# YOU CAN BET YOUR LIFE ON IT! REGULATING SENIOR SETTLEMENTS TO BE A FINANCIAL ALTERNATIVE FOR THE ELDERLY

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*As seniors struggle to keep pace with medical care costs and other expenses, many must look to alternative sources of financial freedom. Senior settlement agreements, through which a senior may sell her life insurance policy to a third party for a percentage of its future value, may provide one such alternative. In this Note, Jessica Maria Perez explores the history of senior settlement agreements from their birth as sisters to similar agreements made by the chronically ill, to the present in which they are increasingly entered into by healthy seniors. Perez analyzes the positive and negative aspects of these agreements from basic economic risk to ethical issues to tax implications. She analyzes recent regulatory developments in this area, including the Viatical Settlements Model Act and various state statutes. Perez recommends increased regulation at the state level, encouraging states to adopt the Model Act. She also recommends that these transactions be made tax-exempt and that attorneys play a greater role in the making of senior settlements. With these reforms, Perez suggests that the senior settlement agreement can be a safe and effective method by which seniors can realize financial freedom.*

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## I. Introduction

When John was seventy-six, he suffered an unexpected and permanently disabling heart attack.[1] A once proud man, John must now contemplate how to finance his own long-term care. Unprepared for this unfortunate event, John's family has to consider the daunting cost of a care facility.[2] The family's only major asset is a $500,000 life insurance policy, which is payable only upon the death of the insured.[3] What financial options do John and his family have?

There are several options a person carrying a life insurance policy has to obtain immediate financial benefits.[4] One could borrow against the cash surrender value of the life insurance policy, cash out the policy based on the available cash surrender value, obtain accelerated benefits if offered by the insurance company, borrow from friends or family using the life insurance policy as collateral, or sell the life insurance policy in a viatical or senior settlement.[5]

A senior settlement allows a person aged sixty-five or older to sell his or her life insurance policy at a discount to investors.[6] The investor's return is based on the life expectancy of the elderly policyholder.[7] The elderly person selling his or her discounted policy receives a lump-sum amount of money to spend on long-term care services, or anything else he or she wants or needs.[8]

This Note considers the use of senior settlements as a long-term care financing option and advocates for increased regulation of these settlements. Part II examines the history and development of the viatical settlement industry, which has led to the growth of the senior settlement industry. Part III analyzes recent regulatory developments in the senior settlement debate. Part IV recommends increased regula-

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1. This scenario is based on a case study presented in Welcome Funds' brochure (on file with author), *available at* http://www.welcomefunds.com/senior-settlements.htm) (last visited Aug. 20, 2002) [hereinafter Welcome Funds].
2. *Id.*
3. *Id.*
4. The Viatical and Life Settlement Association of America, *at* http://www.viatical.org/questions.html (last updated Sept. 27, 2001).
5. *Id.*
6. *Id.*; *see* discussion *infra* Part II.C.1.
7. The Viatical and Life Settlement Association of America, *supra* note 4; *see* discussion *infra* Part II.C.1.
8. Barbara Looney, *Viatical Settlements—An Overview of the Use of Viatical Settlements as a Long-term Care Financing Option for the Elderly (Part I of III)*, NAELA Q., Fall 1995, at 11.

tion of the senior settlement industry as a means of keeping senior settlements as a viable financial alternative for the elderly.

## II. Background

### A. The Advent of Viatical Settlements

Knowing the history of senior settlements is an important first step toward understanding the existing regulation and financial treatment of these transactions. Senior settlements are actually part of a secondary market for life insurance policies that began with the viatical[9] settlement industry in the late 1980s, at the height of the Acquired Immune Deficiency Syndrome (AIDS) outbreak.[10] In the early 1990s, the average medical cost of AIDS treatment from the time of the onset of full-blown AIDS until death was approximately $69,000 per patient.[11] The AIDS epidemic created a population of people with short life spans, high medical costs, and few assets other than life insurance policies.[12] In response to the financial needs of this fast growing population, viatical settlement companies quickly emerged onto the scene and accounted for "$5 million in life insurance policies in 1989, to perhaps $200 million in 1995."[13] In need of quick cash, AIDS patients looked to viatical settlements for money they needed to pay medical costs, and the settlements typically provided investors with a high rate of return.

9. The word "viatical" stems from the Roman Catholic term "viaticum," which refers to the Eucharist or communion received prior to death. Its Latin definition is "journey money" or "money provided for a long journey." WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY OF THE ENGLISH LANGUAGE UNABRIDGED 2548 (3d ed. 1993).

