconsistencies between medical records and insurance applications;

2. A description of the procedures for reporting suspected fraudulent viatical settlement acts to the commissioner;

3. A description of the plan for antifraud education and training of underwriters and other personnel; and

4. A description or chart outlining the organizational arrangement of the antifraud personnel who are responsible for the investigation and reporting of possible fraudulent viatical settlement acts and investigating unresolved material inconsistencies between medical records and insurance applications.

Antifraud plans that are submitted to the state insurance commissioner are privileged and confidential. They will not be made public record and are not subject to discovery or subpoena in a civil or criminal action.

**Injunctions; Civil Remedies; Cease-and-Desist**

The state commissioner may seek an injunction in a court of competent jurisdiction in addition to the penalties and other enforcement provisions contained in the NAIC Model Act. He or she may apply for temporary and permanent orders that the commissioner determines are necessary to stop the individual from continuing to commit violations. Those harmed by the acts of another may bring a civil action against them.

If a viatical settlement purchase agreement violates any of the Acts, the purchase agreement becomes voidable and subject to rescission by the viatical settlement purchaser, upon return of the policy he or she received. Suit for the rescission may be brought in a court of competent jurisdiction or where the alleged violator lives or has a principal place of business or where the alleged violation occurred.
The commissioner may issue a cease-and-desist order when an individual is violating any provision of the NAIC Act or state regulations. If the commissioner feels activity violates this act and presents an immediate danger to the public, he or she may issue an emergency cease-and-desist order reciting the facts that require immediate action. The cease-and-desist order then becomes effective immediately upon service of a copy on the respondent and remains effective for 90 days. If the commissioner begins non-emergency cease-and-desist proceedings the emergency cease-and-desist order remains effective, unless discharged by a court with jurisdiction.

A person convicted of a fraudulent viatical settlement act must be ordered to pay restitution to those harmed. Restitution must be ordered in addition to a fine or imprisonment, but not in lieu of a fine or imprisonment.

Fines and imprisonment might include:

1. Imprisonment for not more than 20 years or to payment of a fine of not more than $100,000, or both, if the value of the viatical settlement contract is more than $35,000;

2. Imprisonment for not more than 10 years or to payment of a fine of not more than $20,000, or both, if the value of the viatical settlement contract is more than $2,500 but not more than $35,000;

3. Imprisonment for not more than five years or to payment of a fine of not more than $10,000, or both, if the value of the viatical settlement contract is more than $500 but not more than $2,500; or

4. Imprisonment for not more than one year or to payment of a fine of not more than $3,000, or both, if the value of the viatical settlement contract is $500 or less.

Unfair Trade Practices

Violation of the Viatical Model Act, including commission of fraudulent viatical settlement acts, will be considered an unfair trade practice under the state’s Unfair Trade Practices Act, subject to the penalties stated.
Authority to Promulgate Regulations

The state’s commissioner has the authority to promulgate regulations implementing the NAIC Viatical Model Act, establish standards for evaluating reasonableness of payments under viatical settlement contracts for those who are terminally or chronically ill, and establish appropriate licensing requirements, fees, and standards for continued licensure of providers, brokers, and investment agents. The commissioner may require a bond or other mechanism for financial accountability for providers and brokers. He or she may also adopt rules governing the relationship and responsibilities of insurers and viatical settlement providers, brokers, and investment agents during the viatication of a life insurance policy or group certificate.

If any portion of the Act or any Model Act amendments are held invalid by a court, the remainder of the Act or its applicability to other persons or circumstances will not be affected.
The following covers the National Conference of the Insurance Legislators (NCOIL) Life Settlement Model Act. For the most part, the language is exactly as they stated it. You will note that it refers to “this state” in many areas. The Model Act makes the assumption that those states adopting these acts will do so in its entirety, so using the phrase “this state” would be appropriate. The term always applies to the adopting state.

While some states may adopt NCOIL’s Life Settlement Model Act, others will adopt the NAIC Model Act and some states may use portions of each or develop their own state-specific requirements. The reader will see many similarities between the National Association of Insurance Commissioner’s recommendations and the National Conference of Insurance Legislature’s recommendations. Differences are often in the details, such as specific definitions that might be more restrictive in one versus the other. Such details may seem relevant only to the attorneys debating the issues, but many of the details will have a bearing on those in the viatical business since it affects how transactions must be carried out. Whatever format the individual states adopt, those who sell and process viatical settlement contracts must follow all state requirements, so it is always important to know and understand your state requirements.

NCOIL NOTE: “It is an essential public policy objective to protect consumers against stranger-originated life insurance (STOLI). STOLI is a practice or plan to initiate a life insurance policy for the benefit of a third party investor who, at the time of policy origination, has no insurable interest in the insured. STOLI practices include but are not limited to cases in which life insurance is purchased with resources or guarantees from or through a person, or entity, who at the time of policy inception, could not lawfully initiate the policy themselves, and where, at
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the time of inception, there is an arrangement or agreement, whether verbal or written, to directly or indirectly transfer the ownership of the policy and/or the policy benefits to a third party. Trusts, that are created to give the appearance of insurance interest and are used to initiate policies for investors, violate insurable interest laws and the prohibition against wagering on life. STOLI arrangements do not include those practices set forth in Section 2L(2) of this Act.

Trusts that are created to give the appearance of insurable interest and are used to manufacture policies for investors are illegal STOLI schemes. As the United States Supreme Court held, a person with insurable interest cannot lend that insurable interest “as a cloak to what is in its inception a wager.”

Grigsby V. Russell, 222 U.S. 149 (1911).

This Act is referred to as the Life Settlement Act.

Definitions

‘Advertisement’ means any written, electronic or printed communication or any communication by means of recorded telephone messages or transmitted on radio, television, the Internet or similar communications media, including film strips, motion pictures and videos, published, disseminated, circulated or placed before the public, directly or indirectly, for the purpose of creating an interest in or inducing a Person to purchase or sell, assign, devise, bequest or transfer the death benefit or ownership of a life insurance policy or an interest in a life insurance policy pursuant to a Life Settlement Contract.

‘Broker’ means a Person who, on behalf of an Owner and for a fee, commission or other valuable consideration, offers or attempts to negotiate Life Settlement Contracts between an Owner and Providers. A Broker represents only the Owner and owes a fiduciary duty to the Owner to act according to the Owner’s instructions, and in the best interest of the Owner, notwithstanding the manner in which the Broker is compensated. A Broker does not include an attorney, certified public accountant or financial planner retained in the type of practice customarily performed in their professional capacity to represent the Owner whose compensation is not paid directly or indirectly by the Provider or any other person, except the Owner.
‘Business of life settlements’ means an activity involved in, but not limited to, offering to enter into, soliciting, negotiating, procuring, effectuating, monitoring, or tracking, of Life Settlement Contracts.

‘Chronically ill’ means:

1. Being unable to perform at least two (2) activities of daily living (i.e., eating, toileting, transferring, bathing, dressing or continence);

2. Requiring substantial supervision to protect the individual from threats to health and safety due to severe cognitive impairment; or

3. Having a level of disability similar to that described in Paragraph (1) as determined by the United States Secretary of Health and Human Services.

‘Commissioner’ means the Commissioner or Superintendent of the Department of Insurance.

‘Financing Entity’ means an underwriter, placement agent, lender, purchaser of securities, purchaser of a policy or certificate from a Provider, credit enhancer, or any entity that has a direct ownership in a policy or certificate that is the subject of a Life Settlement Contract, but:

1. Whose principal activity related to the transaction is providing funds to effect the Life Settlement Contract or purchase of one or more policies; and

2. Who has an agreement in writing with one or more Providers to finance the acquisition of Life Settlement Contracts.

Financing Entity does not include a non-accredited investor or Purchaser.

‘Financing Transaction’ means a transaction in which a licensed Provider obtains financing from a Financing Entity including, without limitation, any secured or unsecured financing, any securitization transaction, or any securities offering which either is registered or exempt from registration under federal and state securities law.
‘Fraudulent Life Settlement Act’ includes acts or omissions committed by any person who, knowingly and with intent to defraud, for the purpose of depriving another of property or for pecuniary gain, commits, or permits its employees or its agents to engage in acts including, but not limited to:

1. Presenting, causing to be presented or preparing with knowledge and belief that it will be presented to or by a Provider, Premium Finance lender, Broker, insurer, insurance producer or any other person, false material information, or concealing material information, as part of, in support of, or concerning a fact material to one or more of the following:
   a) An application for the issuance of a Life Settlement Contract or insurance policy;
   b) The underwriting of a Life Settlement Contract or insurance policy;
   c) A claim for payment or benefit pursuant to a Life Settlement Contract or insurance policy;
   d) Premiums paid on an insurance policy;
   e) Payments and changes in ownership or beneficiary made in accordance with the terms of a Life Settlement Contract or insurance policy;
   f) The reinstatement or conversion of an insurance policy;
   g) In the solicitation, offer to enter into, or effectuation of a Life Settlement Contract, or insurance policy;
   h) The issuance of written evidence of Life Settlement Contracts or insurance;
   i) Any application for or the existence of or any payments related to a loan secured directly or indirectly by any interest in a life insurance policy; or
   j) Enter into any practice or plan which involves STOLI.

2. Failing to disclose to the insurer where the request for such disclosure has been asked for by the insurer that the prospective insured has undergone a life 4 expectancy evaluation by any person or entity other than the insurer or its authorized representatives in connection with the issuance of the policy.

3. Employing any device, scheme, or artifice to defraud in the business of life settlements.
4. In the solicitation, application or issuance of a life insurance policy, employing any device, scheme or artifice in violation of state insurable interest laws.

In the furtherance of a fraud or to prevent the detection of a fraud any person commits or permits its employees or its agents to;

1. Remove, conceal, alter, destroy or sequester from the Commissioner the assets or records of a licensee or other person engaged in the business of life settlements;
2. Misrepresent or conceal the financial condition of a licensee, financing entity, insurer or other person;
3. Transact the business of life settlements in violation of laws requiring a license, certificate of authority or other legal authority for the transaction of the business of life settlements;
4. File with the Commissioner or the chief insurance regulatory official of another jurisdiction a document containing false information or otherwise concealing information about a material fact from the Commissioner;
5. Engage in embezzlement, theft, misappropriation or conversion of monies, funds, premiums, credits or other property of a Provider, insurer, insured, owner, insurance, policy owner or any other person engaged in the business of life settlements or insurance;
6. Knowingly and with intent to defraud, enter into, broker, or otherwise deal in a Life Settlement Contract, the subject of which is a life insurance policy that was obtained by presenting false information concerning any fact material to the policy or by concealing, for the purpose of misleading another, information concerning any fact material to the policy, where the owner or the owner’s agent intended to defraud the policy’s issuer;
7. Attempt to commit, assist, aid or abet in the commission of, or conspiracy to commit the acts or omissions specified in this subsection; or
8. Misrepresent the state of residence of an owner to be a state or jurisdiction that does not have a law substantially similar to this Act for the purpose of evading or avoiding the provisions of this Act.

‘Insured’ means the person covered under the policy being considered for sale in a Life Settlement Contract.
'Life expectancy’ means the arithmetic mean of the number of months the Insured under the life insurance policy to be settled can be expected to live as determined by a life expectancy company considering medical records and appropriate experiential data.

‘Life insurance producer’ means any person licensed in this state as a resident or nonresident insurance producer who has received qualification or authority for life insurance coverage or a life line of coverage.

‘Life Settlement Contract’ means a written agreement entered into between a Provider and an Owner, establishing the terms under which compensation or any thing of value will be paid, which compensation or thing of value is less than the expected death benefit of the insurance policy or certificate, in return for the owner’s assignment, transfer, sale, devise or bequest of the death benefit or any portion of an insurance policy or certificate of insurance for compensation, provided, however, that the minimum value for a Life Settlement Contract shall be greater than a cash surrender value or accelerated death benefit available at the time of an application for a Life Settlement Contract. “Life Settlement Contract” also includes the transfer for compensation or value of ownership or beneficial interest in a trust or other entity that owns such policy if the trust or other entity was formed or availed of for the principal purpose of acquiring one or more life insurance contracts, which life insurance contract insures the life of a person residing in this State.

1. ‘Life Settlement Contract’ also includes
   a) a written agreement for a loan or other lending transaction, secured primarily by an individual or group life insurance policy; or
   b) a premium finance loan made for a policy on or before the date of issuance of the policy where:
      I. The loan proceeds are not used solely to pay premiums for the policy and any costs or expenses incurred by the lender or the borrower in connection with the financing; or
      II. The Owner receives on the date of the premium finance loan a guarantee of the future life settlement value of the policy; or
III. The Owner agrees on the date of the premium finance loan to sell the policy or any portion of its death benefit on any date following the issuance of the policy.

2. ‘Life Settlement Contract’ does not include:
   
a) A policy loan by a life insurance company pursuant to the terms of the life insurance policy or accelerated death provisions contained in the life insurance policy, whether issued with the original policy or as a rider;

b) A premium finance loan, as defined herein, or any loan made by a bank or other licensed financial institution, provided that neither default on such loan nor the transfer of the policy in connection with such default is pursuant to an agreement or understanding with any other person for the purpose of evading regulation under this Act;

c) A collateral assignment of a life insurance policy by an owner;

d) A loan made by a lender that does not violate \[\text{insert reference to state’s insurance premium finance law}\], provided such loan is not described in Paragraph (1) above, and is not otherwise within the definition of Life Settlement Contract;

e) An agreement where all the parties [i] are closely related to the insured by blood or law or [ii] have a lawful substantial economic interest in the continued life, health and bodily safety of the person insured, or are trusts established primarily for the benefit of such parties;

f) Any designation, consent or agreement by an insured who is an employee of an employer in connection with the purchase by the employer, or trust established by the employer, of life insurance on the life of the employee;

g) A bona fide business succession planning arrangement:
   - Between one or more shareholders in a corporation or between a corporation and one or more of its shareholders or one or more trust established by its shareholders;
   - Between one or more partners in a partnership or between a partnership and one or more of its
partners or one or more trust established by its partners; or
- Between one or more members in a limited liability company or between a limited liability company and one or more of its members or one or more trust established by its members;

h) (h) An agreement entered into by a service recipient, or a trust established by the service recipient, and a service provider, or a trust established by the service provider, who performs significant services for the service recipient’s trade or business; or

i) Any other contract, transaction or arrangement from the definition of Life Settlement Contract that the Commissioner determines is not of the type intended to be regulated by this Act.

‘Net death benefit’ means the amount of the life insurance policy or certificate to be settled less any outstanding debts or liens.

‘Owner’ means the owner of a life insurance policy or a certificate holder under a group policy, with or without a terminal illness, who enters or seeks to enter into a Life Settlement Contract. For the purposes of this article, an Owner shall not be limited to an Owner of a life insurance policy or a certificate holder under a group policy that insures the life of an individual with a terminal or chronic illness or condition except where specifically addressed. The term ‘Owner’ does not include:

1. any Provider or other licensee under this Act;
2. a qualified institutional buyer as defined in Rule 144A of the federal Securities Act of 1933, as amended;
3. a financing entity;
4. a special purpose entity; or
5. a related provider trust.

‘Patient identifying information’ means an insured’s address, telephone number, facsimile number, electronic mail address, photograph or likeness, employer, employment status, social security number, or any other information that is likely to lead to the identification of the insured.
‘Policy’ means an individual or group policy, group certificate, contract or arrangement of life insurance owned by a resident of this state, regardless of whether delivered or issued for delivery in this state.

‘Premium Finance Loan’ is a loan made primarily for the purposes of making premium payments on a life insurance policy, which loan is secured by an interest in such life insurance policy.

‘Person’ means any natural person or legal entity, including but not limited to, a partnership, Limited Liability Company, association, trust or corporation.

‘Provider’ means a Person, other than an Owner, who enters into or effectuates a Life Settlement Contract with an Owner, A Provider does not include:

1. any bank, savings bank, savings and loan association, credit union;
2. a licensed lending institution or creditor or secured party pursuant to a Premium Finance Loan agreement which takes an assignment of a life insurance policy or certificate issued pursuant to a group life insurance policy as collateral for a loan;
3. the insurer of a life insurance policy or rider to the extent of providing accelerated death benefits or riders under [refer to law or regulation implementing or accelerated death benefits provision] or cash surrender value;
4. any natural Person who enters into or effectuates no more than one agreement in a calendar year for the transfer of a life insurance policy or certificate issued pursuant to a group life insurance policy, for compensation or anything of value less than the expected death benefit payable under the policy;
5. a Purchaser;
6. any authorized or eligible insurer that provides stop loss coverage to a provider; purchaser, financing entity, special purpose entity, or related provider trust;
7. a Financing Entity;
8. a Special Purpose Entity;
9. a Related Provider Trust;
10. a Broker; or
11. an accredited investor or qualified institutional buyer as defined in respectively in regulation D, rule 501 or rule 144A of the federal securities act of 1933, as amended, who purchases a life settlement policy from a Provider.

‘Purchased Policy’ means a policy or group certificate that has been acquired by a Provider pursuant to a Life Settlement Contract.

‘Purchaser’ means a Person who pays compensation or anything of value as consideration for a beneficial interest in a trust which is vested with, or for the assignment, transfer or sale of, an ownership or other interest in a life insurance policy or a certificate issued pursuant to a group life insurance policy which has been the subject of a Life Settlement Contract.

‘Related Provider Trust’ means a titling trust or other trust established by a licensed Provider or a Financing Entity for the sole purpose of holding the ownership or beneficial interest in purchased policies in connection with a Financing Transaction. In order to qualify as a Related Provider Trust, the trust must have a written agreement with the licensed Provider under which the licensed Provider is responsible for ensuring compliance with all statutory and regulatory requirements and under which the trust agrees to make all records and files relating to life settlement transactions available to the Department of Insurance as if those records and files were maintained directly by the licensed Provider.

‘Settled policy’ means a life insurance policy or certificate that has been acquired by a Provider pursuant to a Life Settlement Contract.

‘Special Purpose Entity’ means a corporation, partnership, trust, limited liability company, or other legal entity formed solely to provide either directly or indirectly access to institutional capital markets for a financing entity or provider; or

(a) in connection with a transaction in which the securities in the special purpose entity are acquired by the owner or by a “qualified institutional buyer” as defined in Rule 144 promulgated under The Securities Act of 1933, as amended; or
(b) the securities pay a fixed rate of return commensurate with established asset-backed institutional capital markets.
‘Stranger-Originated Life Insurance’ or ‘STOLI’ is a practice or plan to initiate a life insurance policy for the benefit of a third party investor who, at the time of policy origination, has no insurable interest in the insured. STOLI practices include but are not limited to cases in which life insurance is purchased with resources or guarantees from or through a person, or entity, who, at the time of policy inception, could not lawfully initiate the policy himself or itself, and where, at the time of inception, there is an arrangement or agreement, whether verbal or written, to directly or indirectly transfer the ownership of the policy and/or the policy benefits to a third party. Trusts, that are created to give the appearance of insurable interest, and are used to initiate policies for investors, violate insurable interest laws and the prohibition against wagering on life. STOLI arrangements do not include those practices set forth in Section 2L(2) of this Act.

‘Terminally Ill’ means having an illness or sickness that can reasonably be expected to result in death in twenty-four (24) months or less.

**Licensing Requirements**

All individuals who plan to act as a provider or broker with an owner or multiple owners residing in the state must first obtain a license from the state commissioner. If there is more than one owner on a single policy and the owners are residents of different states, the Life Settlement Contract will be governed by the law of the state in which the owner having the largest percentage ownership resides or, if the owners hold equal ownership, the state of residence of one owner agreed upon in writing by all owners.

When applying for a provider or broker license the prescribed form must be presented to the Commissioner. The established fee must accompany the application. The license and renewal fees for a provider license must be reasonable; the license and renewal fees for a broker license will not exceed those established for an insurance producer.

A life insurance producer who has been duly licensed as a resident insurance producer with a life line of authority in this state or his or her home state for at least one year and is licensed as a nonresident
producer in this state will have met the licensing requirements and be permitted to operate as a broker.

No later than thirty days from the first day of operating as a broker, the life insurance producer must notify the Commissioner on the prescribed form that he or she is acting as a broker, and pay any required applicable fee. Included will be an acknowledgement that he or she will operate as a broker in accordance with this Act.

The insurance company that issued the policy that is the subject of a life settlement contract is not responsible for any act or omission of a broker, provider or purchaser arising out of or in connection with the life settlement transaction, unless the insurer receives compensation for the placement of a life settlement contract from the provider, purchaser, or broker in connection with the contract.