10. *See* Ron Panko, *Playing the Death Pool*, BEST'S REV.—LIFE-HEALTH INS. ED., Apr. 1, 1999, *available at* 1999 WL 11979513.

11. Russell J. Herron, Note, *Regulating Viatical Settlements: Is the Invisible Hand Picking the Pockets of the Terminally Ill?*, 28 U. MICH. J.L. REFORM 931, 931–32 (1995). A 1992 survey distributed to 30,000 AIDS and HIV-positive people found that over fifty percent of respondents had difficulty paying for medication and basic necessities like food and housing. *Id.* at 932. Approximately thirty percent lived on less than $500 per month, while another thirty percent fought to get by on less than $1000 per month. *Id.*

12. Liza M. Ray, Comment, *The Viatical Settlement Industry: Betting on People's Lives Is Certainly No "Exacta,"* 17 J. CONTEMP. HEALTH L. & POL'Y 321, 327 (2000).

13. SEC v. Life Partners, Inc., 898 F. Supp. 14, 17 n.1 (D.C. 1995).

**B. The Viatical Process Defined**

The National Association of Insurance Commissioners (NAIC) adopted the Viatical Settlements Model Act (Model Act) in 1993,[14] and the Viatical Settlements Model Regulation (Model Regulation) in 1994.[15] The Model Act defines a viatical settlement contract as:

> a written agreement establishing the terms under which compensation or anything of value will be paid, which compensation or value is less than the expected death benefit of the insurance policy or certificate, in return for the viator's assignment, transfer, sale, devise, or bequest of the death benefit or ownership of any portion of the insurance policy or certificate of insurance.[16]

In a typical viatical settlement transaction, a terminally or chronically ill policyholder, known as a viator,[17] sells the right to the proceeds of his or her life insurance policy to an investor at a discount.[18] The viator immediately receives a lump-sum cash payout, ranging anywhere from fifty to eighty percent of the face amount of the life insurance policy, which he or she can spend without restrictions.[19] The sooner the viator dies, the higher the rate of return the investor realizes on his or her investment because the investor pays the life insurance premiums for the remainder of the viator's life.[20]

As an example of the typical viatical settlement process, assume John has annual insurance premiums of $1,000 and a third-party investor purchases John's $500,000 life insurance policy at a fifty percent discount. The investor would pay John $250,000, and would pay his insurance policy premiums of $1,000 annually for every year that John lives, thus conditioning the investor's rate of return on John's length of life. Once John dies, the investor would be entitled to the en-

14. VIATICAL SETTLEMENTS MODEL ACT (Nat'l Ass'n of Ins. Comm'rs 1993), *reprinted in* Nat'l Ass'n of Ins. Comm'rs, Model Laws, Regulations and Guidelines § 697-1 to -17 (2001) [hereinafter MODEL ACT].

15. VIATICAL SETTLEMENTS MODEL REGULATION (Nat'l Ass'n of Ins. Comm'rs 1994), *reprinted in* Nat'l Ass'n of Ins. Comm'rs, Model Laws, Regulations and Guidelines § 698-1 to -11 (2001) [hereinafter MODEL REGULATION].

16. MODEL ACT, *supra* note 14, § 697-2.

17. The word "viator" means "traveler; wayfarer." WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY OF THE ENGLISH LANGUAGE UNABRIDGED, *supra* note 9, at 2548; *see also supra* text accompanying note 9.

18. Miriam R. Albert, *The Future of Death Futures: Why Viatical Settlements Must Be Classified as Securities*, 19 PACE L. REV. 345, 348 (1999).

19. Looney, *supra* note 8, at 11, 16. Some terminally ill policyholders have used the money to pay for medical bills, purchase gifts, or go on "dream" vacations. *Id.*

20. Daniel Eisenberg, *Making a Killing*, TIME, Nov. 29, 1999, at 108 ("Profitability is related to the predictability of death.").

tire $500,000 policy payout from the insurance company. The investor's total return would be $500,000 less the $250,000 payment to John and the annual premiums paid to the insurance company on behalf of the viator.

### C. The Trend Toward Senior Settlements

With medical advances creating new drugs to extend the lives of persons with AIDS, investors began targeting life insurance policyholders with such deadly diseases as cancer and advanced heart disease.[21] In 1996, approximately eighty percent of settlements involved the life insurance policies of terminally ill individuals,[22] with the remaining twenty percent belonging to healthy elders.[23] Recently, these percentages have been reversed as the industry is now increasing its focus on the elderly with what have become known as senior settlements.[24] According to Florida State Senator, Steve Geller, Chairman of the Viatical Settlement Subcommittee for the National Conference of Insurance Legislators (NCOIL), "[t]he issue[s] of viatical and life settlements are hot topics in the insurance field right now. Today, the bulk of these transactions are not viatical (terminally ill) settlements, they are life settlements. The majority of the dollars are now in life settlements."[25] Furthermore, this new market in senior settlements is driven by the fact that some elderly citizens no longer want, need, or can afford their life insurance policy coverage.[26]

21. Marilyn Askin, *Viatical Settlements: A Yellow Brick Road*, 190 N.J. LAW 14, 14 (1998) (noting that, as of 1998, the insurance industry was targeting people with cancer, advanced heart problems, Lou Gehrig's disease, and Alzheimer's disease).

22. MODEL ACT, *supra* note 14, § 2(J) (defining the "terminally ill" as persons with an illness that can be expected to result in death within two years or less).

23. Kristina Stefanova, *Death Benefits Viaticals Industry Bruised by Fraud, New AIDS Drugs*, WASH. TIMES (D.C.), Aug. 23, 2001, at B11, *available at* 2001 WL 4160418.

24. *Id.* (As of 2001, only twenty percent of the industry caters to the terminally ill.)

25. Press Release, Mutual Benefits Corp., *NCOIL (The National Coalition of Insurance Legislators)* Adopts New Model Law Governing the Life Settlement and Viatical Industry (Nov. 11, 2000), *at* http://www.mutualbenefitscorp.com/news_press_11_16_00.html (last visited Aug. 20, 2002) [hereinafter *NCOIL Adopts New Model Law*]; *see also* http://www.ncoil.org (discussing the history and purpose behind NCOIL).

26. John Hillman, *Life Settlement Coalition Launched to Educate Insurers*, BEST'S INS. NEWS, Aug. 14, 2001, 2001 WL 24724470.

**1. DEFINITIONS IN SENIOR SETTLEMENTS**

The difference between viatical and senior settlements is that the former target the terminally ill, whereas the latter are geared toward the elderly, regardless of health.[27] The two settlement types differ from one another "more in degree than in kind."[28] A senior settlement is defined as money paid to an individual, typically aged sixty-five or older,[29] in exchange for his or her life insurance policy's death benefits.[30] The seller transfers all policy ownership rights and obligations to a third-party buyer for a percentage of the policy's face value.[31] Senior settlements are also referred to as life settlements, lifetime settlements, or high net worth transactions.[32] Regardless of what this type of settlement is called, senior settlements offer a revolutionary new financial alternative for the elderly.[33]

The senior settlement industry poses two limitations upon the elderly: first, the senior must have a life insurance policy that can be purchased, and second, the senior's life expectancy[34] must typically be less than four or five years.[35]

27. Sanford J. Schlesinger, *Recent Trends in Life Insurance*, 97 PRACTISING L. INST. 47, 67 (2001). The securitization of senior settlements on death benefits, a potential $200 billion market, is a new area of securitization. *Id.* ("Senior settlements are life insurance policies purchased at a discount from people who are sixty-five or older and who are not terminally or chronically ill but who are not expected to live more than three to five years, whereas viatical settlements involve death benefits of people who are terminally or chronically ill.").

28. Hillman, *supra* note 26.

29. ALIR—A Life Insurance Redemption Company, *at* http://www.e-alir.com/seniorlifesettlements.htm (last visited Aug. 8, 2002) [hereinafter ALIR] ("Persons over the age of 65, with some medical conditions that impact their health, [p]ersons over the age of 70, who have no medical problems affecting their health."); Senior Life Settlements, *at* http://www.seniorlifesettlement.net/ (last visited Aug. 23, 2002) [hereinafter Senior Life Settlement] ("Men and women who are at least 65 years of age are eligible.").

30. Living Funds, *at* http://www.livingfunds.com/Senior-Settlements.htm (last visited Aug. 20, 2002) [hereinafter Living Funds].