An attorney, certified public accountant, or financial planner accredited by a nationally recognized accreditation agency may represent the owner and is not required to obtain a viatical license if his or her compensation is not paid directly or indirectly by the provider or purchaser.

Licenses may be renewed as required by the state on the anniversary date upon payment of the periodic renewal fee. The provider renewal fee must be reasonable. Failure to pay the fee within the terms prescribed will result in the automatic revocation of the license.

The term of a provider license will be the same as a domestic stock life insurance company; the term of a broker license will be the same as an insurance producer license. Licenses requiring periodic renewal may be renewed on their anniversary date with payment of the periodic renewal fee. Failure to pay the fees on or before the renewal date will result in lapse of the license.

The applicant must provide whatever information the Commissioner requires on forms prepared by the Commissioner. The Commissioner has the authority, at any time, to require an applicant to fully disclose the identity of its stockholders (except stockholders owning fewer than ten percent of the shares of an applicant whose shares are publicly traded), partners, officers and employees. The Commissioner may, in his or her sole discretion, refuse to issue a viatical license to any
person if not satisfied that any officer, employee, stockholder or partner, who might materially influence the applicant's conduct, does not meet the standards of this Act.

A license issued to a partnership, corporation or other entity authorizes all members, officers and designated employees to act as a licensee under the license, if those persons are named in the application or any supplements to the application.

Upon filing an application and paying the license fee, the Commissioner will begin an investigation of each applicant and may issue a license if he or she finds that the applicant:

1. If a **Provider**, has provided a detailed plan of operation;
2. Is competent and trustworthy and intends to transact its business in good faith;
3. Has a good business reputation and has had experience, training or education so as to be qualified in the business for which the license is applied;
4. If the applicant is a **legal entity**, is formed or organized pursuant to the laws of this state or is a foreign legal entity authorized to transact business in this state, or provides a certificate of good standing from the state of its domicile; and
5. Has provided the Commissioner with their an anti-fraud plan that meets the requirements and includes:
   a. A description of the procedures for detecting and investigating possible fraudulent acts and procedures for resolving material inconsistencies between medical records and insurance applications;
   b. A description of the procedures for reporting fraudulent insurance acts to the Commissioner;
   c. A description of the plan for anti-fraud education and training of its underwriters and other personnel; and
   d. A written description or chart outlining the arrangement of the anti-fraud personnel who are responsible for the investigation and reporting of possible fraudulent insurance acts and investigating unresolved material inconsistencies between medical records and insurance applications.
The Commissioner will not issue any license to any nonresident applicant, unless a written designation of an agent for service of process is filed and maintained with the Commissioner, or unless the applicant has filed his or her written irrevocable consent with the Commissioner that any action against him or her may be commenced by service of process on the Commissioner.

Each licensee must file an annual statement with the Commissioner on or before the first day of March of each year containing whatever information the Commissioner requires.

A provider may not use any person to perform the functions of a broker as defined in this Act unless the person holds a current, valid license as a broker and meets all requirements.

A broker may not use any person to perform the functions of a provider as defined in this Act unless such person holds a current, valid license as a provider and meets all requirements.

A provider or broker must provide to the Commissioner new or revised information about officers, ten percent or more stockholders, partners, directors, members or designated employees within thirty days of any change.

An individual licensed as a broker must complete fifteen (15) hours of training on a biennial basis related to life settlements and life settlement transactions, as required by the Commissioner. A life insurance producer who is operating as a broker pursuant to this Section will not be subject to the requirements of this subsection. Any person failing to meet the requirements of this subsection will be subject to the penalties imposed by the Commissioner.

License Suspension, Revocation or Refusal to Renew

The Commissioner may suspend, revoke or refuse to renew the license of any licensee if the Commissioner finds that:

1. There was any material misrepresentation in the application for the license;
2. The licensee or any officer, partner, member or director has been guilty of fraudulent or dishonest practices, is subject to a final administrative action or is otherwise shown to be untrustworthy or incompetent to act as a licensee;

3. The provider demonstrates a pattern of unreasonably withholding payments to policy Owners;

4. The licensee no longer meets the requirements for initial licensure;

5. The licensee or any officer, partner, member or director has been convicted of a felony, or of any misdemeanor of which criminal fraud is an element; or the licensee has pleaded guilty to nolo contendere with respect to any felony or any misdemeanor of which criminal fraud or moral turpitude is an element, regardless whether a judgment of conviction has been entered by the court;

6. The provider has entered into any life settlement contract that has not been approved pursuant to the Act;

7. The provider has failed to honor contractual obligations set out in a life settlement contract;

8. The provider has assigned, transferred or pledged a settled policy to a person other than a provider licensed in this state, a purchaser, an accredited investor or qualified institutional buyer as defined respectively in Regulation D, Rule 501 or Rule 144A of the Federal Securities Act of 1933, as amended, financing entity, special purpose entity, or related provider trust; or

9. The licensee or any officer, partner, member or key management personnel has violated any of the provisions of this Act.

Before the Commissioner denies a license application or suspends, revokes or refuses to renew the license of any licensee under this Act, the Commissioner will conduct a hearing in accordance with this state's laws governing administrative hearings.
Contract Requirements

No person may use any form of life settlement contract in this state unless it has been filed with and approved, if required, by the Commissioner in a manner that conforms with the filing procedures and any time restrictions or deeming provisions, if any, for life insurance forms, policies and contracts.

No insurer may, as a condition of responding to a request for verification of coverage or in connection with the transfer of a policy pursuant to a life settlement contract, require that the owner, insured, provider or broker sign any form, disclosure, consent, waiver or acknowledgment that has not been expressly approved by the Commissioner for use in connection with life settlement contracts.

An individual may not use a life settlement contract form or provide an owner with a disclosure statement form unless first filed with and approved by the state’s Commissioner. The Commissioner will disapprove a life settlement contract form or disclosure statement form if, in his or her opinion, the contract or the contract’s provisions fail to meet the requirements of this Act or are unreasonable, contrary to the interests of the public, or otherwise misleading or unfair to the owner. At the Commissioner’s discretion, he or she may require the submission of advertising material.

Reporting Requirements and Privacy

For any policy settled within five years of policy issuance, each provider must file an annual statement on or before March 1 of each year with the Commissioner containing whatever information the Commissioner requires by regulation. In addition to any other requirements, the annual statement must specify the total number, aggregate face amount and life settlement proceeds of policies settled during the immediately preceding calendar year, together with a breakdown of the information by policy issue year. The annual statement will also include the names of the insurance companies whose policies have been settled and the brokers that have settled them.
1. Such information will be limited to only those transactions where the insured is a resident of this state. It will not include individual transaction data regarding the business of life settlements or information that could be used to identify the owner or the insured.

2. Every provider that willfully fails to file an annual statement as required, or willfully fails to reply within thirty days to a written inquiry by the Commissioner in connection with it will, in addition to other penalties provided by this chapter, be subject, upon due notice and opportunity to be heard, to a penalty of up to $250 per day of delay, not to exceed $25,000 in the aggregate, for each such failure.

Except as otherwise allowed or required by law, a provider, broker, insurance company, insurance producer, information bureau, rating agency or company, or any other person with actual knowledge of an insured's identity, may not disclose the identity of an insured or information that there is a reasonable basis to believe could be used to identify the insured or the insured's financial or medical information to any other person unless the disclosure:

1. Is necessary to effect a life settlement contract between the owner and a provider and the owner and insured have provided prior written consent to the disclosure;

2. Is necessary to effectuate the sale of life settlement contracts, or interests therein, as investments, provided the sale is conducted in accordance with applicable state and federal securities law and provided further that the owner and the insured have both provided prior written consent to the disclosure;

3. Is provided in response to an investigation or examination by the Commissioner or any other governmental officer or agency or pursuant to NCOIL requirements;

4. Is a term or condition to the transfer of a policy by one provider to another provider, in which case the receiving provider will be required to comply with the confidentiality requirements;

5. Is necessary to allow the provider or broker or their authorized representatives to make contacts for the purpose of determining health status. For the purposes of this section, the term
"authorized representative" will not include any person who has or may have any financial interest in the settlement contract other than a provider, licensed broker, financing entity, related provider trust or special purpose entity. Additionally, a provider or broker must require its authorized representative to agree in writing to adhere to the privacy provisions of this Act; or

6. Is required to purchase stop loss coverage.

Non-public personal information solicited or obtained in connection with a proposed or actual life settlement contract will be subject to the provisions applicable to financial institutions under the federal Gramm Leach Bliley Act, P.L. 106-102 (1999), and all other state and federal laws relating to confidentiality of non-public personal information.

**Examination**

[Drafting Note: NCOIL has established a Model Act for the examination of insurers. This Model should be applied to settlement companies. Where practicable, examination should be detailed in a rule adopted by the Commissioner under the authority of this law.]

The Commissioner may, when deemed reasonably necessary to protect the interests of the public, examine the business and affairs of any licensee or applicant for a license. The Commissioner may order any licensee or applicant to produce any records, books, files or other information reasonably necessary to ascertain whether he or she is acting or has acted in violation of the law or otherwise contrary to the interests of the public. The expenses incurred in conducting any examination will be paid by the licensee or applicant.

In lieu of an examination under this Act of any foreign or alien licensee licensed in this state, the Commissioner may, at his or her discretion, accept an examination report on the licensee as prepared by the Commissioner for the licensee’s state of domicile or port-of-entry state.

Names and individual identification data for all owners and insured individuals will be considered private and confidential information and may not be disclosed by the Commissioner unless required by law.
Records of all consummated transactions and life settlement contracts must be maintained by the provider for *three years after the death of the insured* and must be available to the Commissioner for inspection during reasonable business hours.

**Conduct of Examinations**

Upon determining that an examination should be conducted, the Commissioner will issue an examination warrant appointing one or more examiners to perform the examination and instructing them as to the scope of the examination. The examiner will use methods common to the examination of any life settlement licensee and use those guidelines and procedures set forth in an examiners’ handbook adopted by a national organization.

Every licensee or person from whom information is sought, its officers, directors and agents must provide the examiners with timely, convenient and free access at all reasonable hours at its offices to all books, records, accounts, papers, documents, assets and computer or other recordings relating to the property, assets, business and affairs of the licensee being examined. The officers, directors, employees and agents of the licensee or person must facilitate the examination and aid in the examination so far as it is in their power to do so. Refusal by a licensee, its officers, directors, employees or agents, to submit to examination or to comply with any reasonable written request of the Commissioner will be grounds for license suspension, refusal to renew, or non-renewal of any license or authority held by the licensee to engage in the life settlement business or other business subject to the Commissioner's jurisdiction. Any proceedings for suspension, revocation or refusal of any license or authority will be conducted pursuant to state provisions.

The Commissioner has the power to issue subpoenas, administer oaths and examine under oath any person regarding any matter pertinent to the examination. Upon the failure or refusal of a person to obey a subpoena, the Commissioner may petition a court of competent jurisdiction, and upon proper showing, the court may enter an order compelling the witness to appear and testify or produce documentary evidence.
When making an examination under this Act, the Commissioner may retain attorneys, appraisers, independent actuaries, independent certified public accountants or other professionals and specialists as examiners, the reasonable cost of which will be borne by the licensee that is the subject of the examination.

Nothing contained in this Act will be construed to limit the Commissioner's authority to terminate or suspend an examination in order to pursue other legal or regulatory action pursuant to the insurance laws of this state. Findings of fact and conclusions made pursuant to any examination will be prima facie evidence in any legal or regulatory action.

Nothing contained in this Act will be construed to limit the Commissioner's authority to use and, if appropriate, make public any final or preliminary examination report, any examiner or licensee work papers or other documents, or any other information discovered or developed during the course of any examination in the furtherance of any legal or regulatory action which the Commissioner may, in his or her sole discretion, deem appropriate.

[Drafting Note: In many states examination work papers remain confidential. The previous paragraph should be adjusted to conform to state statute and practice.]

**Examination Reports**

Examination reports will be comprised of only facts appearing upon the books, from the testimony of its officers or agents or other persons examined concerning its affairs, and such conclusions and recommendations as the examiners find reasonably warranted from the facts.

No later than sixty days following completion of the examination, the examiner in charge will file a verified written report of examination under oath with the Commissioner. Upon receipt of the verified report, the Commissioner will transmit the report to the licensee examined, together with a notice that will allow the examined licensee a reasonable opportunity of not more than thirty (30) days to make a written submission or rebuttal with respect to any matters contained in
the examination report (which will become part of the report) or to request a hearing on any matter in dispute.

In the event the Commissioner determines that regulatory action is appropriate as a result of an examination, the Commissioner may initiate any proceedings or actions provided by law.

**Confidentiality of Examination Information**

Names and individual identification data for all owners, purchasers, and insured individuals will be considered private and confidential information and will not be disclosed by the Commissioner, unless the disclosure is to another regulator or is required by law.

Except as otherwise provided in this Act, all examination reports, working papers, recorded information, documents and copies thereof produced by, obtained by or disclosed to the Commissioner or any other person in the course of an examination made under this Act, or in the course of analysis or investigation by the Commissioner of the financial condition or market conduct of a licensee will be confidential by law and privileged. It will not be subject to open records, Freedom of Information, or subject to subpoena, and will not be subject to discovery or admissible in evidence in any private civil action. The Commissioner is authorized to use the documents, materials or other information in the furtherance of any regulatory or legal action brought as part of the Commissioner's official duties. The licensee being examined may have access to all documents used to make the report.

**Conflict of Interest**

An examiner may not be appointed by the Commissioner if the examiner, either directly or indirectly, has a conflict of interest or is affiliated with the management of or owns a pecuniary interest in any person subject to examination under this Act. This section may not be construed to automatically preclude an examiner from being an owner, an insured in a life settlement contract or insurance policy, or a beneficiary in an insurance policy that is proposed for a life settlement contract.

The Commissioner may retain from time to time, on an individual basis, qualified actuaries, certified public accountants, or other similar
individuals who are independently practicing their professions, even though these persons may from time to time be similarly employed or retained by persons subject to examination under this Act.

**Immunity from Liability**

No cause of action may arise nor will any liability be imposed against the Commissioner, his or her authorized representatives, or any examiner appointed by the Commissioner for any statements made or conduct performed in good faith while carrying out the provisions of this Act.

No cause of action will arise, nor will any liability be imposed against any person for the act of communicating or delivering information or data to the Commissioner or his or her authorized representative or examiner pursuant to an examination made under this Act, if the act of communication or delivery was performed in good faith and without fraudulent intent or the intent to deceive.

Individuals will be entitled to an award of attorney's fees and costs if he or she is the prevailing party in a civil cause of action for libel, slander or any other relevant tort arising out of activities in carrying out the provisions of this Act and the party bringing the action was not substantially justified in doing so. For purposes of this section a proceeding is "**substantially justified**" if it had a reasonable basis in law or fact at the time it was initiated.

**Investigative Authority of the Commissioner**

The Commissioner may investigate suspected fraudulent life settlement acts and persons engaged in the business of life settlement contracts.

**Cost of Examinations**

If the adopting state has specific provisions enacted that relate to the cost of conducting examinations, they would be so stated.
Advertising

A broker or provider licensed under this act may conduct or participate in advertisements within their state. Advertisements must comply with all advertising and marketing laws, rules, and regulations that are applicable to life insurers, brokers, and providers licensed pursuant to this Act. Advertisements must be accurate and truthful and not misleading in fact or by implication.

No person or trust may directly or indirectly, market, advertise, solicit or otherwise promote the purchase of a policy for the sole purpose of or with an emphasis on settling the policy. They may not use “free,” “no cost,” or similar words in the marketing, advertising, soliciting or otherwise promoting the purchase of a policy.

Disclosures to Owners

The provider must provide the owner in writing, in a separate document that is signed by the owner and provider, the following information no later than the date the life settlement contract is signed by all parties:

1. The fact that possible alternatives to life settlement contracts exist, including, but not limited to, accelerated benefits offered by the issuer of the life insurance policy;

2. The fact that some or all of the proceeds of a life settlement contract may be taxable and that assistance should be sought from a professional tax advisor;

3. The fact that the proceeds from a life settlement contract could be subject to the claims of creditors;

4. The fact that receipt of proceeds from a life settlement contract may adversely affect the recipients' eligibility for public assistance or other government benefits or entitlements and that advice should be obtained from the appropriate agencies;

5. The fact that the owner has a right to terminate a life settlement contract within fifteen (15) days of the date it is executed by all parties and the owner has received the disclosures contained herein. Rescission, if exercised by the owner, is effective only if
both notice of the rescission is given, and the owner repays all
proceeds and any premiums, loans, and loan interest paid on
account of the provider within the rescission period. If the
insured dies during the rescission period, the contract will be
deeded to have been rescinded subject to repayment by the
owner or the owner’s estate of all proceeds and any premiums,
loans, and loan interest to the provider;

6. The fact that proceeds will be sent to the owner within three (3)
business days after the provider has received the insurer or
group administrator’s acknowledgement that ownership of the
policy or interest in the certificate has been transferred and the
beneficiary has been designated in accordance with the terms of
the life settlement contract;

7. The fact that entering into a life settlement contract may cause
other rights or benefits, including conversion rights and waiver of
premium benefits that may exist under the policy or group
certificate to be forfeited by the owner; assistance should be
sought from a professional financial advisor;

8. The amount and method of calculating the compensation paid or
to be paid to the broker, or any other person acting for the
owner in connection with the transaction. The term
compensation includes anything of value paid or given;

9. The date by which the funds will be available to the owner and
the transmitter of the funds;

10. The fact that the Commissioner will require delivery of a Buyer’s
Guide or a similar consumer advisory package in the form
prescribed by the state Commissioner to owners during the
solicitation process;

11. The disclosure document must contain the following language:
“all medical, financial or personal information solicited or
obtained by a provider or broker about an insured, including the
insured’s identity or the identity of family members, a spouse or
a significant other may be disclosed as necessary to effect the
Life Settlement Contract between the owner and provider. If you
are asked to provide this information, you will be asked to
consent to the disclosure. The information may be provided to
someone who buys the policy or provides funds for the purchase.
You may be asked to renew your permission to share information every two years;  

12. The fact that the Commissioner shall require providers and brokers to print separate signed fraud warnings on their applications and on their life settlement contracts is as follows: “Any person who knowingly presents false information in an application for insurance or Life Settlement Contract is guilty of a crime and may be subject to fines and confinement in prison.”

13. The fact that the insured may be contacted by either the provider or broker or its authorized representative for the purpose of determining the insured’s health status or to verify the insured’s address. This contact is limited to once every three (3) months if the insured has a life expectancy of more than one year, and no more than once per month if the insured has a life expectancy of one year or less;

14. The affiliation, if any, between the provider and the issuer of the insurance policy to be settled;

15. That a broker represents exclusively the owner, and not the insurer or the provider or any other person, and owes a fiduciary duty to the owner, including a duty to act according to the owner’s instructions and in the best interest of the owner;

16. The document must include the name, address and telephone number of the provider;

17. The name, business address, and telephone number of the independent third party escrow agent, and the fact that the owner may inspect or receive copies of the relevant escrow or trust agreements or documents;

18. The fact that a change of ownership could in the future limit the insured’s ability to purchase future insurance on the insured’s life because there is a limit to how much coverage insurers will issue on one life;

The written disclosures must be conspicuously displayed in any life settlement contract furnished to the owner by a provider including any affiliations or contractual arrangements between the provider and broker.
A broker shall provide the owner and the provider with at least the following disclosures no later than the date the life settlement contract is signed by all parties. The disclosures shall be conspicuously displayed in the Life Settlement Contract or in a separate document signed by the Owner and provide the following information:

1. The name, business address and telephone number of the broker;

2. A full, complete and accurate description of all the offers, counter-offers, acceptances and rejections relating to the proposed life settlement contract;

3. A written disclosure of any affiliations or contractual arrangements between the broker and any person making an offer in connection with the proposed life settlement contracts;

4. The name of each broker who receives compensation and the amount of compensation received by that broker; compensation includes anything of value paid or given to the broker in connection with the life settlement contract;

5. A complete reconciliation of the gross offer or bid by the provider to the net amount of proceeds or value to be received by the owner. For the purpose of this section, *gross offer* or *bid* means the total amount or value offered by the provider for the purchase of one or more life insurance policies, inclusive of commissions and fees; and

6. The failure to provide the disclosures or rights described in this section will be deemed an Unfair Trade Practice.

**Disclosure to Insurer**

*Drafting Note: The provisions in this Section pertaining to premium finance arrangements and disclosures may be inserted into a state’s premium finance law. If so, it is recommended that the disclosures be made to the borrower and/or insured by a lender which takes the policy as collateral for a premium finance loan.]*

An insurance company may inquire in their insurance application whether the proposed owner intends to pay premiums with the
assistance of financing from a lender that will use the policy as collateral to support the financing. There is no intention to limit the ability of an insurer to assess the insurability of an applicant and determine whether or not to issue the life insurance policy.