31. *Id.*

32. Welcome Funds, *supra* note 1. The terms "senior settlement" and "life settlement" are used interchangeably.

33. Senior Life Settlement, *supra* note 29. A life settlement is a "dynamic" option that is "revolutionizing how financial planners and advisors can handle an unneeded or about to lapse policy." *Id.*

34. Life expectancy is defined as "the mean of the number of months the individual insured under the life insurance policy to be viaticated can be expected to live as determined by the viatical settlement provider considering medical records and appropriate experiential data." MODEL REGULATION, *supra* note 15, § 2(C).

35. Looney, *supra* note 8, at 11. Some senior settlement companies purchase life insurance policies of elders that are not expected to live more than three to five years. Sanford J. Schlesinger, *supra* note 27, at 67. The life expectancy of a potential viator that a settlement company is willing to enter into a settlement with is

A senior settlement provider is the person or company that takes over the life insurance policy in return for payment made to the seller.[36] The senior settlement provider becomes the policy owner, is responsible for premium payments, and is entitled to receive the full amount of the death benefit from the issuing insurance company.[37] A senior settlement broker is the person or company who represents the policy seller, can seek out senior settlement buyers for the best deal, and gets paid a commission from the buyer upon sale of the policy.[38]

### 2. THE PROCESS OF PROCURING A SENIOR SETTLEMENT

Once an interested senior reaches the minimum age requirement of sixty-five, the senior settlement process involves a series of steps.[39] First, the elderly policy owner initiates the process by filling out an application and submitting supporting documentation to the senior settlement company.[40] Second, the candidate must submit his or her medical and insurance records to the settlement company.[41] Third, the settlement company reviews the candidate's information and a team of underwriters determines eligibility.[42] Fourth, the settlement company presents an offer price to the candidate for the life insurance policy.[43] Fifth, if the candidate accepts the offer, contracts and forms are completed by a senior settlement representative.[44] The transaction is completed with the sixth step when the candidate transfers policy ownership to the settlement company and the price of the policy is then paid to the individual.[45]

The purchase price of a life insurance policy involved in a senior settlement is determined by several factors: the face value of the policy, the amount of premium payments, the estimated life expectancy of the insured, the rating of the insurance carrier, the cash value of the

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determined on a case-by-case basis. MODEL REGULATION, *supra* note 15, § 2(c). Some settlement companies will enter into a settlement with an elder that has up to a ten-year life expectancy. Welcome Funds, *supra* note 1.

36. NAT'L ASS'N OF INS. COMM'RS, SELLING YOUR LIFE INSURANCE POLICY: UNDERSTANDING LIFE SETTLEMENTS, http://www.naic.org (last visited Aug. 20, 2002).

37. *Id*.

38. *Id*.

39. Welcome Funds, *supra* note 1; *see also* ALIR, *supra* note 29.

40. Welcome Funds, *supra* note 1.

41. *Id.*

42. *Id.*

43. *Id.*

44. *Id.*

45. *Id.*

policy, the policy type, prevailing interest rates, and any outstanding loans against the insured's policy.[46] An offer for a life insurance policy can range anywhere between fifteen percent to eighty-five percent of the policy's face value.[47]

### 3. THE MARKETING OF SENIOR SETTLEMENTS TO THE ELDERLY

Senior settlement companies advertise that a settlement can typically offer more money than the cash surrender value of his or her life insurance policy and that there are a number of goals that can be accomplished through a senior settlement.[48] For example, the senior can finance a new investment venture, donate to a charity, give gifts to family members, fund a revised estate plan, pay gift taxes, buy back corporate stock, and avoid responsibility for premium payments.[49]

Due to elders living longer lives and because the average length of retirement has increased, more and more investors are focusing on buying policies from healthy senior citizens.[50] To increase marketability, some companies dealing with senior settlements are willing to increase the life expectancy requirement by purchasing policies from elders aged sixty-five or older with life expectancies of ten years.[51] Although the viatical industry has begun to fade, the senior settlement business is rapidly expanding.[52] An estimated $1 billion per year of funding is currently going into the senior settlement industry, primarily from institutional investors rather than independent investors.[53]

46. ALIR, *supra* note 29; Living Funds, *supra* note 30; Senior Life Settlement, *supra* note 29.

47. Living Funds, *supra* note 30 (typically offers from fifteen to seventy percent of policy's face value); Welcome Funds, *supra* note 1 (most cases settle for fifty to eighty-five percent of the policy's face value; however, elderly candidates with life expectancies greater than five years can expect an offer between twenty to fifty percent of the face value).

48. ALIR, *supra* note 29; Senior Life Settlement, *supra* note 29; Welcome Funds, *supra* note 1.

49. Senior Life Settlement, *supra* note 29.

50. Marilyn Ostermiller, *Selling to Seniors (Changes to Life Insurance with Increased Life Expectancy)*, BEST'S REVIEW—LIFE-HEALTH INS. ED., Apr. 1, 1999, 1999 WL 11979498.

51. *See* Michael Fritz, *CNA Putting to Sleep Viaticals Buying Unit: Stops Buying Policies of Elderly, Terminally Ill*, INVESTMENT NEWS, Aug. 6, 2001, *available at* 2001 WL 10247411; *see also* David Pilla, *New Life Settlement Company Formed in Minnesota*, BEST'S INS. NEWS, Jan. 11, 2002, *available at* 2002 WL 4523672 (Some senior settlement companies will buy a life insurance policy from an elder with a life expectancy up to thirteen years, while that elder is in good health.).

52. Ron Panko, *NAIC Committee Adopts Report on Life Settlements*, BEST'S INS. NEWS, Dec. 6, 2000, 2000 WL 23702822.

53. Hillman, *supra* note 26.

The senior settlement industry is encouraging life insurance companies to recommend this financial alternative to elderly policyholders who decide to cancel a policy.[54] Alan Buerger, chief executive officer and cofounder of Coventry Financial, one of the largest senior settlement companies in the United States, explains, "If the carrier doesn't tell a policyholder about this option, and they surrender the policy for cash value, or one of the other standard nonforfeiture options, the insurance company may be open to suit if the policyholder finds out down the road that they could have received more money with a [senior] settlement arrangement."[55]

The internet is steadily becoming a marketing device for reaching the elderly.[56] The American Association for Retired Persons (AARP) estimates that thirteen million senior citizens are now online.[57] By posting links to senior settlement companies on such websites as the AARP's, more and more elders will be made aware of this option. The biggest push in marketing senior settlements to the elderly is the fact that many interest-sensitive life insurance policies have been affected negatively by the recent economic slump. Many citizens that were promised diminishing premiums have either seen their premiums not diminish or have even seen them rise.[58] As a result, a senior settlement may get the elder a larger amount of money than the cash surrender value of the policy.[59]

## III. Analysis

### A. Arguments in Favor of Senior Settlements

#### 1. AN ALTERNATIVE FINANCIAL SOLUTION FOR THE ELDERLY

Spending on health care continues to increase at a higher rate than the rest of the economy, "accounting for an ever-larger share of the country's gross domestic product."[60] This increase is partially at-

54. *Id*.
55. *Id*.
56. Ostermiller, *supra* note 50.
57. *Id*.
58. *Id*.
59. *Id*.
60. HEALTH INS. ASS'N OF AM., ISSUE BRIEF: WHY DO HEALTH INSURANCE PREMIUMS RISE? 5 (2000), http://www.hiaa.org (last visited Aug. 22, 2002) [hereinafter HIAA ISSUE BRIEF].

tributed to the aging population.[61] Persons aged sixty-five years or older numbered thirty-five million in 2000, an increase of approximately 3.7 million since 1990.[62] What this means for the elderly population is that premiums for long-term care insurance are increasingly expensive, to the point of being unaffordable for most senior citizens.[63] Households containing families headed by persons aged sixty-five and older reported a median income in 1999 of $33,148.[64] The median income of persons aged sixty-five and over in 1999 was $19,079 for males and $10,943 for females.[65] Given these incomes, how can an elderly person aged sixty-five or older expect to afford an average annual premium of $2,305, or $7,022 for those seventy-nine or over?[66] "[I]ncreasing health care costs relative to family income remains the single most significant factor driving the rising number of Americans without health insurance coverage."[67]

In 1998, elderly consumers averaged over $2,900 in out-of-pocket health care expenses, up thirty-three percent since 1990.[68] The elderly spent twelve percent of their total expenditures on health, three times the amount spent by younger customers.[69] Average health costs incurred by the elderly consisted of $1,528 (52%) for insurance, $670 (22%) for drugs, $596 (20%) for medical services, and $142 (5%) for

61. *Id*. at 18. Among the significant reasons for the current increases in health coverage costs are increased spending on prescription drugs, the aging population, excess capacity in the health care system, and low premiums that were offered in the 1990s. *Id.*

62. *See* ADMIN. ON AGING, U.S. DEP'T OF HEALTH & HUMAN SERVS., A PROFILE OF OLDER AMERICANS: 2001, *at* http://www.aoa.dhhs.gov/aoa/STATS/profile/2001/1.html (last modified Dec. 21, 2001).