If the loan provides funds that can be used for a purpose other than paying for the premiums, costs, and expenses associated with obtaining and maintaining the life insurance policy and loan, the application must be rejected as a violation of the Prohibited Practices in Section 13 of this Act.

If the financing does not violate Section 13, the insurance carrier may make disclosures, to the applicant and the insured, either on the application or an amendment to the application to be completed no later than the delivery of the policy. The disclosures may include but are not limited to the following:

“\text{"If you have entered into a loan arrangement where the policy is used as collateral, and the policy does change ownership at some point in the future in satisfaction of the loan, the following may be true:}

\begin{itemize}
  \item a) \text{A change of ownership could lead to a stranger owning an interest in the insured’s life;}
  \item b) \text{A change of ownership could limit in the future your ability to purchase future insurance on the insured’s life because there is a limit to how much coverage insurers will issue on one life;}
  \item c) \text{Should there be a change of ownership and you wish to obtain more insurance coverage on the insured’s life in the future, the insured’s higher issue age, a change in health status, and/or other factors may reduce the ability to obtain coverage and/or may result in significantly higher premiums;}
  \item d) \text{You should consult a professional advisor, since a change in ownership in satisfaction of the loan may result in tax consequences to the owner, depending on the structure of the loan.} \\
\end{itemize}

The insurance carrier may require certifications, such as the following, from the applicant and/or the insured:

\begin{itemize}
  \item \text{“I have not entered into any agreement or arrangement providing for the future sale of this life insurance policy”};
\end{itemize}
• “My loan arrangement for this policy provides funds sufficient to pay for some or all of the premiums, costs, and expenses associated with obtaining and maintaining my life insurance policy, but I have not entered into any agreement by which I am to receive consideration in exchange for procuring this policy”; and
• “The borrower has an insurable interest in the insured.”

**General Rules**

A provider entering into a life settlement contract with any owner of a policy, wherein the insured is terminally or chronically ill, must first obtain:

1. If the owner is the insured, a written statement from a licensed attending physician that the owner is of sound mind and under no constraint or undue influence to enter into a settlement contract; and

2. A document in which the insured consents to the release of his or her medical records to a provider, settlement broker, or insurance producer and, if the policy was issued less than two years from the date of application for a settlement contract, to the insurance company that issued the policy.

The insurer must respond to a request for verification of coverage submitted by a provider, settlement broker, or life insurance producer not later than thirty calendar days of the date the request is received. The request for verification of coverage must be made on a form approved by the Commissioner. The insurer will complete and issue the verification of coverage or indicate in which respects it is unable to respond. In its response, the insurer must indicate whether, based on the medical evidence and documents provided, the insurer intends to pursue an investigation at this time regarding the validity of the insurance contract.

Before or at the time of execution of the settlement contract, the provider must obtain a witnessed document in which the owner consents to the settlement contract, represents that he or she has a full and complete understanding of the settlement contract, has a full
and complete understanding of the benefits of the policy, acknowledges that he or she is entering into the settlement contract freely and voluntarily, and, for persons with a terminal or chronic illness or condition, acknowledges that situation and that the terminal or chronic illness was diagnosed after the policy was issued.

The insurer may not unreasonably delay effecting change of ownership or beneficiary with any life settlement contract lawfully entered into in this state or with a resident of this state.

If a settlement broker or life insurance producer performs any of these activities required of the provider, the provider is deemed to have fulfilled the requirements. If a broker performs verification of coverage activities required of the provider, the provider is deemed to have fulfilled the requirements.

Within twenty days after an owner executes the life settlement contract, the provider will give written notice to the insurer that issued that insurance policy that the policy has become subject to a life settlement contract. The notice will be accompanied by any required documents.

All medical information solicited or obtained by any licensee will be subject to the applicable provision of state law relating to confidentiality of medical information, if not otherwise provided in this Act.

All life settlement contracts allow the owner to rescind the contract on or before fifteen days after the date it was executed by all parties. Rescission, if exercised by the owner, is effective only if both notice of the rescission is given, and all proceeds are repaid by the owner, including any premiums, loans, and loan interest paid by the provider within the rescission period. If the insured dies during the rescission period, the contract will be deemed to have been rescinded subject to repayment of all proceeds, including premiums, loans, and loan interest to the provider.

Within three business days after receipt of the owner’s documents to allow the transfer of the insurance policy, the provider will pay the proceeds of the settlement to an escrow or trust account managed by a trustee or escrow agent in a state or federally chartered financial
institution pending acknowledgement of the transfer by the issuer of the policy. The trustee or escrow agent will be required to transfer the proceeds due to the owner within three business days of acknowledgement of the transfer from the insurer.

Failure to tender the life settlement contract proceeds to the owner by the date disclosed renders the contract voidable by the owner for lack of consideration until the time the proceeds are tendered to and accepted by the owner. Failure to give the owner written notice of their right of rescission extends that right until thirty days after the written notice has been given.

Any fee paid by a provider, party, individual, or an owner to a broker in exchange for services provided to the owner pertaining to a life settlement contract will be computed as a percentage of the offer obtained, not the face value of the policy. A broker may reduce his or her fees below this percentage if the broker so chooses.

The broker must disclose to the owner anything of value paid or given to him or her that relates to the life settlement contract.

Individuals may not enter into a life settlement contract for the first two years of a life insurance policy (commencing from the date of policy issuance). This prohibition will not apply if the owner certifies to the provider that:

1. The policy was issued upon the owner’s exercise of conversion rights from a group or individual policy, provided the total time covered under the conversion policy plus the time covered under the prior policy is at least twenty-four months. The time covered under a group policy must be calculated without regard to a change in insurance carriers, provided the coverage has been continuous and under the same group sponsorship; or

2. The owner submits independent evidence to the provider that one or more of the following conditions were met within the two-year period:
   a. The owner or insured is terminally or chronically ill;
   b. The owner or insured disposes of his ownership interests in a closely held corporation, pursuant to the terms of a buyout or other similar agreement in effect at the time the insurance policy was initially issued;
c. The owner’s spouse dies;
d. The owner divorces his or her spouse;
e. The owner retires from full-time employment;
f. The owner becomes physically or mentally disabled and a physician determines that the disability prevents the owner from maintaining full-time employment; or
g. A final order, judgment or decree is entered by a court of competent jurisdiction, on the application of a creditor of the owner, adjudicating the owner bankrupt or insolvent, or approving a petition seeking reorganization of the owner or appointing a receiver, trustee or liquidator to all or a substantial part of the owner’s assets;

3. Copies of the independent evidence will be submitted to the insurer when the provider submits a request for verification of coverage. The copies will be accompanied by a letter of attestation from the provider that the copies are true and correct copies of the documents received by the provider. Nothing in this Section prohibits the insurer from exercising their right to contest the validity of any policy;

4. If the provider submits a copy of independent evidence to the insurer when the provider requests the transfer of the policy to the provider, the copy is deemed to establish that the settlement contract satisfies the requirements of this section.

Authority to Promulgate Regulations; Conflict of Laws

The Commissioner may promulgate regulations implementing this Act and regulating the activities and relationships of providers, brokers, insurers and their agents, subject to statutory limitations on administrative rule making.

Conflict of Laws

If there is more than one owner on a single policy and they are residents of different states, the life settlement contract will be governed by the laws of the state in which the owner having the largest percentage of ownership resides. If the owners hold equal ownership, the state of residence of one owner agreed upon in writing by all of the owners will be used. The laws of the state of the insured
will govern in the event that equal owners fail to agree in writing upon a state of residence for jurisdictional purposes.

A provider from this state who enters into a life settlement contract with an owner, who is a resident of another state that has enacted statutes or adopted regulations governing life settlement contracts, will be governed in the effectuation of that life settlement contract by the statutes and regulations of the owner’s state of residence. If the state in which the owner is a resident has not enacted statutes or regulations governing life settlement contracts, the provider must give the owner notice that neither state regulates the transaction upon which he or she is entering. For transactions in those states, however, the provider is to maintain all records required if the transactions were executed in the state of residence. The forms used in those states need not be approved by the Insurance Department.

If there is a conflict in the laws that apply to an owner and a purchaser in any individual transaction, the laws of the state that apply to the owner will take precedence and the provider will comply with those laws.

**Prohibited Practices**

It is unlawful for any person to:

1. Enter into a life settlement contract if such person knows or reasonably should have known that the life insurance policy was obtained by means of a false, deceptive or misleading application for such policy;

2. Engage in any transaction, practice or course of business if such person knows or reasonably should have known that the intent was to avoid the notice requirements of this Section;

3. Engage in any fraudulent act or practice in connection with any transaction relating to any settlement involving an owner who is a resident of this state;

4. Issue, solicit, market or otherwise promote the purchase of an insurance policy for the purpose of or with an emphasis on settling the policy;
5. Enter into a premium finance agreement with any person or agency, or any person affiliated with such person or agency, pursuant to which such person shall receive any proceeds, fees or other consideration, directly or indirectly, from the policy or owner of the policy or any other person with respect to the premium finance agreement or any settlement contract or other transaction related to such policy that are in addition to the amounts required to pay the principal, interest and service charges related to policy premiums pursuant to the premium finance agreement or subsequent sale of such agreement; provided, further, that any payments, charges, fees or other amounts in addition to the amounts required to pay the principal, interest and service charges related to policy premiums paid under the premium finance agreement shall be remitted to the original owner of the policy or to his or her estate if he or she is not living at the time of the determination of the overpayment;

6. With respect to any settlement contract or insurance policy and a broker, knowingly solicit an offer from, effectuate a life settlement contract with or make a sale to any provider, financing entity or related provider trust that is controlling, controlled by, or under common control with such broker;

7. With respect to any life settlement contract or insurance policy and a provider, knowingly enter into a life settlement contract with an owner, if, in connection with such life settlement contract, anything of value will be paid to a broker that is controlling, controlled by, or under common control with such provider or the financing entity or related provider trust that is involved in such settlement contract;

8. With respect to a provider, enter into a life settlement contract unless the life settlement promotional, advertising and marketing materials, as may be prescribed by regulation, have been filed with the Commissioner. Marketing materials may not expressly reference insurance as “free” for any period of time. The inclusion of any reference in the marketing materials that would cause an owner to reasonably believe that the insurance is free for any period of time will be considered a violation of this Act; or
9. With respect to any life insurance producer, insurance company, broker, or provider to make any statement or representation to the applicant or policyholder in connection with the sale or financing of a life insurance policy to the effect that the insurance is free or without cost to the policyholder for any period of time unless provided in the policy.

A violation will be deemed a Fraudulent Life Settlement Act.

**Fraud Prevention and Control**

Fraudulent life settlement acts, interference and participation of convicted felons are prohibited.

1. A person shall not commit a fraudulent life settlement act.

2. A person shall not knowingly and intentionally interfere with the enforcement of the provisions of this Act or investigations of suspected or actual violations of this Act.

3. A person in the business of life settlements shall not knowingly or intentionally permit any person convicted of a felony involving dishonesty or breach of trust to participate in the business of life settlements.

**Fraud Warning Required**

Life settlement applications and contracts, regardless of the form of transmission, will contain the following statement or a substantially similar statement:

"Any person who knowingly presents false information in an application for insurance or Life Settlement Contract is guilty of a crime and may be subject to fines and confinement in prison."

The lack of the required statement does not constitute a defense in any prosecution for a Fraudulent Life Settlement Act.
Mandatory Reporting of Fraudulent Life Settlement Acts

Any person engaged in the business of life settlements having knowledge or a reasonable belief that a fraudulent life settlement act was or will be committed must provide the Commissioner with all information regarding it in a manner prescribed by the Commissioner.

Any other person having knowledge or a reasonable belief that a fraudulent life settlement act has or will be committed must also provide the Commissioner with the required information in a manner prescribed by the Commissioner.

Immunity from Liability

No civil liability may be imposed on and no cause of action may arise from a person’s furnishing information concerning suspected, anticipated or completed fraudulent life settlement or insurance acts, if the information is provided to or received from:

• The Commissioner or his or her employees, agents or representatives;
• Federal, state or local law enforcement or regulatory officials or their employees, agents or representatives;
• A person involved in the prevention and detection of fraudulent life settlement acts or that person’s agents, employees or representatives;
• Any regulatory body or their employees, agents or representatives, overseeing life insurance, life settlements, securities or investment fraud;
• The life insurer that issued the life insurance policy covering the life of the insured; or
• The licensee and any agents, employees or representatives.

There would not be protection from civil liability if statements were made with actual malice. If a civil suit is brought against an individual that provided information, who did not act with malice, he or she is entitled to an award of attorney’s fees and costs if he or she is the prevailing party in the action for libel, slander or any other relevant tort. For purposes of this section a proceeding is “substantially
justified” if it had a reasonable basis in law or fact at the time that it was initiated.

Confidentiality

The documents and evidence provided pursuant to fraudulent acts, whether suspected or proven, or information obtained by the Commissioner in an investigation of suspected or actual fraudulent life settlement acts will be privileged and confidential. They may not be made a public record and will not be subject to discovery or subpoena in a civil or criminal action. This does not prohibit release of documents and evidence obtained in an investigation by the Commissioner of suspected or actual fraudulent life settlement acts:

• In administrative or judicial proceedings to enforce laws administered by the Commissioner;

• To federal, state or local law enforcement or regulatory agencies, to an organization established for the purpose of detecting and preventing Fraudulent Life Settlement Acts or to the NAIC; or

• At the discretion of the Commissioner, to a person in the business of life settlements that is aggrieved by a fraudulent life settlement act.

Release of documents and evidence does not abrogate or modify the privilege in other circumstances.

Other Law Enforcement or Regulatory Authority

This Act will not:

1. Preempt the authority or relieve the duty of other law enforcement or regulatory agencies to investigate, examine and prosecute suspected violations of law;

2. Preempt, supersede, or limit any provision of any state securities law or any rule, order, or notice issued thereunder;

3. Prevent or prohibit a person from voluntarily disclosing information concerning life settlement fraud to a law enforcement or regulatory agency other than the insurance department; or
4. Limit the powers granted elsewhere by the laws of this state to the Commissioner or an insurance fraud unit to investigate and examine possible violations of law and to take appropriate action against wrongdoers.

Life Settlement Antifraud Initiatives

Providers and brokers must have antifraud initiatives reasonably calculated to detect, prosecute and prevent fraudulent life settlement acts in place. At the discretion of the Commissioner, he or she may order, or grant a licensee’s request, to modify the following required initiatives as necessary to ensure an effective antifraud program. The modifications may be more or less restrictive than the required initiatives so long as the modifications may reasonably be expected to accomplish the intended purpose.

Antifraud initiatives must include fraud investigators, who may be provider or broker employees or independent contractors; and an antifraud plan, which must be submitted to the Commissioner. The antifraud plan must include, but not necessarily limited to:

- A description of the procedures for detecting and investigating possible fraudulent life settlement acts and procedures for resolving material inconsistencies between medical records and insurance applications;
- A description of the procedures for reporting possible fraudulent life settlement acts to the Commissioner;
- A description of the plan for antifraud education and training of underwriters and other personnel; and
- A description or chart outlining the organizational arrangement of the antifraud personnel who are responsible for the investigation and reporting of possible fraudulent life settlement acts and investigating unresolved material inconsistencies between medical records and insurance applications.

Antifraud plans submitted to the Commissioner are privileged and confidential and are not public record. Plans are not be subject to discovery or subpoena in a civil or criminal action.
Injunctions; Civil Remedies; Cease-and-Desist

In addition to the penalties and other enforcement provisions of this Act, if any person violates this Act or any rule implementing this Act, the Commissioner may seek an injunction in a court of competent jurisdiction in the county where the person resides or has a principal place of business and may apply for temporary and permanent orders necessary to prevent additional violations.

Any person damaged by the acts of another in violation of this Act or any rule or regulation implementing this Act, may bring a civil action for damages in a court of competent jurisdiction against the person committing the violation.

The Commissioner may issue a cease-and-desist order upon a person who violates any provision of this part, any rule or order adopted by the Commissioner, or any written agreement entered into with the Commissioner, in accordance with this state’s governing administrative procedures.

When the Commissioner finds an action presents an immediate danger to the public and requires an immediate final order, he or she may issue an emergency cease-and-desist order reciting with particularity the facts underlying the findings. The emergency cease-and-desist order is effective immediately upon service of a copy of the order on the respondent and remains effective for 90 days. If the department begins non-emergency cease and desist proceedings, the emergency cease and desist order remains effective, absent an order by an appellate court of competent jurisdiction. In the event of a willful violation of this Act, the trial court may award statutory damages in addition to actual damages in an additional amount up to three times the actual damage award. The provisions of this Act may not be waived by agreement. No choice of law provision may be utilized to prevent the application of this Act to any settlement in which a party to the settlement is a resident of this state.
Penalties

It is a violation of this Act for any person, provider, broker, or any other party related to the business of life settlements, to commit a fraudulent life settlement act.

For criminal liability purposes, a person that commits a fraudulent life settlement act is guilty of committing insurance fraud and shall be subject to additional penalties under the applicable state’s jurisdiction.

The Commissioner will be empowered to levy a civil penalty not exceeding the appropriate state’s fine and the amount of the claim for each violation upon any person, including those persons and their employees licensed pursuant to this Act, who is found to have committed a fraudulent life settlement act or violated any other provision of this Act.

The license of a person licensed under this Act that commits a fraudulent life settlement act will be revoked for the period of time determined by the applicable state.

Unfair Trade Practices

A violation of this Act will be considered an unfair trade practice pursuant to state law and subject to the penalties provided by state law.

Effective Date

A provider lawfully transacting business in the adoptive state prior to the effective date of this Act may continue to do so pending approval or disapproval of that person’s application for a license as long as the application is filed with the Commissioner not later than 30 days after publication by the Commissioner of an application form and instructions for licensure of providers. If publication of the application form and instructions is prior to the effective date of this chapter, then the filing of the application will not be later than 30 days after the effective date of this Act. During the time that such an application is pending with the Commissioner, the applicant may use any form of life
settlement contracts that have been filed with the Commissioner pending approval thereof, provided that such form is otherwise in compliance with the provisions of this Act. Any person transacting business in this state under this provision shall be obligated to comply with all other requirements of this Act.

A person who has lawfully negotiated life settlement contracts between any owner residing in this state and one or more providers for at least one year immediately prior to the effective date of this Act may continue to do so pending approval or disapproval of that person’s application for a license as long as the application is filed with the Commissioner not later than 30 days after publication by the Commissioner of an application form and instructions for licensure of brokers. If the publication of the application form and instructions is prior to the effective date of this chapter, then the filing of the application shall not be later than 30 days after the effective date of this Act. Any person transacting business in this state under this provision shall be obligated to comply with all other requirements of this Act.
Defining STOLI

Stranger-originated life insurance (STOLI), also known as 
**speculator-initiated life insurance** or **SPIN-Life**, is life insurance 
policies taken out on strangers. In other words, these arrangements 
try to circumvent state insurable-interest statutes. Such laws are 
intended to assure that people who buy life insurance have a true and 
meaningful interest in the life being insured.

Stranger-originated life insurance policies are a specific “loan-to-life 
settlement” technique. Investors are primarily interested in the 
insured’s date of death, since their profits are directly tied to the 
length of the insured’s life. Other names for the same or similar 
investments include investor-owned life insurance, two-year free 
insurance, charity owned life insurance, speculator-initiated life 
insurance and investor-initiated life insurance.

The generally accepted purpose of life insurance is the protection of 
individuals who depend upon the insured for financial support. 
Obviously strangers would receive no financial support from the 
insured, so could not be financially dependent upon the insured.