63. *See* HIAA ISSUE BRIEF, *supra* note 60, at 18. "The cost of health coverage has become a significant national issue. The most recent available data show that 44 million Americans lack health insurance coverage. The cost of health benefits has a direct impact on the number of uninsured in this country." *Id.*

64. ADMIN. ON AGING, U.S. DEP'T OF HEALTH & HUMAN SERVS., A PROFILE OF OLDER AMERICANS: 2001, *at* http://www.aoa.dhhs.gov/aoa/stats/profile/profile2000.html (last modified June 21, 2001) [hereinafter PROFILE 2000].

65. *Id.*

66. HEALTH INS. ASS'N OF AM., RESEARCH FINDINGS: LONG-TERM CARE INSURANCE IN 1997–1998 (Mar. 2000), *available at* http://www.hiaa.org (last visited Sept. 22, 2002); HIAA, *supra* note 60, at 24 (These average annual premiums include a lifetime five percent compounded inflation protection feature and a nonforfeiture benefits feature added to the base plans. The base plan for the sixty-five or older age group is $1,007, annually, and $4,100 for the age group hitting seventy-nine or older.)

67. *Id.* at 18.

68. PROFILE 2000, *supra* note 64.

69. *Id.*

medical equipment.[70] In 2002, the average nursing home stay cost approximately $44,000 a year—over three times the median income of the elderly in 2000.[71] A few visits per week by a home health aide cost over $15,000 per year.[72]

> Long-term care spending from all public and private sources, which was about $137 billion [in 2000] for persons of all ages, . . . will increase dramatically in the coming decades as the baby boom generation ages. Spending on long-term care services just for the elderly is projected to increase at least two-and-a-half times and could nearly quadruple in constant dollars to $379 billion by 2050, according to some estimates.[73]

Today's reality is that the elderly and their families use out-of-pocket money to help cover over fifty percent of long-term care costs, while the remainder of these costs are paid for by state and federally provided funds.[74]

There are several reasons why more financial alternatives are needed for the elderly. First, the average length of retirement is over seventeen years due to increased life expectancies.[75] Although many elders are living longer without disabilities, the chances of having to live in a nursing home or needing at-home help to aid with basic living functions (i.e., eating, walking, going to the bathroom, getting dressed) increases with age.[76] Second, an increasing number of Americans are choosing to retire early.[77] Third, the future of corporate 401(k) plans is questionable.[78] The recent Enron disaster exemplifies

70. *Id.*

71. Janemarie Mulvey & Annelise Li, *Long-Term Care Financing: Options for the Future*, BENEFITS Q., Second Quarter 2002, *available at* 2002 WL 15992338.

72. *Id.*

73. *Address Funding Crisis Facing Long Term Care: United States General Accounting Office Congressional Testimony Before the Special Comm. on Aging* (2002), 2002 WL 25099422 (statement of David M. Walker, Comptroller General of the United States).

74. Mulvey & Li, *supra* note 71.

75. Ostermiller, *supra* note 50.

76. Tim Smart, *Get Ready for New Wrinkles in Long-Term Care Insurance*, AARP BULL. ONLINE, Dec. 2001, *at* http://www.aarp.org/bulletin/departments/2001/long_term/1205_longterm_1.html. Industry experts say that if people have other means for taking care of themselves such as savings or help from family members, then long-term care insurance may not be needed. *Id.*

77. Phillip Harper, *Is Retiring Early Too Risky?* (Apr. 3, 2002), *at* http://money.msn.com/articles/retire/basics/9099.asp. In the wake of the Enron proceedings, individuals are now coming to the realization that company pensions and retirement savings plans "are not always the bedrock upon which a retirement can be built." *Id.*

78. Carole Fleck, *Enron's Legacy: How Safe Is Your 401(k)?*, AARP BULL. ONLINE (Feb. 2002), *at* http://www.aarp.org/bulletin/departments/2002/money0210_money_1.html. David Wray, president of the Profit Sharing/401(k) Council

the current instability of corporate 401(k) plans[79] and demonstrates that employees need to focus on other long-term financing options. The surprise downfall of the Enron corporation caused many workers and retirees to lose their 401(k) retirement savings.[80] Enron employees and retirees lost hundreds of thousands of dollars. For many, this was their life savings.[81]