Life insurance serves a social function, protecting family members 
and others from financial loss when the major breadwinner dies 
prematurely. Life insurance is also used in a business capacity, 
protecting businesses and employees from the financial loss due to the 
death of a key employee. In all cases, the intent of life insurance 
legislation was to have some type of financial tie between the insured 
and those associated in some way with the policy. Life insurance is 
not generally intended for speculative use by strangers, but that is 
how STOLIs function.
As Kenneth Kingma and Stephan Leimberg explain it in their article titled *Deterring Stranger-Originated Life Insurance: Two New Model Life Settlement Acts*, the STOLI is "*a practice or a plan to initiate a life insurance policy for the benefit of a third party investor who, at the time the life insurance policy is originated, has no insurable interest in the insured.*"

Stranger-originated life insurance is not something that is just now being used; they have actually existed in some form for more than 100 years. That being the case, many agents will be surprised to just now learn of the practice. What has changed is the current aggressive trend to market policies that once were considered illiquid assets. In other words, consumers did not previously think of their life insurance policies the same way they thought of such things as stocks or annuities. Marketing companies are using advertisements to encourage consumers to view their policies differently than they previously did. Investors hope to receive between 9 and 12 percent returns, so it is easy to see why interest has risen in STOLI's.

Issued life insurance policies have generally experienced lapse rates that range from 35 to 50 percent, depending upon the company and the types of policies sold. Some companies report as high as an 80 percent lapse rate prior to policy maturity. With the advent of STOLIs insurance companies will probably find themselves paying out more death benefits since policies will be sold to third parties who will keep premiums paid. By 2030, baby-boomers will be between 66 and 84 years old, making up 20 percent of America’s population. These individuals are likely to have life insurance policies and also likely to sell a portion of those policies to viatical firms. While the majority will likely be policies that were purchased without any intent to sell them to a third party, a portion is also likely to be purchased for that express purpose.

Policy owners have always assigned life insurance policies to third parties for one reason or another, but the secondary market was not formalized until the last twenty years. Viatical settlement companies were willing to purchase life insurance polices from those who were terminally ill. Initially the policies purchased were primarily bought from AIDS patients to help them finance their medical costs and general costs of living. Many of these individuals had lost their jobs by this point, so their medical insurance also eventually lapsed.
As instances of fraud were disclosed to the public and with advances in medical care, viatical settlement investments lost favor during the last half of the 1990s. We are now seeing a rise in their popularity and states either have or will soon be passing stranger-oriented life insurance legislation to protect the various consumers that participate in these contracts.

While it may not be said in most articles on stranger-oriented life insurance contracts, state legislation also protects the insurance companies and their future clients. If insurers cannot accurately predict their risk when issuing life insurance contracts, unexpected financial loss becomes part of their risk. Traditionally, insurers knew policy lapse rates, which were part of their risk analysis. With the advent of SOLIs these lapse rates are much less reliable. Therefore, their risk analysis is also less reliable. Losses will be passed on to legitimate consumers buying life policies for traditional reasons: their family’s financial protection from their premature death.

We see two different names used: life settlements and viatical settlements. Technically there is a difference between the two, but they are often used interchangeably. While there may be variances in how the two terms are used, usually viatical settlements refer to existing policies that were purchased without the intent of selling them to a third party, while life settlements refer to policies purchased for the specific purpose of selling them to a third party, or in the secondary market. State legislation will specify their definition for the purposes of their laws; sellers and other participants in viatical and life settlements must be aware of their state’s use of the terms. Of course, all state laws must be followed.

The states are seeing increased interest in the sale of life insurance policies, whether they happen to be viatical or life settlements. It is clear that investors are interested in the viatical concept and the insured’s are willing to sell their policies under the right circumstances. One research firm has estimated that the life settlement insurance industry grew to approximately $6.1 billion in 2006.¹ Not everyone has agreed with their figures. LIMRA (Life Insurance Marketing & Research Association) felt these figures were too high. In the past life

¹ STOLI Alert (December, 2007) published by the American Council of Life Insurers and National Association of Insurance and Financial Advisors
settlement companies were not required to provide state insurance departments with detailed information on sales, but this is changing as legislation is passed. The next few years will provide statistics that did not previously exist.

The growth of the life and viatical settlement business has been fueled by stranger-originated life insurance programs where brokers or speculators encourage individuals to buy policies with the intent of selling them to third parties. They offered economic incentives, such as so-called “free insurance,” cruises, and cash payments to encourage consumers to buy life insurance policies, with the intent eventually selling them to investors who have no insurable interest in their lives. When a policy is purchased for a valid reason, such as protecting one’s family and those with insurable interests in the insured, the majority view in the U.S. is that the policy may be later assigned to anyone, even a person or party with no insurable interest. While STOLIs may initially appear to have been purchased with an insurable interest, the underlying intent is that of violating the state’s insurable interest laws. Even aside from potential insurable interest law violations, STOLI programs present other troublesome issues, including taxation questions, securities violations, “wet ink” settlements, prohibited premium rebates, premium finance, and usury issues.

Stranger-oriented life insurance promoters are attempting to keep state laws vague enough or broad enough to allow continuance of current practices. Sometimes it only takes a change in wording to allow them to continue doing business as usual. Usually, promoters want wording that allows a policy to be sold immediately following issuance. In other words, the policy is initially taken out with a demonstrated insurable interest, but once issued it may be immediately sold to a third party. The model acts developed by NCOIL and the NAIC attempt to prevent this practice.

What most consumers are unlikely to realize is the effect stranger-oriented life insurance practices will have on insurance companies, and ultimately on our citizens who need insurance for valid reasons. For this reason, state insurance regulators are also concerned since it is their job to protect the public. The economic effect STOLIs (also called SOLI) will have on the life insurance industry and the insurance-buying public is far greater than the average consumer realizes.
Actuarial Life Expectancies

Insurance rates are based on actuarial life expectancy tables as well as other measurements that have been tracked for decades, allowing accurate predictions of the insurer’s risk. The insurable interest requirement allows insurers to make these life expectancy predictions and establish premiums that accurately reflect their risk of benefit payout, especially as it might apply to adverse selection (where sicker or riskier individuals seek life insurance with the purpose of selling the policy). A primary objective in requiring an insurable interest is economic – to be certain that parties to a life insurance policy are not likely to adversely affect the statistics of an insured’s survival. The insurer’s insistence of an insurable interest at the inception of the life insurance contract can be seen as an effort to preserve the integrity of the risk pool and the avoidance of adverse selection. Insurers will be more likely to investigate death claims that occur in the first two years of the policy, looking for undisclosed facts on the original application. When they find undisclosed information, they are more likely to deny claims. That same motivation will make it more likely that insurers will look for a lack of insurable interest when applications are made or claims presented.

State Legislation

State insurance regulators and other consumer groups have shown their commitment to deterring STOLI programs by providing model legislation that is intended to be enacted by state legislatures. The first model act (the Viatical Settlements Model Act) was approved by the National Association of Life Insurance Commissioners (NAIC) in December, 2006, and amended on June 4, 2007. The National Association of Insurance Commissioners is a voluntary organization of the chief insurance regulatory officials of the 50 states, the District of Columbia and five U.S. territories. It assists state insurance regulators in protecting consumers and helping maintain the financial stability of the insurance industry by offering financial, legal, actuarial, computer, research, market conduct, and economic expertise.
The second model act (the Life Insurance Settlements Model Act) was approved by the National Conference of Insurance Legislators (NCOIL) in November, 2007.

The NAIC model act would end STOLI and strengthen consumer protection in the life settlement area. It addresses the most obvious and blatant form of STOLI - the direct sales of life insurance policies specifically initiated for the purpose of allowing investors to purchase them. The NAIC model act establishes a five-year moratorium on the settlement of policies having STOLI characteristics and requires life settlement brokers to disclose to policy owners vital information about settlement transactions, such as commissions and other purchase offers. There are very broad exceptions to assure legitimate non-STOLI transactions would not be within the scope of the 5 year ban. The NAIC’s Life Insurance and Annuities Committee will examine proposals to deter STOLI transactions that do not involve a direct settlement but accomplish the same result by shifting a beneficial interest in life insurance to investors through a transfer of an interest in a trust or other vehicle which holds the policy.

If one or more of the following conditions have been met within the five year period, the ban would not apply:

1. The viator or insured is terminally or chronically ill;
2. The viator’s spouse dies,
3. The viator divorces his or her spouse,
4. The viator retires from full-time employment,
5. The viator becomes physically or mentally disabled and a physician determines that the disability prevents the viator from full time employment,
6. A final order, judgment or decree is entered by a court of competent jurisdiction, on the application of a creditor of the viator, adjudicating the viator bankrupt or insolvent, or approving the petition seeking reorganization of the viator or appointing a receiver, trustee or liquidator to all or a substantial part of the viator’s assets.
Yet another exception in A3 of Section 11 provides that the five year ban on settlement does not apply if the seller has paid policy premiums exclusively with unencumbered assets. This would include an interest in the life insurance policy being financed only to the extent of its net cash surrender value, with full recourse liability incurred by the insured that has no agreement or understanding with any other person to guarantee the liability or purchase the policy. This would include forgiving of the loan. Neither the insured nor the policy should have been evaluated for settlement, meaning no life expectancy analysis has been performed.

The National Conference of Insurance Legislators (NCOIL) is an organization of state legislators whose primary focus is insurance legislation and regulation. Many legislators active in NCOIL either chair or are members of the committees responsible for insurance legislation in their respective state houses across the country. The NCOIL model act serves as an alternative to the NAIC model act. It attempts to address all manifestations of STOLI, whether they involve direct settlements of life insurance, or indirect sales of life insurance to investors through a sale of an interest in trust (or LLC or FLP) or through other practices.

**Life Settlement Participants**

Consumers had such a positive reaction to selling their policies that the potential for a secondary market for life insurance contracts grew despite the potential pitfalls. A life settlement involves buyers, sellers, brokers and investors who provide the funding for the purchase of the life insurance policy. The **seller** in a life settlement is the **policy owner**, but not necessarily the insured since the two may be different people. While it varies, today the insured is typically 65 years old and probably in deteriorating health with a life expectancy of less than fifteen years. The policy generally has a face value of $100,000, is past the two-year contestability period, and has been issued by an insurance company with a rating of “A” or higher. The buyer (life settlement provider) will evaluate the medical records of the insured, determining the insured's life expectancy and establishing a price for the life insurance policy. The broker may be the policyholder's financial planner or insurance agent and matches buyers with sellers. Investors supply the capital to purchase the life insurance policy.
From the perspective of the seller, a life settlement has several stages: the realization of need, application, documentation, review, policy match, offer, closing package, notification, and funds transfer. If the life settlement provider resells the policy, the pooling and securitization process adds an additional layer to the transaction. Life settlement providers generally pool together the in-force life insurance policies that they purchase and sell fractional interests to institutional investors. Collectively, these policies are expected to pay out certain amounts of money over a certain time period. Because there tends to be a large number of diverse policies in the pool, on average, the payout expectations hold true. Essentially, life settlement providers (LSP) are reselling the life insurance policies that they have purchased. This resale of the policies replenishes the provider’s supply of capital, allowing it to continue purchasing more life insurance policies. The securitization of life settlement portfolios has become so popular that some financial institutions have funded LSPs with the intention of securitizing the final life settlement portfolio.

Life settlements are being used to dispose of life insurance policies that are no longer needed, wanted, or affordable. Prior to an organized secondary market, a life policy owner could either let their policy lapse, or surrender it back to the life insurance company for the surrender values. Traditionally, only the insurer had the ability to provide cash from a life insurance policy, which is why it was considered an illiquid asset. It should not surprise anyone that money is the primary reason for selling a life insurance policy in the secondary market. When the seller will receive a higher payout in the secondary market than he or she would have by surrendering the policy to the insurance company, viaticals are sure to appeal to consumers. The payout from the secondary market will be higher where the life expectancy of the insured is less than that originally forecast when the policy was originally issued. There are two primary reasons that this could happen: the insured is in deteriorating health, or the mortality tables upon which the policy was originally based no longer fairly represent the value of the policy. Life settlement providers have the benefit of current medical assessments and mortality tables, while the issuing life insurance company was making a long-term prediction based on less accurate data.

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2 Life Insurance Settlement Association, CASHING IN ON UNNEEDED LIFE INSURANCE POLICIES: HOW SENIORS ARE BENEFITING FROM LIFE SETTLEMENTS, NOVEMBER, 2006
Individuals decide to sell an existing policy for several reasons. The policyholder may no longer be able to afford the premium payments, for example. He or she may need to fund something else, such as long-term care, making continued premium payments difficult. The intended beneficiaries may have predeceased the policy owner or now be in a better financial position, no longer needing financial protection through policy proceeds. If the intended beneficiaries were minor children at the time the policy was purchased, they may now be grown and financially independent.

Estate and financial planning often play a role in determining the suitability of selling a life insurance policy. It may be determined that a life policy is no longer needed or even wanted. In some cases, it may be determined that a new policy covers the goals more effectively, outdating the existing policy. Perhaps some goals and estate planning needs have changed. Other investment vehicles, either not considered or not available at the time the policy was issued, may offer the types of returns desired by the policyholder. If the existing policy represents considerable premiums already paid in, selling it to a third party for more than the surrender values will obviously be favorably considered by the policy owner.

Viatical firms often perform services that are well received because both the sellers and investors are likely to feel they gain personally. With stranger-originated life insurance many professionals feel the sellers may not fully understand the transaction they are entering into or realize the potential for industry abuse.

Stranger-originated life insurance (also referred to as stranger-owned life insurance) makes use of three separate but legitimate markets:

- The primary market for new life insurance products issued by the insurer,
- The secondary market where in-force life insurance products can be sold, and
- The market of special-purpose lenders who finance life insurance premiums.

There are at least six parties to a STOLI transaction, including the insured individual, a trust and trustee, a life insurance broker, an investor group (life settlement market maker), a special-purpose
lender, and the life insurance company. The IRS may be a party as well because STOLI policies do not qualify for tax exempt treatment afforded to other forms of life insurance. Not all STOLI transactions involve a trust but many do. The insured and the policy owner are not always the same individual so each individual may be a separate component to the process or a single component, depending upon the specific circumstances.

STOLI transactions can be outlined in four basic steps:

**Step 1**
The insured is likely to be 70 to 80 years of age, in good health (but not perfect), and has already been an insurance buyer.

**Step 2**
A policy on the life of the insured will then be purchased by an irrevocable trust or some other entity naming the insured’s family or favorite charity as the beneficiary.

**Step 3**
Next, a special purpose lender will loan the trust a sufficient amount to cover the first two years’ premiums. The loan may also cover the policy origination fee as well as the trust administration fees and other expenses related to the transaction. The short term loan interest rate is generally on a prime-plus basis, which might be as high as 12 to 18 percent because of the non-recourse nature of the note and the lack of sufficient collateral.

**Step 4**
After two years when the loan has matured, the trustee is given a choice:

1. The trustee may pay off the loan with any additional fees and interest that have accumulated since origination, thereby retaining possession of the policy. In this case the trustee may sell the policy to an investor group, paying off the loan and keeping any profit thereafter; or

2. The trustee may walk away from the loan and let the lender foreclose on the insurance policy as collateral. The typical expectation is that the trust will sell the policy to the market maker. After the first two policy years, the market maker will
purchase the policy from the insured for its fair market value. The market maker is not usually required to purchase the policy and the purchase price is not guaranteed.

It is easy to understand why investors find STOLI transactions attractive; there is the opportunity for providers to view current medical records to make current estimates of life expectancy of the insured. The insured is motivated by the offer of two years’ “free” insurance; if he or she dies in the first two years, while the policy is owned by the trust, his or her beneficiary will receive the death proceeds less the outstanding loan.

**Important note: these are generalities.** It is always necessary to view the actual contract since contracts can and do vary.

There are many elements of concern for stranger-originated life insurance. The first primary concern is confidentiality, especially for the insured that may be ill or nearing death. The financial interest the investor has in the insured’s death is often referred to as “accelerated mortality.” If the premium financing loan is not a non-recourse loan, the insured’s personal assets may be at risk as well. By selling one’s excess insurability, the insured may be limited in future purchases of personal insurance, meaning he or she may not be able to purchase additional coverage for personal needs.

If the practice of providing cash incentives to the insured is deemed to be rebating, the insured could face taxation at ordinary income levels for these payments. Charity-owned life insurance (CHOLI), a practice similar to STOLI, was targeted in the Pension Protection Act of 2006 and now requires charities involved in CHOLI transactions to report such activity to the IRS for two years (an attempt to impose a 100% excise tax on the cost of CHOLI acquisition failed).

Several other significant tax issues exist including calculation of basis and characterization of gain, should either the insured or the trustee sell the policy. That is why the characterization of “loan-to-life settlements” as “free” insurance is filled with assumptions that could cause some very unpleasant consequences, including whether the purchaser of the policy has an insurable interest in the insured.
Policy Transfers and Insurable Interest

Each state might have different laws, depending upon the basis used. Most states will utilize either or both the NAIC and the NCOIL model viatical acts, but each state may also insert language specific to their state. Those selling viatical or life settlements must know and follow their own state’s laws. Of course, any federal requirements must also be followed.

The decisional law regarding the validity of life insurance assignment to a party without an insurable interest varies from state to state; the prevailing view is that the assignment is valid, and, where no unlawful purpose is shown, the agreement of the assignee to pay future premiums does not invalidate the assignment. Under other authority, however, the assignment of a valid life insurance policy to an assignee lacking an insurable interest is invalid, at least where the assignee agrees to pay all the premiums, although under some, but not all, authorities the rule does not apply where insured pays all the premiums.3

In 1939, the Minnesota supreme court held in Peel v. Reibel that an insurable interest is unnecessary to establish the validity of the gifting of an individual’s life insurance policy where the assignment was made “in good faith and not as a mere cover [for taking out insurance in the beginning in favor of one without insurable interest].”4

In 1937, the First National Bank of Saint Paul had insured a subsection of its employees under a group life insurance policy issued by the Minnesota Mutual Life Insurance Company.5 One of the insured was George Peel who had designated his estate as his beneficiary. Conceding “the general rule that a policy of life insurance may be the subject of a valid gift,” the defendant failed to convince the court that the plaintiff’s lack of insurable interest invalidated the gift.6 The Supreme Court observed that “if there were proof that Peel procured his insurance with a view to making plaintiff, with no insurable interest in his life, the beneficiary, we would have a different problem.” Without such evidence, “to hold [in favor of the defendant] would...put

3 CJS Insurance § 236 (citing the respective authorities).
5 Peel, 286 N.W. at 345.
6 Id. at 346.
upon the insured’s right of disposition of his policy conditions which are justified by neither law nor by the contract.”

As early as 1871, the Supreme Court had announced that life insurance is not a mere contract of indemnity; Justice Clifford wrote: *Life insurances have sometimes been construed in the same way, but the better opinion is that the decided cases which proceed upon the ground that the insured must necessarily have some pecuniary interest in the life of the cestui qui vie are founded in an erroneous view of the nature of the contract, that the contract of life insurance is not necessarily one merely of indemnity for a pecuniary loss, as in marine and fire policies, that it is sufficient to show that the policy is not invalid as a wager policy, if it appear that the relation, whether of consanguinity or of affinity, was such, between the person whose life was insured and the beneficiary named in the policy, as warrants the conclusion that the beneficiary had an interest, whether pecuniary or arising from dependence or natural affection, in the life of the person insured.*

The focus on whether the policy itself was a wager policy was evident in *Connecticut Mutual. Life Ins. Co. v. Schaefer*, in which the Supreme Court held that an ex-wife who continued to pay premiums for a life insurance policy on her ex-husband was entitled to receive death proceeds despite her insurable interest terminating upon finalization of the divorce.

In 1911, the Supreme Court drew a distinction in *Grigsby v. Russell* between the need for a beneficiary’s insurable interest in the insured at the time a policy is issued and the need for the assignee of the same policy to have an insurable interest in the insured’s life. In *Grigsby v. Russell*, the insured, John Burchard, in need of money for surgery and facing an overdue premium payment, assigned his life insurance policy to Dr. Grigsby in exchange for $100 and the

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*Id.* The Court had previously noted that “nothing in [the] master policy or employee’s certificate [gave] the bank as employer any right to limit or control the employee's [sic] right of assignment….” Neither did the fact that the insured was a donee beneficiary of the main contract affect his ability to assign the policy to a third party. *Id.* at 346.

assumption of the payment of the premiums. Because Dr. Grigsby had no insurable interest in the insured, the Sixth Circuit Court of Appeals, relying on a previous ruling of the Supreme Court, “held the assignment valid only to the extent of the money actually given for it and the premiums subsequently paid.” The Supreme Court, however, found Grigsby v. Russell to be different from those upon which the Sixth Circuit relied – Burchard’s policy had not “been taken out for the purpose of allowing a stranger association to pay the premiums and receive the greater part of the benefit, and having been assigned to it at once.” The distinction was important because the Supreme Court, recognizing life insurance to be an important form of investment and saving, found it desirable, “so far as reasonable safety permits, to give to life policies the ordinary characteristics of property.” The value of the life insurance policy, the Supreme Court observed, is “diminished appreciably” if it can be sold only to those with an insurable interest in the life of the insured.

The Supreme Court has, therefore, established that when the motive of assignment is to circumvent the law, the assignment is void. The Supreme Court has held that the assignment of a policy after issuance “would not render it void, whatever the lack of insurable interest on the part of the assignee.” Cammack v. Lewis is one of the Supreme Court’s earliest cases addressing the simultaneous issuance and assignment of a life insurance policy. The insured, being in poor health and owing the plaintiff, Cammack, a note for $70, obtained a term life insurance policy at Cammack’s suggestion for $3,000. As soon as the policy was issued, Lewis assigned it to Cammack, who proceeded to pay the first year’s premiums of $25 after having agreed in writing to pay one thousand dollars to Lewis’ wife should there be a payment made from the policy. Seven months after the policy was issued, Lewis died. The Supreme Court remarked that “the

11 Grigsby, 222 U.S. at 154.
12 Id. at 154. The Sixth Circuit analyzed six prior Supreme Court rulings regarding the extent to which an assignment of a life insurance contract is valid when the assignee lacks an insurable interest in the insured. See Russell v. Grigsby, 168 F. 577 (6th Cir. 1909).
13 Grigsby, 222 U.S. at 156 (citing Warnock v. Davis, 104 U.S. 775 (1881)).
14 Grigsby, 222 U.S. at 156.
15 See generally Jeffrey A. Baskies and Brian J. Samuels, Aggressive Viatical Settlement Transactions: Gambling on Human Lives, 28 EST. PLAN. 76, 78 (Feb, 2001) (discussing “wet-ink” transactions within the viatical settlements industry).
16 Cammack v. Lewis, 82 U.S. 643 (1872).
17 Cammack, 82 U.S. at 643-644.
18 Id. at 644.
disproportion between the real interest of the creditor and the amount to be received by him ($70 debt plus the $25 premium versus the $2,000 received) deprives it of all pretence to be a bonâ fide effort to secure the debt."¹⁹ Unwilling to conclude that the acquisition of the policy was itself fraudulent, the assignment to Cammack was held to be valid to the extent of the debt owed to him by Lewis plus the premiums paid to keep the policy in force.

Similar facts were presented to the Supreme Court nine years later in Warnock v. Davis in which the deceased had procured a policy on his life with the intent to assign it to a creditor.²⁰ The Supreme Court expressly disapproved of prior decisions by the New York Court of Appeals which had held that the assignee of a life insurance policy is fully entitled to collect on the full sum of the policy regardless of consideration given for the assignment or insurable interest in the insured.²¹ Recognizing that "many other adjudications" supported this view, the Court went on to note:

> if there be any sound reason for holding a policy invalid when taken out by a party who has no interest in the life of the assured, it is difficult to see why that reason is not as cogent and operative against a party taking an assignment of a policy upon the life of a person in which he has no interest.²²

To hold the assignment valid beyond the debt owed to the creditor, any premiums paid, and reasonable interest thereupon, would "encourage the evils for which wager policies are condemned."²³

The task of deciding whether public policy allows for an assignee with no insurable interest to recover debts under a life insurance policy has been left to the states, although the Supreme Court has provided significant guidance in determining what may qualify as an insurable interest.²⁴

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¹⁹ Id. at 648.
²⁰ Warnock v. Davis, 104 U.S. 775 (1881).
²¹ Warnock, 104 U.S. at 781.
²² Id. at 782.
²³ Id. at 781.
²⁴ In language that echoed that Justice Clifford’s in Phoenix Mutual, see supra note 8, Justice Field observed
Recent Regulatory Changes

In the spring of 2006 the NAIC began to discuss changes to the Viatical Settlements Model Act aimed specifically at stranger-originated life insurance. While several changes directed toward consumer protection in general were made, a five-year ban on settling a life insurance policy where “specified elements indicative of a STOLI transaction are present” was the most controversial amendment to the Model Act. Only if the viator certified to the viatical settlement provider that at least one of several specified conditions existed within the five-year time frame could they be sold or assigned to a third party that did not have a traditional insurable interest. The qualifying conditions include terminal or chronic illness of the viator, death of the viator’s spouse, divorce from the viator’s spouse, retirement from full-time employment, physician-corroborated mental or physical disability, preventing the maintenance of full-time employment, bankruptcy, insolvency, or other approved reorganization of the viator. The five-year prohibition is also relaxed where the viator enters into a viatical settlement contract more than two years (the contestability period) after the date of policy issuance and three criteria are met at all times.

[In all cases there must be a reasonable ground, founded upon the relations of the parties to each other, either pecuniary or of blood or affinity, to expect some benefit or advantage from the continuance of the life of the assured. Otherwise the contract is a mere wager, by which the party taking the policy is directly interested in the early death of the assured. Such policies have a tendency to create a desire for the event. They are, therefore, independently of any statute on the subject, condemned, as being against public policy.]

Warnock, 104 U.S. at 779.

25 Changes include new bonding requirements for viatical settlement providers and viatical settlement brokers [NAIC Model Act § 3F(4) (July, 2007)]; [a] requirement that viatical settlement brokers disclose to the viator the gross offer for settlement made by any viatical settlement provider and the total compensation that would be paid to the broker [VIATICAL SETTLEMENTS MODEL ACT § 8B(3) (Nat’l Ass’n Ins. Comm’rs, 2007)]; [a] requirement that viatical settlement brokers disclose to all viators that the broker represents the viator exclusively, and not the insurer or viatical settlement provider [VIATICAL SETTLEMENTS MODEL ACT § 8A(2) (2007)]; other new disclosure requirements for viatical settlement brokers and viatical settlement providers, including a requirement that brokers and providers disclose to insurers any transaction, or series of transactions, entered into for the purpose of engaging in viatical settlements during the five-year prohibition period [VIATICAL SETTLEMENTS MODEL ACT § 9 (2007)]; [a]n expanded rescission period for settlements [VIATICAL SETTLEMENTS MODEL ACT § 10C (2007)]; [a] requirement that insurers promptly effect lawful changes in ownership or beneficial interests in a policy [VIATICAL SETTLEMENTS MODEL ACT § 8D (2007)]; new conflict of interest requirements that prohibit viatical settlement brokers from doing business with affiliated viatical settlement providers and other affiliated entities [VIATICAL SETTLEMENTS MODEL ACT § 12 (2007)].
between the date of policy issuance and the incontestability clause of two years: (1) the funding of the policy premiums must have been made with unencumbered assets, with any interest in the policy financing extending only to the cash surrender value; (2) there has been no agreement or understanding with any person to either guarantee the liability for or purchase the policy, including assumption or forgiveness of a loan; and (3) neither the insured nor the policy was evaluated for settlement.

Prior to the drafting of the Section 11 language, the NAIC Life Insurance and Annuities Committee received testimony for and against the five-year ban. It is not surprising that those involved in viaticals felt the five-year ban was unfair to policy sellers (viators). They voiced concerns that the property rights of policyholders would be affected by this ban. With the five-year prohibition now adopted as part of the Model Act, NAIC members are obliged to “devote significant regulator and association resources to educate, communicate and support the model.”

Life insurance companies generally favored the NAIC’s five-year prohibition. All states were urged to adopt the NAIC Viatical Model Act for the protection of consumers and insurers. While it may seem logical for all states to adopt the NAIC Model or some type of similar legislation, it is not a simple matter. Viatical settlements were previously regulated in many states, but not STOLIs. As stranger-owned life insurance becomes increasingly a public issue, the states must pass appropriate legislation without stepping on consumer’s rights to sell their property, including life insurance policies.

Stranger-originated life insurance is still something most Americans have not heard of, but this will change if it becomes widely used by investors. Since STOLIs may encourage obtaining life policies under fraudulent conditions, insurers have a stake in regulating these transactions. The public also has a stake in STOLIs since they have the potential for causing higher premiums for the legitimate life insurance buyers wanting to protect their families from loss of financial security. Public policy regarding the transfer and assignment of life insurance policies by the insured to a third party is not new changing little since the Supreme Court decision in 1911. Stranger-oriented life insurance transactions, as investor vehicles, create an interest in the death of the insured rather than the life of the insured. Because such
transactions leverage primary markets, secondary markets, and the market of special-purpose lenders, state legislators not only have to reconcile conflicting industry interests, but decide how those interests should be balanced considering the numerous STOLI abuses that have taken place. State legislatures must consider whether or not the five-year ban on the settlement of life insurance policies is in the interests of their constituents, be they purchasers or providers. Three options are available to the states: take no action, adopt the amendments to the Model Act as written, or adopt the amendments to the Model Act with modifications.

The primary question has to do with intent: was the life insurance policy purchased with the intent of selling it upon policy issuance or at some point following the two year incontestability period? Although the insured’s intend is the prevailing question, how can that intent be known? Imposing a time factor, such as a five year ban on selling the policy, is not a guarantee that the policy was purchased with a genuine insurable interest. Although some policy purchase factors certainly indicate intent to sell the policy following issuance, placing restrictions could still penalize those who do not have that intent.

There is probably no fool-proof way to know a purchaser’s intent so states have traditionally deferred to the property rights of the assignor. Unfortunately, with the secondary market for life policies changing and abuses rising, states are being forced to reconsider their previous position. Past Supreme Court decisions may no longer apply in today’s growing stranger-oriented life insurance market.

The decision in Warnock v. Davis reaffirmed that any semblance of a wagering policy, one where “the party taking the policy is directly interested in the early death of the insured,” one “that [tends] to create a desire for the event....is, therefore, [independent] of any statute on the subject, condemned as being against public policy.”26 Just as in Cammack, the Supreme Court forcefully stated that “the extent in which the assignee stipulates for the proceeds of the policy beyond the sums advanced by him, he stands in the position of one holding a wager policy.”27 The Supreme Court did not do an about-face in Grigsby v. Russell as suggested by the Life Insurance Settlement Association. In fact, Grigsby added little to what we accept

26 See supra note 24 and accompanying text.
27 Warnock, 104 U.S. at 779.
as an insurable interest. Finding that the insured had assigned his policy to a party without an insurable interest in his life, the Supreme Court said that “cases in which a person having an interest lends himself to one without any, as a cloak to what is, in its inception, a wager, have no similarity to those where an honest contract is sold in good faith.”28 **Warnock**, then, with contemporaneous application, issuance and assignment of the life insurance policy, has no similarity to **Grigsby v. Russell**, where the insured had contemplated neither present nor future assignment at the time of applying for the life insurance policy in question.29 The Supreme Court’s announcement that it is “desirable to give to life policies the ordinary characteristics of property,” did not contradict the holdings of previous cases; rather it reinforced a forty-year-old prohibition on wagering contracts by defining what is *not* a wagering contract.30

Each state will eventually determine when and under what circumstances public policy against wagering contracts trumps the insured individual’s right to sell property, in this case their life insurance policy. Unless the federal government becomes more involved, which could happen, state policies will vary to some degree, although it is likely they will all be uniform in their intent to limit abuses. There are some indications that the federal government is interested in taking over state control of insurance regulation, although it is also likely that the states will oppose such actions.

### A Speculative Contract

As we know, stranger-originated life insurance policies are a speculative contract on the life of the insured. The investor is interested in the death of the insured, not his or her life. The insured taking out the contract merely to sell it is interested in the income they receive. Neither party is interested in financially protecting a beneficiary with an insurable interest. It is a complex situation: viatical settlements and life settlements are secondary market transactions, and limitations on a policyholder’s ability to dispose of his or her policy conflict with the recognition of ordinary property rights in a life insurance policy. Life settlements take place for several reasons:

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28 *Grigsby*, 222 U.S. at 156.
29 See generally *supra* notes 10-*Error! Bookmark not defined.*, 20-23 and accompanying text.
30 *Grigsby*, 222 U.S. at 156.
the policy may no longer be needed or wanted because the intended beneficiary has passed away; a better policy may provide greater coverage at reduced cost; premium payments may have simply become unaffordable whether due to unemployment or rising health care costs; or some other estate planning need may over-ride the policyholder’s willingness to keep the policy in force. Recognizing the value life insurance plays in an individual’s overall financial portfolio, restricting the liquidity of life insurance policies by cutting off avenues to the secondary market would unfairly put upon the insured’s right to dispose of her policy when it was deemed appropriate.

With one exception, the NAIC’s amendments to the Viatical Settlements Model Act do not unreasonably restrict a policyholder’s ability to dispose of his or her life insurance policy. The NAIC Model Act allows disposal of life insurance policies in the secondary market after five years. Any issue regarding loss of property rights primarily hinges on the restrictions in place after the two-year period of contestability and the five-year anniversary of policy issuance. The language of the five-year ban creates an assumption that, where a viator or insured enters into a viatical settlement contract between the issued policy’s second and fifth year, sufficient evidence then exists that the life policy was a wagering policy. Unless the viator or insured can submit independent evidence to the viatical settlement provider of a terminal or chronic illness, the death of or divorce from a spouse, retirement from full-time employment, inability to sustain full-time employment, or a final order or adjudication of bankruptcy or insolvency, he or she will be assumed to have intended to settle the policy at the time of the original application.

Unfortunately, these conditions do not help less catastrophic changes in a viator’s financial situation that may require cash. The Life Insurance Settlement Association and the Life Settlements Institute, proposed several revisions, recommending what would have been an additional exemption to the five-year ban where a viator or insured could submit independent evidence to the viatical settlement provider that “the viator experiences a significant decrease in income that is unexpected and that impairs the viator’s reasonable ability to pay the policy premium.” With this exception to the five-year ban, a viator or insured would be able to dispose of an unneeded or unaffordable life insurance policy where substantial changes to the health, welfare or economic condition have occurred.
The amendments to the Model Act allow for the increasing prevalence of stranger-originated life insurance while conforming to the Supreme Court’s requirement of insurable interest and wagering policy cases. A viatical settlement contract is generally a written agreement to exchange anything of value, at any time, for the viator’s assignment or transfer of an insurance policy. Such an agreement would be prohibited within five years of issuance of the policy unless certain criteria are met. Entering into a viatical settlement contract within five years of issuance of the respective policy is evidence that the policy was applied for as a wagering policy. This is certainly true for the one transaction explicitly included in the new definition: premium finance loans made for a life insurance policy on, before, or after the date of issuance where the viator or insured on the date of the loan receives a guarantee of future settlement value or promises to sell the policy on that or any future date. Just as in Warnock, where the agreement to assign was made on the same day of policy application, it is reasonable to assume that such a quid pro quo is evidence of a wagering policy. Section 11 of the NAIC Viatical Settlements Model Act clearly prohibits this.

Loan proceeds made solely to pay premiums for the policy or other costs are explicitly excluded from the definition of a viatical settlement contract, and not subject to the five-year prohibition. Also excluded from the definition of a viatical settlement contract are those agreements where all parties are related by blood, law, or have a lawful economic interest in the continued life health and safety of the insured, recognizing the decisional law including affinity and certain pecuniary interests in the definition of insurable interest.

If an exception to the five-year prohibition for an unexpected inability to pay the premiums for an otherwise appropriately obtained life insurance policy is included, the five-year settlement prohibition would not remove a policyholder’s property rights in the policy. The prohibition would create a refutable assumption that entering into a viatical settlement contract within five years of policy issuance is evidence of a wagering policy. Given the predatory nature of many stranger-originated life insurance and the various consequences that are still unknown, it puts pressure on the states to put consumer protections in place. Both the insurance and life settlements industries
are likely to benefit by preventing investors from wagering on the lives of consumers, particularly senior citizens.
Viatical Settlements have seen much recent legislation. While legislation can happen for many reasons, consumer harm is a major reason it occurs. In the case of viaticals, there are two groups of consumers: those who sell their policies and those who invest in the life insurance contracts.

Since ethics are a matter of perception, the study of ethics is not always a simple process. While we would hope laws are ethical, laws may not be perceived as such by some groups of people. For example, our history is full of laws that protected some groups while discriminating against others. That is why we have laws that protect children (remember the clothing factories and child labor issues?), voting rights (women marched for the vote and the right to own property independent of their husbands), people of color, the disabled, and more recently, gays who hope to marry their partners and receive equal spousal employment benefits as their straight counterparts.

Ethics are seldom black-and-white although many groups would have us believe otherwise. Since ethics are defined as perceptions of right and wrong, it would seem that any action could only be right or wrong. For example, we have laws against killing another person yet send our troops into situations that force them to kill others. There are many examples where ethics are not a black-and-white, right-or-wrong situation.

Consider the following questions:

1. Is it wrong to steal?

2. If you are starving is it wrong to steal food from another to ease your hunger?
3. If your child has not eaten is it your ethical duty to feed him or her, even if it means stealing from another?

4. If you feel it is your ethical duty to feed your child, would that same ethical duty apply to your neighbor’s hungry child?

5. If your answer is “yes” to feeding your neighbor’s child, what defines your neighbor? Must he or she live beside you, on the same block, in the same town, or in the same country?

6. What is the geographical cut-off for feeding a neighbor’s starving child? Does it extend to your neighboring country (Canada and Mexico)?

Let’s assume you said it is wrong to steal. If you were starving is it your ethical responsibility to first try to earn some food or ask permission to take food?

If you are refused food, is it then still wrong to steal food regardless of how hungry you are?

If you have a hungry child and no avenue for earning food and no person willing to share food, where does your ethical duty lie?

1. To your ethical belief that it is wrong to steal, or

2. To your starving child that is looking to you for nourishment?

Parents certainly have a moral duty to care for their children. Are there alternatives to stealing food? Could you give your child to foster care, for example, rather than stealing food? If you positively believed that foster care was harmful in some way, are you acting immorally to place your child in harm’s way so that he or she is fed?

What duty do you owe to your neighbor’s children? If you noticed a child from your neighboring apartment stealing another’s milk from a doorstep, should you report the theft or provide the child with food? If the child is not from your neighbor’s apartment but rather from a building across the street, does that change your moral duties? If the child is a different race than you, or speaks a different language, does that relieve you from your ethical obligation?

If you feel you have an obligation to any starving child, is that moral obligation extended to the child’s parents? If the child is hungry, it
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would be a natural conclusion that the parent is too. Where does your obligation end? Must the entire family be fed and for how long? At what point does your obligation end and theirs begin? Are you simply allowing the adults to continue in a self-defeating lifestyle by continuing to feed their family?

Would you feed a starving cat or dog that showed up at your door quicker than you would a dirty, thin man that knocked asking for food?

Most of us are lucky enough to have enough to eat, so we can say it is wrong to steal and truly believe it. It is very easy to see only what is before our eyes, never knowing “the rest of the story,” as the saying goes.

Ethics are only black-and-white when all is going well. People are most likely to feel ethical and express their values when their current lives or status are not threatened.

We are not saying it is acceptable to steal, lie, or cheat. Obviously the point of this chapter is the opposite; we advocate honesty in all viatical and financial aspects, regardless of the representative’s personal circumstances. However, we feel it is important to understand the difference between actions for personal gain and circumstances that may represent more than a simplistic right-or-wrong view.

Most people are not totally honest. While we may declare our ethical standards, and believe we are following them, we still copy a musical CD for our friend, depriving the artist of their legal commission. We feel little remorse when dodging the tax bullet. We bring home items from our employer that does not belong to us.

There are always ways to rationalize these small unethical acts. Perhaps we simply ignore the implications of these actions. I guess it could be asked: at what dollar amount does it change from “unimportant” to “important” stealing? Is taking a box of ink pens less important than embezzling money from our employer? Does it make a difference if our employer is a large insurance organization or a small brokerage or viatical firm? Is the wealth of our employer applicable to what we take without permission?
In a truly black-and-white society there would be no moral or ethical difference between the man that stole a loaf of bread to feed his hungry children and the man that robbed a bank. The concept is very black-and-white: if you don’t own it and you take it, you are stealing.

Studies have shown that 90 percent of the American population lies every day. Most probably are insignificant (“of course I like your new hairstyle”). Some lies seem to flow through our daily conversations, ranging from an attempt to fit in with the group to what we accomplished during the day. These lies do not affect others and are seldom meant to be malicious. They mostly make the teller feel better about themselves.

Conversational lying is one thing; lying to deprive another of funds, security, or lifestyle is in an entirely different category. The retiree won’t be harmed by an agent who lies about the car he or she drives, but will be harmed by a persuasive lie that causes an unwise investment.