As a result of unexpected financial circumstances, not saving enough, or spending too much, many senior citizens are incurring large amounts of debt to cover expenses.[82] In 2000, retirees owed an average of $23,000,[83] an increase of $15,000 from the average debt owed by retirees in 1992.[84] Given these staggering numbers, it is imperative to provide the elderly with alternatives that will allow them to ease their financial burdens. Senior settlements provide such a viable option. The money received by the elderly individual can be used in any way he or she wants, and the premium payments are taken over by the senior settlement company.[85]

The insurance industry now offers a competing product known as accelerated death benefits.[86] An accelerated death benefit involves only the insured and the insurance company, whereas a senior settlement involves an additional third-party senior settlement agent/broker.[87] Insurance companies have set up accelerated death benefits to compete with the senior settlement and viatical settlement

of America, states that there are no guarantees in 401(k)s: "[t]he 401(k) is about investing and getting the returns. It's a wealth accumulation program and you can't have wealth accumulation and protection at the same time." *Id.*

79. *Id.*

80. *Id.*

81. *Id.* For example, one sixty-seven-year-old retiree lost the nearly two million dollars that he had accumulated over his thirty years of employment with Enron. *Id.* A senior settlement may provide this retiree with a financial solution to a very unfortunate situation.

82. Lucy Lazarony, *Seniors Pile on More and More Debt*, *at* http://moneycentral.msn.com/articles/banking/basics/92300.asp?special=msn (last visited Aug. 20, 2002).

83. *Id.*

84. *Id.* In the early nineties, retired elders owed an average of $8,000. *Id.* Many retirees are becoming victims to the fixed-income syndrome, where "things get relatively more expensive every year but your income doesn't go up. So it gets put on the credit cards." *Id.* (quoting Ginita Wall, a certified financial planner and coauthor of *Your Next 50 Years: A Completely New Way to Look at How, When and If You Should Retire*).

85. Looney, *supra* note 8, at 11.

86. Askin, *supra* note 21, at 14.

87. Joseph B. Treaster, *Death Benefits, Now for the Living*, N.Y. TIMES, Sept. 27, 1998, § 3, at 5.

industries by offering the policyholder ninety percent or more of the policy's worth, which is ten to twenty percent more than investors are willing to offer.[88]

Accelerated death benefits typically come in the form of a rider to an insurance policy, and these riders vary among insurers.[89] Most of these riders "provide that payment will be made only to persons who are expected to die within six months or a year."[90] Such riders may also vary in terms of the percentage of the policy's death benefit that may be received in this manner.[91] If a life insurance policy does contain a separate rider, an elder can opt to take twenty-five to one hundred percent of the policy's value. The elder may take payment in the form of either a lump-sum payment or installments.[92] Whether an elder would be better off with an accelerated death benefit versus a senior settlement depends on what each will offer in exchange for the elder's insurance policy. There are also differences in tax implications, which will be discussed below.

In addition to offering a financial alternative that alleviates the increasing costs of long-term care, senior settlements also provide more money than obtaining the cash surrender value of a surrendered life insurance policy.[93] For instance, many policies that promised vanishing premiums have not kept that promise, or even worse, premiums have increased.[94] As a result, the elderly are often forced to surrender their life insurance policies.[95] Leaders in this industry state that a senior settlement option might be the "better way for a policyholder to go in surrendering a policy . . . by getting the policyholder perhaps many times the current cash value of the policy."[96]

### 2. INCREASED REGULATORY SAFEGUARDS

While a large degree of fraud has resulted in the viatical settlement industry's poor public image, the senior settlement industry has

88. *Id*.
89. LAWRENCE A. FROLIK & RICHARD L. KAPLAN, ELDER LAW IN A NUTSHELL 146–47 (2d ed. 1998).
90. *Id*.
91. *Id*.
92. JOAN M. KRAUSKOPF ET AL., ELDERLAW: ADVOCACY FOR THE AGING § 12.72 (Supp. 2000).
93. Hillman, *supra* note 26.
94. *Id*.
95. *Id*.
96. *Id*.

focused on establishing increased regulatory safeguards to protect both the elderly policy owner and the investor purchaser.[97] Industry leaders have formed educational and regulatory associations to work with state and federal legislatures to protect consumers and investors from the fraudulent acts that plagued the viatical industry in the 1990s.[98] In 2001, the Life Settlement Coalition was formed with the primary goal of educating insurers about the senior settlement option for life insurance policies.[99] The Life Settlement Coalition consists of senior settlement brokers and providers that purchase life insurance policies.[100]