Some of the states demonstrate their view on the need for viatical morality by requiring a business character report prior to issuing a license to work in the viatical field. A “business character report” is a statement certified by an independent third party that has conducted a comprehensive review of the individual seller’s background. They certify that the biographical information provided in the report, as completed by the applicant, has no inaccurate or conflicting information. An independent third party is one that has no affiliation with the applicant and is in the business of providing background checks and investigations for multiple companies.

Depending upon the state, the commissioner’s office may need to see all viatical settlement contracts and disclosure statements that will be used for the viatical investments. These would include those that need to be approved, but also any that were previously used or approved. A copy of the provider trust will also need to be submitted with the application.

Since viatical settlement contracts were used prior to state regulation, a report of any civil, criminal, or administration actions taken or pending against the viatical settlement provider in any state or federal court or agency, regardless of the outcome may be required
along with the application. This would include all actions in all states, not just the domicile state.

Like insurance agents, in many states viatical settlement brokers must obtain continuing education. States may not necessarily have the same education requirements, but all will have the goal of participants who understand the products they sell and an understanding of their ethical requirements while doing so. If the states adopt education requirements in the NAIC Model or the NCOIL Model, brokers must obtain 15 credit hours per licensing period.

Viatical ethics are primarily a willingness to follow the laws of the domicile state, regardless of whether or not the participant agrees with them. There are some areas of ethics that do not require agreement, but when it comes to investments, agreement is not an option. The federal and state laws rule all conduct of the participants. Because all laws must be followed, the viatical firm and their associates must be aware of their state laws (how else could they follow the requirements?).

Acceptable continuing education often means completing courses that have been approved by the state in some capacity. If acceptable to the state, a nationally recognized designation program may provide the education as long as it meets the necessary viatical criteria. In some states viatical training may also provide education for other licenses, such as the type held by insurance agents. This should not be assumed however; licensed insurance agents can check for dual credit with their state insurance department.

A person may not meet his or her viatical education requirements prior to obtaining the initial viatical settlement license in most cases. Viatical settlement brokers may not usually take the same continuing education course twice and receive the credit twice in the same CE reporting term. This is true even if the same course was taken in a classroom and again over a website. If it is the same course credit may not be utilized twice for purposes of renewing a license.

For example:

Vicki is a viatical broker. She attends a seminar that she feels is especially good. The first time she attends she receives a CE training completion certificate for her
attendance. Since the course was so good, Vicki decides to repeat it a few months later. Although the course instructor may give her a second certificate, it is unlikely that her state will give her credit for attending both seminars. States assign an education number to state approved courses. If the second course is the same as the first, the CE number will be the same both times she attended; therefore, she could turn in the certificate only once within the same licensing renewal period.

**Ethical Goals**

Everyone needs to have a goal, even viatical brokers and providers. Each of us must include an ethical goal in our lives if we are to stay on a moral path. Ethical salespeople are just as successful as the unethical so why do we hear so much about the crooks? The primary reason may be the impact the unethical provider or broker may have on those who invest in viatical contracts. It is not news when Ivana Investor does well and experiences a positive yield on her viatical settlement contract. It is news if she is the victim of fraud in the viatical process. Not only is it news, it is necessary to report the news so others do not also fall victim to the same company or investment vehicle.

At one time there was a billboard in Houston, Texas that asked: "Whatever happened to personal responsibility?" The answer is simple: each of us still has responsibility – even those who refuse to accept it. *Refusing to act responsibly does not remove the requirement.*

Viatical brokers and providers have a responsibility to the other viatical participants along with their other professional responsibilities. In fact, that may be why the reader is completing this course: it is their professional responsibility to do so. Even without federal or state requirements, however, professionals will still read product brochures, news articles, and industry magazines, striving to learn more about their chosen industry. That is part of our personal responsibility as industry professionals.
It is hard to understand how individuals can commit some of the past fraud we have seen in the viatical industry. In April 1997 four people were charged with viatical fraud. Sixteen hundred people who invested as high as $300,000 lost a combined total of $95 million dollars to Personal Choice Opportunities (PCO), based in Palm Springs, California. PCO was so convincing that even viatical brokers invested their own money, expecting up to 25 percent yields on their investments. Not a single life insurance policy was purchased. PCO invented viators and their medical history and even the insurance policies they were supposed to have purchased.

Some investors did receive returns, but most received nothing. The principal, David Laing and his partners received most of the investments. Laing used more than $30 million personally, including $10 million he spent gambling in Las Vegas.

It is not easy to recognize the legitimate company from the bogus viatical company. PCO used an escrow trust company as one would expect; they employed Escrow Plus of Burbank, CA. Unfortunately for the investors, Escrow Plus was a participant in the investor deception.

How did so many investors get caught in PCO’s Ponzi scheme? One of the company’s principals was on many radio programs promoting the viatical settlement product as an untapped investor market, so many investors probably came as a result of those appearances. PCO had a web site, which also drew investors. However, many came through referrals who believed the company was legitimate, including insurance brokers who recommended these viatical settlements to their clients. Many of the investors purchased PCO viatical settlements on the advice of their investment advisor (through First Securities USA).

Personal Choice Opportunities is not the only company that used viatical settlement investments to commit financial fraud. The Securities and Exchange Commission charged Mutual Benefits Corporation (MBC) from Florida with fraud. Considered one of the largest viatical companies, they agreed to settle the charges without having to either admit or deny the charges. They were charged with selling unregistered securities and misrepresentation.
Not all companies committed fraud, but they still experienced loss of investor funds. Dignity Partners, considered a leading viatical company, was well respected in the industry and the first viatical funding firm listed on the stock market.\(^1\)

Just a month after they went public the Vancouver AIDS Conference was held, announcing the trial runs of a new 3-drug combination that included protease inhibitors. The drugs were able to wipe out detectable levels of the HIV virus in AIDS patients. This was the first therapy that had the potential to improve life and lengthen the life spans of AIDS victims. At that time, AIDS was considered a death sentence.

Individuals with AIDS comprised 95 percent of Dignity Partners insurance portfolio. The company stock price dropped by 31 percent almost immediately. Within a few months, their stock was down 77 percent. Although they suspended additional purchases, within a year the company folded. A class action lawsuit followed on the charge that Dignity Partners violated federal securities laws. The lawsuit also claimed the company had knowledge of protease inhibitors but failed to take them into consideration. Whether this amounted to negligence or simply short-sightedness, underwriting is a major responsibility of viatical providers. Of course, the class action lawsuit was much more complicated than we will take the time to cover, but it demonstrates an important point: viatical settlements contain investor risk.

Viatical firms also face risk: viator fraud. In this case individuals purchase life insurance by making false applications. They omit known information and may even have an imposter pose as them for any required medical examinations. If the insured dies after the incontestability clause, the insurer may take the case to court, but there is no guarantee the insurance company will win, since it is generally felt insurers have an obligation to pay past the incontestability clause. It may, however, delay payment to investors, sometimes for years. Today most insurance companies require the applicant to show photo proof of identity when taking medical tests for the purpose of obtaining life insurance.

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\(^1\) Viatical Settlements by Gloria Grening Wolk, M.S.W.
Unfortunately insurance agents have also promoted viatical fraud. Obviously no amount of ethic training will change how these agents do business. In the early days of viatical settlements many agents helped AIDS victims obtain life insurance policies for the purpose of selling the contracts to viatical firms. This defrauded the viatical firms and their investors.

Anyone who works in the viatical field has an obligation to understand it inside and out. Of course this is true for many industries but it becomes especially important when mistakes, even if unintentional, can cost the investor thousands of dollars in lost funds.

Obligation is really just another word for accountability. This can include many things but education is certainly at the top of the list. Any person who does not fully understand the viatical settlements he or she is representing has the potential to financially harm others.

Accountability can be a trickle down effect. If the company owner or manager is accountable, his or her employees are much more likely to be as well. If the viatical firm is misrepresenting any aspect of the viatical process to their sales staff, this misrepresentation will be carried on to the viatical investors. Only a well educated representative will be able to protect themselves from the misrepresentation, even if unintentional, of the viatical company.

Being fully informed is a personal responsibility. The person who understands his or her viatical industry is more likely to stay well informed and ask the necessary questions. Just asking the questions may not be enough however. When the answers do not seem correct or adequate, the responsible representative must step away, even if it means giving up income. In severe cases, he or she may even have an obligation to notify the proper authorities of possible industry improprieties.

**Promoting Ethical Activity**

Everyone says they want our society to be ethical, protecting those who are unable to protect themselves. It would be best if each viatical participant behaved ethically without legislation, but the past has shown this to be unlikely. There will always be some who value
money more than ethical conduct. There will always be some who let
greed overtake their values.

It may be impossible to legislate ethical values, but they can legislate
how certain industries conduct business. Conduct may not be
legislated under the title of ethics, but consumer laws are one way the
federal and state governments attempt to ensure ethical activity.
Governments have no way to instill ethics in viatical participants; their
only available course of action is consumer legislation aimed at
promoting ethical business practices. There will always be some
individuals who ignore the intent of the law, and there will always be
federal and state officials who prosecute the offenders. The majority
of viatical participants will follow the laws, so in this way ethical
conduct is primarily maintained.

In the long run, it pays financially as well as personally to be ethical.
Those who plan to stay in the viatical field will do better financially
when they are ethical. The unethical individual may do better
financially for a short period of time, but eventually they must either
move on to another industry or risk discovery and resulting legal
problems.

For many people, being ethical is important personally; it is a matter
of pride. Our actions are a reflection of who we are as a parent and as
a member of the community; we want to be proud of the choices we
have made. Each person will have their individual reasons for their
own code of ethics. It is not possible to sit on the fence when it comes
to ethical behavior; either you are ethical or not – there’s no in-
between. Your actions will also define who you are to your friends and
business associates.

**Following the Law**

From a purely practical standpoint, each viatical representative must
know and follow their state’s laws. Many states are implementing
specific educational requirements in an attempt to dispel the old “I
didn’t know” response when caught disobeying the law. Many states
include in their viatical education requirements a chapter like this one
on ethical conduct. While it is hard to believe an individual does not
know it is illegal to cheat another, having formal education requirements puts personal responsibility on each viatical participant.

**Ethics in the Workplace**

Regardless of our occupation, each of us faces ethical issues every day. When any given profession deals with a commission base, this seems to be especially true. Ethics could be talked to death and frankly, talk is not worth much. It is actions that really tell the true story. The bottom line is fairly simple when it concerns industry ethics: each individual is responsible for understanding what is acceptable and following applicable laws. Additionally there should be a strong “do no consumer harm” philosophy.

**Consider the definition of ethics:**

eth'ics (eth'iks) n. pl. (1) the principles of honor and morality. (2) accepted rules of conduct. (3) the moral principles of an individual. - eth'ic, adj. pertinent to morals.

*The New American Webster Dictionary*

**Ethics: the principles of honor and morality.** That seems like a fairly simple statement, but what does it mean to a viatical representative? It certainly means being honest in all viatical transactions.

**Ethics: accepted rules of conduct.** Rules of conduct apply to following all federal and state viatical laws. From an ethical standpoint, this would mean knowing what those laws are, since that is the only way to be sure conduct is proper.

**Ethics: the moral principles of an individual.** Each person establishes their own set of values or moral principles. These ethics determine and define who we are as individuals.

**It Is Always Wrong**

The study of ethics is complex with many philosophies by many brilliant men and women who have studied human nature. It is the abstract view of what is right and wrong with few absolutes and many
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varied definitions. We can simplify it when it comes to finances however:

1. It is always wrong to deceive another into investing without first providing full disclosure of the risks involved.

2. It is always wrong even if you think you will lie “only this time” or deceive another “only once.” Even if you perform ethically a thousand times, one lie, one deception is still unethical.

3. It is always wrong to take any action that is prohibited by federal or state law.

4. It is always wrong to lie about or knowingly misrepresent a financial product or service.

5. It is always wrong to purposely omit pertinent information regarding the product or investment.

6. It is always wrong to consider one’s personal gain over the potential loss another might experience.

The Same by Any Other Name

Ethics may sometimes be referred to as values. It may also be referred to as morality. It really does not matter what label we give it because the term is merely a word. What matters is how we make our decisions, how we respond to others, and how we view ourselves and our lives. Regardless of whether our ethics are stated or implied, they are always present. The decisions that are made, with or without ethical considerations, have profound effects on our own lives and those of others.

Businesses do, of course, base many of their decisions on financial aspects. What will bring a profit? How can costs be cut? How can taxation be minimized?

There are always many aspects to a business and we often assume that a business is neither moral nor immoral. After all, the goal is profits. Companies do, however, have a moral or ethical responsibility to their employees, community, and even to itself. Many companies
have demonstrated they can make large profits while operating ethically. Being ethical does not automatically reduce profits.

A background of ethics or values form the foundation of the decisions made. A company trying to minimize taxation may not think they are considering ethical issues, but ethics will be part of the final conclusion. If the company faithfully follows all lawful procedures while minimizing taxes that is an ethical decision. If the company makes misrepresentations to minimize tax payments, that is also an ethical decision. It just isn’t labeled as such by the company.

Because values become an integrated part of both personal lives and business conduct, individuals are often unaware that decisions are made with an ethical context. A person who has formed an ethical core in early life will continue to make the majority of his or her decisions based on that early training (even if he or she is unaware of it).

For example, a salesperson that formed their early sales presentation on the basis of honesty and ethical conduct will, over the months and years, make a habit of saying their presentation in a certain manner. Court cases have been won and lost on this concept of "repetitive actions." As time goes by, this sales presentation becomes a "habit" with little variation. Eventually, the salesperson may well forget how the original presentation was formed, but if ethics played a part in the original presentation, ethics will continue to play a part as time passes.

The same may be said of driving a car, riding a bicycle, and other daily habits that were initially "learned behavior" but become "reflex behavior."

Ethics began as society's code of unwritten rules. From the time humans began living together, such codes of unwritten rules were necessary simply to survive. Survival could not continue if the strong (typically males) took everything, including food and shelter, from those who were weaker. The weaker individuals were likely to be women and children. If women and children did not survive, the species could not have survived either. These rules established the way in which others were to be treated for the benefit of all.
For centuries, societies have argued over what is ethical or moral. It was during the fifth century B.C. in Greece that the philosopher Socrates gave ethics its formal beginning. The word ethics comes from the Greek word ethos, which means "character."

Each country will have ethics that are unique to its people and ethics that are common everywhere. In America, we have many variances in what is believed to be ethical because we have a varied population with varied backgrounds. Our laws require each individual to conform to the laws of our country, even if they differ from their country of origin.

Our Past Continues into our Future

Every individual is a product of their past. Each of us has been affected in some way by our past. Even when society changes rapidly, current attitudes are formed from past experiences. Whether how we live today is a reflection of what we enjoyed or liked in the past or a rejection of what occurred in the past, we are still affected by it. Perhaps it is impossible to understand current ethical considerations without having some understanding of the past and how it brought us to this point.

Our values, our thinking, and our actions are often directly related to the availability of education in America. Societies that wish to restrict the freedoms of others nearly always limit their access to education. Individuals who do not have education available to them are less likely to understand their rights and therefore assert their rights.

Higher levels of education naturally lend themselves to questioning. It is probably this questioning that has brought about much of the beneficial change in America. If certain groups had not questioned the use of child labor in factories, a women’s right to cast her political vote, or a minority’s right to receive their education in any school building, change would never occur.

Ethics always plays a role in major change. When morally educated people recognized children had personal rights, they questioned use of children in factories. The factory owners insisted it was good for the family’s financial standing to work their children. Ironically, the
families involved did not seem to oppose the use of their children as laborers in dangerous, depressing conditions; in fact, the parents often toiled beside their children. Rather it was other groups, such as religious organizations, that recognized how the children were exploited that brought about new child labor laws.

Education often evolves into questioning of why certain things are believed or done. Child labor was used because it was cheap; they received very little pay. Therefore, the products they produced were less expensive to buy.

It was not just education that prompted many to view the cheap labor as wrong; it was the moral view that children should not be economically exploited. The factories gave little value to the quality of the children’s lives while working. Conditions were deplorable and many children were injured in industrial accidents.

In the sixties, two major movements swept America: civil rights and antiwar sentiments. Though primarily led by our youth, the movements were backed by the majority of our mainline churches and other organized groups.

Who can forget the images we saw of Martin Luther King, groups of protesters, and the numerous conflicting views brought into our lives. For many people, this meant a new look at what we must perceive as right or wrong. There were many who disagreed with the anti-war groups, thinking they must be against America if they voiced their disagreement with her global or national policies. In fact, disagreement is what is generally needed to bring about major social changes; disagreement is not America’s enemy – it is apathy. When Americans care too little or are indifferent to what is going on around them, greed and exploitation of the weak will follow.

Much of the issues that America and her citizens have wrestled with are basically related to one issue: what is the right thing to do? Current economic issues have meant new challenges but the ethical issues do not change, although perceptions of ethical issues may. We must choose the right path independent of personal gain if we are to be moral beings.
Individuals may not have the answers to the big problems, but we are often a mirror of what is going on in our neighborhoods. If, as individuals, we are surrounded by people who are primarily concerned with themselves, it is likely that we will have that same attitude. If the company we work for stresses only production without any other input, we could lose sight of the role ethics must play in our jobs. When ethical behavior is not deemed important by our management and immediate peers, it is not surprising that problems eventually materialize.

It could be said that ethics are a recipe for living. Our code of ethics gives each of us our personal rules and values, which determines the choices we make each day of our lives. These choices affect not only ourselves, but everyone around us. Some types of ethics tell us what not to do (it is wrong to steal). Others tell us what we ought to do (be kind to animals). In addition, there are those ethics or morals that actually take us beyond the basics of moral obligations. Mary Mahowald, a medical ethicist at the University of Chicago, calls this added ethical stand virtues. Virtues might be referred to as going beyond the call of duty. It may also be referred to as moral excellence. Such moral excellence would include those who have no legal or moral duty to another, but go to extremes to help them anyway. It refers to the person who gives their life during a crisis so a stranger might live or goes to other countries to help people they do not know. Virtue is going beyond what we are ethically obligated to do.

Why do some people seem to have such a deep feeling of morality while others struggle with their personal actions? There are probably no answers to that question, but it would seem probable that ethical feelings were established in childhood by caring parents and other family members or by unusual circumstances, such as experiencing how another feels during illness or hardship.

In today's lawsuit prone society, the wise viatical firm or viatical representative will make a point of following state regulations, but ethics actually goes beyond what is simply mandated by state or federal governments. Ethics define us as individuals. A man who tells constant lies is known to others as a "liar" (although studies show that 90 percent of us lie regularly). A man who steals is known to others
as a "thief". A viatical representative who is unethical will also earn a reputation for such.

It has been said that legal authorities may be able to mandate behavior, but not ethics. While this may be correct, behavior can be modified by required procedures. A person who would like to steal may not do so because required procedures make theft more difficult. Therefore, his behavior is controlled, but his ethics are not. Although he does not steal, he would still like to.

The states hope mandated behavior will eventually lead the individual to an understanding of ethical behavior and learn to follow an ethical path. It is not unusual for an individual to become the person they pretend to be. A person who acts ethically, even if they do not desire to be, may eventually soak in the ethical behavior and adopt some of that potential. In fact, since morality is about the way we live, we do learn it over our entire lifetime. To think that a person who is not ethical today will never be ethical is simply wrong. In fact, it could go the other way as well. The person who is behaving ethically today may not do so tomorrow.

It seems to be a popular notion that toughness is needed in the business world. Ethics may be perceived as a quality that does not belong with toughness. This is actually far from the truth. As many religions will be quick to confirm, toughness is often a vital part of ethical behavior. Children are the first to realize this. Peer pressure often demeans behavior that is ethical. Certainly the child that can withstand the stress of peer pressure is displaying toughness.

Toughness may be necessary to succeed in business. The viatical salesperson that cannot take repeated rejection will not likely stay with the industry; at least not as a salesperson. Toughness that is coupled with a code of high ethics may not always experience smooth sailing, but it is likely that the combination will produce an atmosphere that promotes the amount of business desired. Toughness with ethics gives a passion for productivity and efficiency, along with the spirit of competition, all of which contributes to the traditional measures of economic success.

America was founded on the beliefs of many people who questioned the actions of the countries they came from. Those looking for
freedom, religion, the right to work, the right to own possessions and land, and the right to make their own decisions all came together to form America. These were tough individuals out of necessity.

It is doubtful that any person is only good or bad. We continue to learn as new ideas are presented and new experiences encountered. Unfortunately, if we have been poorly educated on ethical conduct, we might be faced not only with learning the basics of ethical behavior, but unlearning bad conduct as well. We typically refer to our ethical code as our conscience, saying such things as “he has no conscience.” What we are really saying is that the person has no ethical code or that his code of conduct is opposite from ours.

This brings up another issue. Of course each of us believes our code of ethics is the correct one. Branding another as unethical is sometimes merely a disagreement as to what is right and wrong. Ethics are based on personal perceptions, not on scientific fact.

There is little doubt that each of us is influenced by others. Even so, for each path chosen, we alone must take responsibility (again, it comes to personal accountability). Each of us has the ability to build, change, or destroy our own character. Part of our character is, of course, our ethical guidelines.

It should be noted that no single act defines our personal character. Each of us has likely participated in an act that was wrong (and we knew it at the time). That one action does not define our total character just as one kind act does not build our entire character. Character is more a matter of adding and subtracting our actions and thoughts. A good person can do something unkind, yet still be a good person. A person who normally behaves badly can do something kind for another and yet remain basically an immoral person. We refer to these isolated deeds as being "out of character." An action that is not consistent with one's normal behavior is not likely to form or change the character of a person (although that single action can affect another in either a positive or negative fashion).
Companies Set Guidelines

No business can exist without establishing guidelines. Most businesses have guidelines for multiple aspects, such as financial forecasts, company operations, office procedures, sales procedures and employee conduct. Many company procedures also include a code of ethics, which should be a written code for maximum effect. Every business tells their employees what actions are right and wrong by printed ethics but also by what is tolerated. It may be as simple as stating that overtime will not be paid unless properly authorized, or it may be as complex as a manager who turns his head when an unethical act is openly performed.

Ethical decisions are made everyday in the workplace. These decisions will affect the quality of work performed, employment opportunities, safety of workers and products, advertising, and simple day-to-day operations.

It is encouraging to note that businesses across our nation are responding to ethics and community values. Most large corporations in the United States now have a written code of ethics. This trend is growing. Additionally, speeches of chief executive officers and annual reports are containing talk of ethical needs and approaches in business. Whether this is window dressing for the public or a real move to business values may be debated, but certainly the knowledge of ethical actions exists.

Some of the open talk of ethics in business has to do with money; companies have been sued over negligent actions with increasing court awards. Companies can no longer afford financially to ignore ethical issues. Insurers now underwrite more carefully, using methods to ensure the proper person is providing medical requirements for life insurance applications. Viatical firms are now monitored through state requirements.

A business owner must be aware that without ethical employees, the only restraint is the law. Without ethics, any business transaction that was not witnessed and recorded could not be trusted. This would certainly cripple a business if employees could not be trusted. On the other hand, when employees cannot trust their employer to be fair, problems can also develop. Those who own and manage the business
must demonstrate ethics, fair play, and community involvement to financially protect themselves and their company.

We seem to expect unethical behavior in some areas, such as the government, which is probably the first step in allowing it to continue. If we believe it can’t be changed, then it won’t be changed. If we accept inept or dishonest conduct in our government, we are condoning it. We have seen multiple cases of government representatives that were voted in again despite proven illegal (and certainly unethical) conduct. What message does that send? It says we will overlook their actions, so they are free to continue.

Government fraud is usually called public corruption and it is becoming an accepted part of life by too many people. Common types of government fraud include awarding contracts to workers who offer bribes or provide political favors of some sort, voter fraud issues, embezzlement, subsidy fraud, and accepting illegal kickbacks.

Of course we are all aware of the failings of the banking and mortgage industry. The subprime lending crisis and resulting credit crunch resulted in significant losses and many lawsuits involving the mortgage lending and securitization process. There were civil lawsuits, criminal and regulatory investigations, government efforts to correct the impact of the subprime crisis and credit crunch, and litigation and regulatory actions relating to the collapse of the auction rate securities market. Taxpayers will be covering the numerous bailouts for decades. Our children and grandchildren are likely to experience a lower quality of life due to the taxes that will be required to correct the mistakes of our generation.

The inspection of Wachovia Securities caught many of us by surprise, perhaps even Wachovia Securities. Securities regulators from six states began an inspection on July 17, 2008 as part of a probe into the company’s sales of auction rate debt. The inspection was triggered by their failure to comply fully with information requests from Missouri securities regulators.

Massachusetts sued Merrill Lynch over auction rate securities. The state alleged Merrill Lynch was committing fraud by pushing the sale of auction rate securities, knowing that the auction market was unstable.
Many people lost their homes due to a collapsing housing market. Of course, some of the problems came not from fraud or shady practices but from over-eager buyers and mortgage lenders who turned a blind eye to their own accountability (there’s that word again!). As we know, a mortgage is a loan made against real property with the intent of repayment as agreed by the borrower, under an amortization schedule until it reaches maturity. This would normally have been interrupted only by significant life events such as moving, unemployment leading to bankruptcy, divorce, or serious medical events.

Mortgages were successfully handled by banks and lending institutions for many years using sound lending practices. Underwriting requirements ensured the lending institutions that their borrowers had the financial means to meet the repayment agreements. All the elements that could cause repayment failure, such as bankruptcy, or serious life changing events were known by the actuaries that underwrote the loans, so risk factors were easily analyzed.

Consumers understood the concept that they were “sold” the house, but they did not consider the mortgage itself as being “sold” to them. Rather borrowers sought out the lending institution and made a loan application. That changed. Advertisements came in full force on television, radio and print. These advertisements promised that anyone could get a home mortgage regardless of many previously unlendable situations. Both banks and non-banks saw an opportunity and all seemed to want their chunk of the business.

Why did lending companies want to extend credit to those surely doomed to repayment failure? Because they were lending on the premise that the majority of these loans would be refinanced or the debt would be sold. Consumers often fail to realize that “debt” is a commodity that has value in the financial markets. Consequently, the following “concepts” were accepted by even normally sound lending institutions:

1. Down payments, signifying the ability to save and plan for the future, were no longer required. Many lending institutions would lend 100% of the home value.
2. Lending institutions made the assumption that few, if any, of the borrowers planned to keep the loan to maturity. In other words, they would either refinance or sell the home prior to the loan being fully paid off. If the borrowers refinanced their loan, it was likely to be with the same lending institutions. Borrowers were encouraged to utilize loans they might not otherwise have used, such as interest only loans. This allowed borrowers to buy more expensive homes than they would have ordinarily qualified for.

3. Borrowers were qualified based on the amount of the initial house payment – not the total loan amount. Therefore, banks and other lending institutions knew the borrower’s would be forced to refinance in many cases because they could not afford the increasing cost of their house payment. Initial “teaser rates” went up over time, causing often dramatic increases in monthly home mortgage payments.

4. Finally, many lending institutions did not qualify the borrowers to the extent that had always been done in the past. Some were jokingly saying that the borrower’s pulse was good enough. In effect, some loans simply took the borrower’s word that he or she could afford even the initial house payment. Many of them could not even afford that initial low rate, but the lending companies did not care. It was a matter of getting their initial commission and moving the debt along to the next company.

These loans were not based on the home’s equity because no down payment was required in many cases and loan amounts were therefore on the full value of the home. Of course, many expected the rising housing market values to continue to rise despite signs that it was getting ready to cap. In fact, people bought second and third homes on the premise that they would be sold within two years for profit based entirely on rising home values.

Many of us thought these were new ideas that just didn’t work, but that is not the case. In the 1920’s similar lending practices were used and had basically the same results in the 1930’s when the housing market dropped. Although consumers may have thought these were new practices, responsible lending institutions were well aware of what happened in the 1930’s. Because it was common knowledge in lending circles, it was difficult to sell mortgage-backed securities based
on ballooning rates without an extra yield premium, so some lenders simply lied.

Of course, not all lenders were unethical. Many lenders continued to work with sound lending practices, including some who were successfully lending to those with even low credit scores. They continued to require down payments and verifiable incomes that were likely to continue into the future (meaning they had stable jobs).

One might ask how this could happen since it was already experienced in the 1930’s. Didn’t the government correct the possibility that it could happen again? Actually, yes they did but the law was ignored. Title 12, Sec. 1831o mandates banking regulators take prompt corrective action regarding any troubled bank. The law mandates specific actions well before the bank faces failure. It further states that a troubled bank must “restrain senior executive compensation” meaning no bonuses or raises. Obviously this law was successfully ignored not only by the banks, but the regulators as well.

Unethical practices in the housing industry were ignored. Writer Robert Peston² wrote regarding Wall Street: “The underlying cause of the current global financial crisis is a system in which there’s little personal responsibility for lending decisions.” Responsibility is more than a word; it is a necessity in the financial fields.

In the case of the home loan problems, much of the driving power came from commissions for issuing home loans. Many of those issuers did not work for the banking and lending institutions, but rather were paid on the volume of mortgages they arranged. The incentive became production rather than quality. Rather like the insurance broker who wants insurance applications, not necessarily qualified applicants.

Have you ever wondered where all these bad loans end up? The paperwork and administration duties are handled by specialist companies, some of which have gone into bankruptcy protection. The debt itself ends up on Wall Street with such banks as Goldman Sachs, Morgan Stanley, Merrill Lynch and others who take the debt and process it into asset-backed securities or bonds. The banks

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² 8/20/08 Corporation Watch
themselves may have no connection to the actual creation of the debt; they merely handle it once it is there. They do not know if the debt is secure or not (if it will be paid as required or default). Debt is a commodity that is bought and sold without regard to those owing the debt. The banks do have historic data but due to the types of loans that were being generated such historic data may be worthless in determining risk.

The companies will assess the risk value of the bond or security based on the data on hand, so accurate verification of the risk may not be possible. For a fee, special credit rating agencies, such as Standard & Poor or Moody’s will verify what they believe to be the correct risk rating, but unless they have better data such a rating is obviously flawed. As a result many of the bonds and securities have received inaccurate ratings so those who invest in them are receiving flawed investment advice from those who sell them. Data may eventually emerge allowing a more accurate prediction of the risk involved for investors, but by then it will be too late for many people.

Unfortunately for investors, not all involved have done their best to provide accurate risk assessment. Since many investors do not want any part of the mortgage industry, some have become creative when marketing these bonds. Sometimes they have been mixed with other bonds in collateralized debt obligations to hide the risk involved. As the mix becomes more muddled, additional investors (believing they are avoiding mortgage debt) will actually be purchasing in part the very thing they are trying to avoid. Some have branded mortgage debt “toxic waste.” As a result of these “mix and measure” bonds, many large investors are simply avoiding bonds entirely. The mixed bonds have been sold worldwide so it is actually affecting global finances to some degree.

It is not only American institutions that have performed shamefully; this has been a global financial issue in one form or another. It is not something that the general investor is going to unravel.

A survey conducted some years ago by Business Week magazine stated that 59 to 70 percent of managers feel pressured to compromise personal ethical views in order to achieve corporate goals. This perception of pressure seemed to be especially high among lower level managers. On the positive side, 90 percent of the managers said
they would support a code of ethics in their business place and the teaching of ethics in business schools.

Even a normally ethical individual can be influenced by unethical pressure from others, especially upper management. In today's economic climate, individuals often feel they would be unable to survive financially if they lost their job. As a result, he or she may be willing to participate in an activity once hired that they would not have participated in prior to being hired.

It is interesting that the FBI shifted agents from terrorism activities to work on Wall Street investigations, including one into the fraud of Bernard Madoff. Apparently we have decided that the threat to our society is higher from the financial sector than it is from the more physical terrorists.³

Laboratory research has shown unethical behavior rises as the industry or climate becomes more competitive. Perhaps that is why some companies push competitive contests and look the other way when activities seem to compromise ethical behavior. These studies further indicated that when unethical behavior is rewarded (as with prizes or additional commissions) it further erodes ethical standards. On the other hand, the same studies noted that when unethical behavior was punished, unethical behavior was deterred.

Those who study the rise and fall of ethical behaviors have made some observations: it is necessary, to preserve ethical behavior, to require:

1. A sensitive and informed conscience;
2. The ability to make ethical judgments individually; and
3. A corporate climate that rewards ethical behavior and punishes unethical behavior.

Most ethicists believe that the more complex our society becomes, the more we need to teach ethics to the general population. In the past, ethical behavior was primarily taught to children by their parents and churches. As families became more complex and spread out, ethical teachings seemed to diminish. Some studies have suggested

³ Business Today; December 21, 2008
that the loss of grandparent interaction is partly responsible for the loss of ethical teachings.

There are probably multiple factors causing the perceived decline in ethical behavior. For example, when people interact face-to-face with others, there is less temptation to be dishonest. When we do not see or know the person we are dealing with, dishonest activity becomes easier. It is simply easier to cheat an individual we do not personally know. If that is true, then our increased use of the internet and other non-contact activities might cause further decline in our ethical code.

Example:
Scenario #1: Betsy finds a large sum of money on the bus. There is no obvious person who left it behind. The honest thing, of course, is to turn the money in so the owner can be found, but statistically Betsy is likely to keep it.

Scenario #2: Betsy finds a large sum of money on the bus on the seat an elderly woman had been occupying. Betsy had briefly chatted with her and learned she was on the way to see her new great grandchild. Having had a personal connection with the possible owner of the cash, statistically Betsy is more likely to turn the money in to authorities.

Promoting Ethical Behavior

Ethics is not entirely about oneself; it is also about others. It is not so much what one knows that makes an individual ethical, but rather what he or she understands. We all know it is wrong to steal, but understanding how stealing harms others is more likely to promote ethical activity.

Making ethical decisions addresses four basic issues:

1. Is it possible to teach others ethical behavior?
2. What is the scope of ethics?
3. What does it take to be a moral person?
4. What are a person's responsibilities to other moral persons?
There is no doubt that each of us, regardless of our occupation, faces ethical issues on a daily basis. Those in an occupation with a public interest are especially faced with ethical issues and probably legal consequences.

Ethics are standards to which agents and brokers must aspire to; it is accepting the ethical commitment owed to each investor. Each type of profession has an informal code of ethics, which may sometimes be more understood than written. Ethics are a means of creating standards within any given profession to upgrade it and give it honor. It is a means of measuring performance and acknowledging outstanding individuals. Ethics are often a means of providing priorities and building traditions based on integrity.

It would be hard to imagine doing business with anyone that we knew to be unethical. Can you imagine turning over control of your financial affairs to an attorney convicted of stealing from his other clients? Would you buy a car from a person who had knowingly lied to others about the cars he represented? Would you deal with an insurance agent who had repeatedly misrepresented the products he or she sold? Ethics are the only element, other than legal mandates, that add an element of trust to many industries. It is very difficult to mandate ethics. Only behavior, as we previously stated, may actually be mandated. If a person is ethical, that is something within themselves that simply adds to their trustworthiness.

No matter what our profession may be, as individuals, each of us faces ethical issues each day. Some are very simplistic in nature while others are complex and may have many sides (and many correct answers) to them. We face moral issues every day. Such questions as: How much should I give to the poor? Is it wrong for me to take drugs? Should I report someone who is cheating? are daily concerns.

Some types of ethical or moral questions can be directed to our religious institutions for support in determining the right answer. Sometimes the answers can be found in our legal system. If our state or federal government says commingling investor funds with our own is illegal, for example, then we could also state that it must be unethical as well. Sometimes, determining what is ethical is simply a matter of what feels right emotionally. We have all said or heard someone else say "it just doesn't feel right." That feeling of right and
wrong is probably the result of our childhood upbringing. Even if we do not distinctly remember being taught that a particular action is either right or wrong, somewhere in our upbringing or past experiences, we have received such teachings.

While this chapter cannot instill ethics into anyone who has none, it may provide the tools for determining the more complex issues. By using basic concepts and theories and by having an appreciation of what constitutes an ethical solution, decisions may be made on the basis of reason.

It should be noted that different conclusions may be reached to the same ethical question. It does not mean that one solution is right and another wrong. Ethical questions often have multiple answers, all of which may be correct. Many ethical questions involve multiple hues; some decisions may be based solely on facts, while others may be based less on facts and more on emotional factors (or what simply feels right).

Business leaders often question whether ethics may be taught in the workplace. This, of course, depends upon multiple factors. First of all, does the employee desire to be ethical? As with all things, the person must want to achieve the goal at hand. If other goals are more important to the individual, then it will perhaps not be possible to teach ethical behavior. If however, ethical behavior is important to the individual, even if other goals are also sought, ethics may be taught. Unfortunately, those who are faced with the responsibility of hiring personnel can seldom determine the individual's ethical attitude.

A general requirement of ethics is a willingness to take into account the interests, desires and needs of others. One could argue that it is necessary to look out for one's own interests, desires and needs. While this is certainly true to a point (we must cloth, feed and house ourselves and our families), taking our own interests into account need not mean making unethical or immoral decisions regarding others. Even commissioned salespeople are able to make a very good living while still maintaining ethical behavior. In fact, the best salespeople do not need to behave unethically because they have mastered their trade through the development of communication skills and professional training.
When a child asks his or her parent: "Why do I have to share my toys?" the reply may be "Because if you don't share your toys with your sister, she will not share her toys with you." This simple logical answer teaches the child a valuable lesson. Our interests are tied to the interests of others. Just as our ancestors had to protect one another to survive, we must treat each other ethically so society and all that involves can survive. For example, if only those who wanted to pay taxes did so we would not have free schools, decent roads and bridges, emergency services, libraries, and many other luxuries that exist solely due to the taxes we pay.

Every aspect of our society is built on the premise that it must be ethically run for the good of those who cannot adequately protect themselves. Our laws protect the weak, the less educated, and the unusual from others. We know the system is not perfect; there will always be those who cheat, lie, and steal. There will always be those who kill others, those who harm their own family members, and those who cannot look beyond their own self interests. Even so, our society runs pretty well as long as we are constantly vigilant about enforcing ethical behavior. When we fail to act ethically there are unfortunate consequences, as seen in the housing and loan markets.

Just as the man who is known as a liar or a thief will find others unwilling to trust him or her, the business man or woman who is not ethical will, at some point, find making a living difficult because clients do not wish to deal with him or her. We are better able to achieve our goals when we recognize the goals and interests of others. Plato argued that immorality (unethical behavior) is ultimately self-defeating. While the con artist may not believe this and some unethical people do seem to prove the point, most people believe that, at some point in time, each person must deal with their past behavior. The Bible says we will reap what we sow. Even if we do not get back what we give others (whether that be good or bad), most people would agree that it is easier to be happy with ourselves when we feel we have done the right thing.

**Egoism**

Not everyone believes it is in their own self-interest to behave ethically. Some who reject the idea of other's interests and desires
are called **egoists**. Do not confuse this with egotism. An egotist is a person who is self-absorbed. These people make poor egoists. Webster's dictionary defines **egoism** as the doctrine that self-interest is the basis of all behavior whereas **egotism** is the habit of being too self-absorbed, talking too much about oneself or conceit.

Psychological egoism maintains that people are always motivated to act in their own perceived best interest. Psychological egoism is not an ethical theory since it does not tell people outright how to behave. Rather it attempts to explain why people behave in certain ways. Even so, ethical theorists consider this theory since it does have a bearing on their theories of ethical behavior.

Another version of egoism is a genuine ethical theory. Traditionally named "ethical egoism," it maintains that people **ought** to act in their perceived best interest. An ethical egoist argues that people should act in their best interest at all times because it is good for the general economy (providing industry and jobs, for instance). In the case of viatical investing, an honest viatical firm is helping others while also profiting because the viator benefits from the cash he or she receives from selling their life insurance policy and the investor benefits from their yields at contract maturity. Therefore, the viatical firm, while acting in their own best interest to earn profits, also benefits the other viatical parties.

In the marketplace we all try to buy low and sell high. That is certainly an attempt to pursue our own self-interest. It is unlikely that the buyer worries about the seller when buying low, nor does the seller worry about the buyer when selling high. Individual self interest is at work. Even though this may be an excellent example of ethical egoism, it tends to be both orderly and productive to our society. Therefore this theory has positive dimensions to it despite what could be termed a selfish basis.

A political economist, Adam Smith, believed in ethical egoism. He felt that people, while being interested in their own needs and desires, created good for society as a whole. Smith felt that economic conditions were created and expanded when people acted in their own behalf.
If we were to fully believe in psychological egoism, which states that humans automatically act in their own behalf, many of the acts of heroism that we see could not be explained. There are countless heroic acts that are clearly not in the hero’s best interest; in fact, some of these heroes die or are severely injured as a result of their desire to help others.

There is more day-to-day heroism than one might realize. Such simple things as the child who shares his lunch with another student, the woman who gives her last dollars to a homeless person or the man who donates his only day off for a food drive are all acts of kindness that consider the needs and desires of others above their own interests.

**Is it possible to teach ethical behavior to others?**

Many people feel it is possible to teach another to act ethically, though certainly not in every situation. A person who has never considered ethical behavior might suddenly begin to do so if the company where he or she works begins a strong ethics campaign. On the other hand, a person might continue to act unethically regardless of any threats of retribution. One thing is certain: the effort must be made to emphasize ethical behavior because there will always be those who will respond favorably.

**What is the scope of ethics?**

Ethics is not a simple subject, since *perception* determines ethics. In many industries, including the viatical and insurance industry, the professionals have knowledge that the general population does not have. As a result, those individuals who seek out the professionals must rely upon their honesty and integrity. A feeling of ethical standards must exist. It was the potential for abuse of power that provided a set of rules for what is commonly called "ethical behavior." Sometimes, ethics are written standards, which may be mandated by law on either a state or federal level. The premise, upon which practical ethics must be based, is that power must be exercised in the interest of the viators and investors who seek the professionals out and may not be exercised solely in the best interest of the professionals themselves.
Early viatical history gave these investments a bad name. To this day, many agents and potential investors avoid the viatical industry based solely on the reputation they gained in the 1980’s and 1990’s. It will take years for viatical settlements to gain a positive image; it will only happen when an ethical track record can be seen by investors and state regulating authorities. Even insurance companies are leery of viatical settlements and viatical companies since the viatical industry seems to encourage terminally ill people to seek out policies under fraudulent circumstances.

People and cultures do not always agree on what is ethical. What one culture or society may consider ethical another may not. Even within the same culture or society, people may disagree on what is and is not ethical. America has seen many instances of ethical disagreement; currently there is disagreement on such issues as abortion and giving gay partners the same status as straight partners (specifically, the right to marry and have it legally recognized for employment benefits).

Every person probably has some degree of greed or selfishness within them. The ethical person realizes this possibility. Since ethics is a code of values to guide man's choices and actions, the ethical person will bypass their own greed and do what is perceived as best for the majority of people or best for the person they are dealing with. In choosing his or her actions and goals, constant alternatives are faced. It is not always easy to decide which choice is best and ethical. Without a standard of values, ethical choices would be very hard to make. At some level, our religious background may set the standard of values by which we make our choices. However we arrive at it, understanding how others feel determines many of our ethical decisions.

**What does it take to be a moral person?**

Most people know right from wrong. While what is right may not always be agreed upon, as long as the person acts according to what they perceive to be right, they are acting ethically. Most of us are not involved in the global ethical questions; our ethical issues involve family and profession. Most of us deal with the simple things in life – earning an honest living, paying taxes, supporting our families, giving to our churches, helping our elderly parents, and all the other aspects
of daily life. Our quest for ethical guidelines is fairly simple. We don’t have to address the issues on Wall Street or achieve world peace.

The ethical person believes in doing what is right. He or she doesn’t have to think about it; they know the path to take. The ethical viatical representative or firm believes in full disclosure; the ethical viator would not consider applying for a life insurance policy under fraudulent conditions.

**Quality of Work**

One’s quality of work might include how clients are treated, performance of work-related duties, acquiring continuing education even when not state mandated, and the viatical contracts purchased or sold. It is quality, not quantity of work that counts. Forging signatures, misstating health conditions, omitting information for the sake of a sale, or any act that is not based on honesty, determines the quality of one’s work. True professionals simply feel their integrity is worth more to them than a quick sale. We all occasionally make mistakes and that is not a reflection of quality unless we do nothing to correct the errors or learn from them. If an error occurs and no effort is made to correct it, then that would reflects on the type of work performed.

**What do I want my legacy to be?**

Most people want to be remembered in a favorable way. I doubt we go through life worrying about it, but we also don’t want people standing around our grave saying “I sure am glad he’s gone!” No one wants their friends or family to say “I showed up at the funeral just to make sure she was really dead!”

Those who proclaim the loudest that they don’t care what anyone thinks probably care the most. Most of us want to be remembered in a favorable light. We want our children to keep our picture on display; we want our grandchildren to talk fondly of the time we spent with them; we want our friends to remember the good times.

While the legacy that matters most is the personal one we leave our family and friends, we will also leave a business legacy. Hopefully it
will be one of competency. Of course, most people would not view themselves as incompetent even if they were which is why the industry is supposed to remove those that are incompetent. Sometimes, competency is merely a matter of obtaining required or necessary education within any given industry. It is always interesting to note the amount of sincere education acquired by the leaders in an industry. The leaders are nearly always more concerned with educating themselves to a greater degree than are those at the bottom. Education and ethics go together just as success and education go hand-in-hand.

**Ethics Start at the Top**

We need to recognize that the companies we work for also have an ethical obligation to their investors and their employees. When our employers do not display an ethical attitude not only does it affect our ability to work with the public, but it also impacts each employee and associate personally in some way. When ethical behavior is not deemed important by the company individuals may eventually be swayed to also act unethically; our view of ethical behavior may become distorted. When an individual feels their day-in, day-out role is primarily connected to making money without any regard as to how the money is made, personal satisfaction and happiness may be affected.

**What are our responsibilities to other moral persons?**

Most people realize that they are responsible for their personal actions. Everyone has a moral responsibility to treat others professionally, to fully disclose pertinent investment facts, and to follow all applicable laws. We further have a responsibility to know our products and the laws that govern them. If we do all of this, are we fulfilling our responsibilities to other moral people? Most would agree that we are. Therefore, ethics that are followed in our personal and professional lives generally also fulfill our moral responsibilities to other moral people.

Even though we act morally and ethically, based on our own perceived standards of right and wrong, that does not necessarily mean others will agree. This would especially be true if the outcome
was not as the other individual expected. Every financial planner, for example, must have a disclaimer since he or she cannot predict what their financial recommendations will produce in yield. The planner may not even be able to accurately predict the outcome of principal since investments involve risk of principal as well as earnings. The same is true for viatical settlement investments. Representatives cannot guarantee yields will be 25 percent, for example, even though the analysis of the life insurance policy may predict it. When investors do not receive what was expected, even an ethical viatical representative may be accused of unethical behavior. Therefore, like the financial planner that has her clients sign a disclaimer that all risk was disclosed, the viatical representative must confirm that his or her clients fully understand the risk involved (a disclaimer may be necessary to confirm this understanding).

Few people want to admit that they do not understand what was just explained to them by the viatical representative. Therefore, it is possible that the investor will nod their understanding when actually they do not fully understand the risks at all. This might especially be true if the investor does not have a complete understanding of the terms used in viatical settlement contracts. Representatives must use language that is easy to recognize and understand. Using industry terminology should only be used if the investor is seasoned and knows what the terms refer to. Never should a viatical representative show off his or her expertise by using terms the general lay person would not understand or could misunderstand. There is risk involved in all investments, but viatical settlements have not been used by the general public, so they are not likely to be fully understood by the general public.

Viatical representatives can make it easier for their potential investors to admit lack of understanding by acknowledging many people are not familiar with the concept, such as: “Mr. Smith, this is new to many people. Most of my clients have not seen these investments and do not understand all the terms. Are you like most of my clients? Do some elements of this seem confusing in any way?”

This allows the prospective investors to voice any concerns or questions. Yes, it will take more of the representative’s time, but that time will be well spent since the investor will be more likely to trust
the representative and will be more likely to understand their investment risks.

**Objectivist Ethics**

Since reason is man's basic means of survival, it is not surprising that we have the ability to form who and what we are. This is called *objectivist ethics*. Since everything man needs has to be discovered by his own mind and produced by his own efforts, there are two basic elements involved in becoming the person we choose to be: *thinking and actions*. We decide who we will be and our actions carry out those thoughts. To be an ethical person we must, through our thinking, choose to be so and then productively work towards it.

If some people do not choose to make any conscience choice, they will develop by imitating and repeating the actions of those around them. This is why it is so important that agencies and management staff make ethical behavior a priority in the workplace. Those who simply repeat the actions of those around them seldom make an effort to develop their own code of ethics, especially in the workplace. Unfortunately, *who* is imitated is seldom a concern to these individuals. As a result, one bad apple can, in effect, spoil the barrel.

As a theory of ethics, objectivist ethics holds man's life as the *standard* of value and his own life as the ethical *purpose* of every individual man. The difference between "standard" and "purpose", as used in this context, can be important. "Standard" is an abstract principle that serves as a measurement or gauge to guide a person's choices in his or her achievements or specific goals. The goal itself or the achievements obtained become the "purpose". Probably every person has some "purpose" or goal in life, but not every one would have a "standard" of life.

**For example:**

Pete was born very poor. This poverty made such an impact on him in his childhood that he now strives to become wealthy. He obtains his accumulating wealth by whatever means necessary. Although Pete definitely has a goal or *purpose* in life of becoming rich, he does not have any *standards*. There is little doubt among those who know Pete that he will become very
rich. Along the way, however, Pete is not finding much happiness. He has not thought out the goals he has established. Pete knows what he is doing, but he does not understand why he is doing it. Pete would be surprised (and perhaps even laugh) if someone told him that ethics are a part of finding happiness.

**Holding our Ethic Code**

Our history is full of wise men that wrote about the philosophies of life. While many of them did not agree on all points, most did agree on one: lack of ethics promotes disorganization, financial turmoil and sometimes even the demise of governments.

The activities and policies of a business tell their employees what the firm's underlying values actually are. It will not matter what is written in the employee manuals. What the firm actually does will be the loudest indicator. Actions reveal more about a business than does executive speeches or advertising campaigns. The employees will judge the company by the way they are treated individually.

As individuals, we may often feel that we have little control over others but we can control ourselves. We may not affect government policy or save another's life, but we do affect our own happiness and the happiness of our friends and family by the way we live our lives. We can certainly affect the lives of those who invest based on our recommendation; by acting responsibly we might affect the investor's happiness. Providing others with the opportunity for happiness is a great ability.

Is the way we treat others an extension of our code of ethics? Often we forget that ethical behavior is not only connected to such things as paying our taxes fairly, following the laws or telling the truth. Ethical behavior can also be connected to how we treat others. Ethics is a code of values to guide man's choices and actions. In choosing one's own actions and even goals, we must face constant alternatives. Even such things as the manner in which we speak to others are a part of our daily alternatives.

Being ethical can be very difficult when being unethical appears more rewarding from a financial or public standpoint. The public standpoint is often overlooked. If we feel strongly about something that no one
else seems to, it is very easy to keep quiet. In fact, that is precisely what gets "followers" into trouble. When a person knows something is not right, but no one else is saying anything, it is easy for the individual to simply go along with the group.

On the surface it would be easy to say that right is right no matter what. It is easy to say what others should do, but it is what each individual does that is most important. Studies suggest people are more likely to stress their ethics if they are not required to take a personal stand on an issue; they are less likely to be ethically firm when it affects their own life. In other words, studies indicate that people are more likely to voice ethical behavior than follow it.

Who we become is a gradual thing. Seldom are we formed by one single experience although one single experience, if great enough, can change our direction or focus in life. Change, for either good or bad, can be a gradual process. So gradual that people may fail to notice what is happening. Therefore, a code of ethics must be a daily goal that we deliberately choose to follow.

We often hear that Americans are the largest consumers of goods and services in the world. We have become a nation of buyers where we were once a nation of savers. Pleasure today is promoted over financial safety tomorrow. This attitude is natural; most people would rather have something now than later. Without a system of values, individuals may come to feel that society owes them a comfortable living in retirement. This rationalization allows them to spend today without worrying about tomorrow. Self-discipline and self-control have given way to self-fulfillment and material consumption. Businesses have also fallen prey to material consumption. Material consumption can often be translated into one general word: greed.

Some might say being ethical is hard work, but others would disagree. Having a specific ethical code could make life easier since such individuals instinctively know who they are and how they wish to respond to any given situation. It removes the stress that might otherwise exist when decisions are necessary regarding personal or business actions. The beauty of having freedom of choice is the ability to improve on past decisions; we are not permanently tied to what we have done in the past.
It is possible to discontinue acting in an unethical manner, or "mend our ways" as it is often referred to. It is never too late to become ethical. For example, John Newton, the man who wrote one of our most famous songs, was the captain of a slave ship. As he came to realize that slavery was wrong, he used his experiences to bring this same understanding to many others. The song written by John Newton was *Amazing Grace*. Knowing this, the words of the song gain greater meaning:

*Amazing grace, how sweet the sound that saved a wretch like me
    I once was lost but now I'm found
    was blind, but now I see.*

A few years ago, the Howard Fischer Associates (one of New York's top executive search firms) conducted a survey of CEOs of the top one hundred companies in the New York area. They were looking for traits most valued by industry leaders.

Of course honesty and fairness were ranked at the very top. These are the other character traits that were listed:

1. Never compromise on matters of principle or standards of excellence, even on minor issues.
2. Be persistent and never give up.
3. Have a vision of where you are going and communicate it often.
4. Know what you stand for, set high standards, and don't be afraid to take on tough problems despite the risks.
5. Spend less time managing and more time *leading*. Lead by example.
6. Bring out the best in others. Hire the best people you can find, then delegate authority and responsibility, but stay in touch.
7. Have confidence in yourself and in those around you, and trust others.
8. Accept blame for failures and credit others with success. Possess integrity and personal courage.

There are many books and so-called experts telling us how to achieve financial and business success. We are not here to say whether that advice is accurate but before accepting advice from others it might be wise to determine what one actually wishes to accomplish during their lifetime. So often individuals lose track of their true goals (rearing happy children, writing a book, or establishing a close family) and become side-tracked with the goals of others, such as the company they work for. When an individual loses track of their own goals, they are more likely to become followers. For business owners, including many self-employed insurance agents, it is easy to become consumed by earning that next commission. Finding new investors may be necessary for financial reasons, but not at the cost of all else in life.

**Mores**

*Mores* are those customs, which are enforced by social pressure. Mores are relative to culture. They are established by patterns of action to which the individual is expected to conform and from which deviation may bring disapproval and perhaps even punishment. While these standards are considered to be a matter of ethics, they may vary from society to society.

The Thorndike Barnhart Comprehensive dictionary defines mores as:

mo.res, noun: traditional rules; customs; manners.

We stated previously that only *behavior* may be dictated, not ethics. The term mores works directly with this context. Mores are ethical standards that are enforced by social pressure. Groups of professional people create ethical standards to give their profession honor. These groups desire society’s approval and they realize that there will always be those among us who will not voluntarily follow ethical procedures. As a result, mores are developed.

Many types of professions deal with knowledge that the average person simply would not have. Viatical settlements and insurance are examples of those professions. As a result, those individuals who seek
out the professionals must rely upon their honesty and integrity. A feeling of ethical standards (which are enforced by social pressure) must exist. It was the potential for abuse of power and knowledge that provided sets of rules or what is often called ethical standards. Sometimes ethics are written standards; sometimes they are merely understood. What was previously understood to be required ethical conduct becomes written laws when individuals do not follow preferred practices. At that point, pressure from society turns what were previously understood procedures into written laws or mandates.

Every consumer wants complete honesty from those they deal with, including complete disclosure. Therefore, complete information is a custom, which is enforced by social pressure. **Mores are established patterns of action to which an individual is expected to conform.**

Mores vary from culture to culture because how people live and what is important to them vary from culture to culture. For example, viatical settlements initially had few regulations because there was no past investing experience in these transactions. Since it was not previously used in the general investment community, the need for specific rules was not known. As the need for regulation became apparent, codes of conduct were instituted by the individual states. As abuses accumulate in any industry, standards are implemented because the need for them brought about pressure from our society.

Mores relates to customs, not always laws, although those customs often develop into laws. Mores are customs that are enforced by social pressure. In this context, "right" simply means according to the mores and "wrong" means in violation of the mores.

It is important to understand that mores do not automatically make an action right or wrong; mores make no attempt to determine moral issues. They simply define what is right or wrong according to the given culture.

A good example of this has to do with the slavery that existed in the United States. It was the custom in some areas to own slaves. Those who lived with those customs generally tended to support slavery. That belief did not necessarily make it morally correct. There is the tendency in any group of people to consider their best interests to be
right. That which is contrary to their best interests may often be termed wrong. Customs are often negative to one group of people and positive to another, even in America where we want to believe every person has equal rights.

As a whole, however, mores tend to be the general rule of conduct for the society in its totality. Generally speaking, it is right for the members of the culture to follow the mores because they developed from the group *in its entirety*. Without mores, any society would lapse into a state of anarchy that would be intolerable for its members. While this basic concept is correct, one should not lose sight of the fact, however, that not all mores are morally acceptable. There is certainly some obligation to conformity in our society for the good of all. If one is deviating from the generally accepted code of behavior, that individual might wish to consider the possibility that his or her deviation has to do with personal gain. If this is the case, that deviation cannot be rationalized away.

When Helen Keller was asked if there were anything worse than being blind, she answered, "Yes. Being able to see and having no vision."

Every person wants recognition. Oprah Winfrey may have said it best: *everyone needs validation*. Each of us needs to be recognized as a person of worth. Even children need to feel they are valued by someone in their life. Having an ethical code often brings about this validation, if only to those with similar values. Validation may come primarily from our place of employment if it is not provided by our family or friends. Unfortunately our employer may not validate more than personal production.

A work atmosphere that is kind and considerate, education oriented, and cooperative can go far in securing ethical behavior practices, but let's be realistic. When an agency is investing heavily in its sales force, it is likely that production is a major criterion for remaining employed there. Certainly there are agencies (many of them) that do promote both sales and ethics. If an individual is lucky enough to work for a good company, it is likely that new comers become more ethical (just as others will become less ethical in the opposite type of atmosphere) just by being exposed to those who work there.
While we clamor for the recognition and respect of others, perhaps what we are really trying to achieve is the recognition and respect that comes from within. Since we all need validation in some way, what we achieve must provide at least some of that recognition in our lives.

“Fast Buck” Items

Any product or service can become a “fast buck” item if it is sold improperly, including viatical settlement contracts. “Fast buck” has to do with how the product or service is sold, not what the product or service is. **Any product paying a commission or finder's fee can become a fast-buck item.** Fast-buck has to do with the attitude of the salesperson. Is the salesperson thinking almost entirely about making some fast money or are they considering the investor’s needs?

The Professional

There are many people willing to be thought of as a professional investment advisor. Simply desiring the title does not make one a professional, however. In many states, a person can give themselves nearly any title they desire. The title may have nothing at all to do with either experience or training. From a business standpoint, it means selecting viatical firms and other support systems that are both professional and knowledgeable.

The first step is to be sure that the viatical firm and their associates are ethical professionals. Whether you represent the viatical firm or are an investor, it is important to deal with legitimate companies. That does not necessarily mean that they must share the same views on the environment, government or community. It does mean that they must be financially and professionally honest in every capacity. Certainly, this means following all laws, but also honest in the way they deal with consumers and business associates.

Due Diligence

The term, due diligence, is primarily derived from the securities industry. Due diligence is typically an analysis of a particular company's products, performance and financial standing. As it relates to viatical firms, it should prove that the settlement contracts they present can actually be achieved. The life insurance contracts should
be past the incontestability period, or clearly disclosed if they are within that period. It is vital to investors that the viatical company uses procedures that produce realistic maturity dates. In short, due diligence is the analysis of whether or not the viatical company can keep their promises.

In the past it has not been easy to pursue due diligence on viatical firms but with state requirements it is getting easier. The first step, therefore, is the state viatical licensing department, which is usually the state insurance department. This may not provide as much information as the inquirer may wish, but it is a good start.

A common sense approach to due diligence may be used as long as the information is confirmed. The goal is not necessarily to find those companies that are sound, but rather to avoid companies that are not. Such things as historical data and other industry related information may give indications of legitimate companies. Perhaps one of the best indicators is how they represent the life insurance policies they are offering to investors. Specifically ask how they determine payment for the life policies, how they analyze maturity risk (dates of death), and how much underwriting is performed.

Consumers often ask other professionals for recommendations. Professionals in other fields may refer their clients to viatical firms, but the investor is still wise to do their own analysis of the viatical firm. Referring professionals might include accountants, health care professionals, insurance agents, and attorneys.

Each of us must manage our day-to-day lives in the best way we can. This includes the management of our finances. In these uncertain financial times, the only sure thing may be death and taxes. If death is a sure bet, it is likely to attract investors through viatical settlement contracts. It may be difficult to locate the people and institutions we feel secure with but it is worth the time spent finding them.

Perhaps the greatest challenge is not philosophical knowledge, but rather moral understanding. The challenge is not necessarily to meet your financial goal, but rather to find happiness on a daily basis. The financial goal will come on its own.