The Viatical and Life Settlement Association of America (VLSAA) is another group that has recently formed to focus on legislative issues in the senior settlement industry.[101] VLSAA works with state insurance organizations and the NAIC in dealing with legislative matters.[102] There are currently twenty-eight VLSAA member companies[103] that are "dedicated to maintaining high ethical standards, including absolute respect of viator privacy and confidentiality."[104] Each VLSAA member is urged to establish a Compliance and Fraud Review Team to ensure that antifraud procedures are implemented.[105]

97. *NCOIL Adopts New Model Law*, *supra* note 25.

98. *See* Pilla, *supra* note 51 (noting Coventry Financial's efforts to put together a trade association).

99. Hillman, *supra* note 26. "The primary goal of the coalition is to encourage life insurance companies to advise policy owners they have an alternative to lapsing or surrendering their life insurance policy, and of the potential increase in policy value if they were to pursue a life settlement." Coventry Fin., *New Life Settlement Coalition Established to Lobby Insurance Industry for Consumer Education on Life Settlements* (Aug. 10, 2001), *at* http://www.coventryfinancial.com/newsevents/files/Covcoal.pdf (last visited Apr. 4, 2002).

100. Hillman, *supra* note 26.

101. *Id.*

102. *Id.* VLSAA's purpose is to educate both the public and government officials about the viatical and senior settlement industry by working with state and federal legislators and regulators. Viatical & Life Settlement Association of America, *at* http://www.viatical.org/index.html (last visited Aug. 20, 2002) [hereinafter VLSAA]. VLSAA is a non-profit trade association composed of viatical and senior settlement brokers, providers (funders), and other organizations with interests in the industry. *Id.*

103. VLSAA, *supra* note 102, *at* http://www.viatical.org/memlist.html (last updated Aug. 16, 2002).

104. VLSAA, *supra* note 102, *at* http://www.viatical.org/aboutvlsaa.html (last updated June 5, 2001). VLSAA members have "pledged to comply with all state, local and federal laws as well as a stringent Code of Ethics. They have pledged to be honest and fair in all their business dealings—particularly with the persons from whom they are buying policies." *Id.*

105. VLSAA, *supra* note 102, *at* http://www.viatical.org/news/index.html (last updated Nov. 27, 2001). The Compliance and Fraud Review Team would be

A major advantage that the senior settlement industry has over its viatical settlement counterpart from a few years earlier is that most of the funding backing senior settlements comes from institutional investors, not from the smaller independent investors.[106] With estimated funding at one billion dollars going into the senior settlement industry in 2002, it is imperative that all fifty states adopt laws regulating such transactions.[107]

The National Coalition of Insurance Legislators is yet another organization working to regulate senior settlements. NCOIL is comprised of state legislators who specifically deal with the insurance industry's public policy issues.[108] NCOIL's purpose is to aid state legislators in making informed decisions on insurance issues that affect people within their states.[109] NCOIL adopted the Life Settlements Model Act in November 2000.[110] The Life Settlements Model Act incorporates consumer and purchaser protection provisions that many state insurance departments have been considering.[111] NCOIL is just another example of the industry's commitment to weed out fraudulent activity and make the senior settlement industry a reliable financial opportunity.

In December 2000, the Life Insurance and Annuities Committee of the NAIC adopted a report that outlined state regulation of senior settlements and expanded the definitions of "viator" and "viatical settlement contract" to include senior settlements.[112] The Model Act currently defines a "viator" as:

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responsible for identifying and reporting potential fraud indicators such as inconsistencies in documents or activities. *Id.*

106. *See* Treaster, *supra* note 87 (noting a lack of "capital to take on the larger policies that are being offered by older people" among small firms).

107. Meg Green, *Institute to Track Viatical, Life Settlement Fraud*, BEST'S INS. NEWS, July 12, 2002, *available at* 2002 WL 23010310 ("Institutional investors have committed $1 billion to buy life settlements this year . . . [w]ithin four or five years, they expect to need $2.5 billion annually to buy expected face amounts of $10 billion to $15 billion.").

108. National Conference of Insurance Legislators, *at* http://www.ncoil.org/ncoilinfo/about.html (last visited Aug. 20, 2002).

109. *Id.* NCOIL's purpose is to also oppose federal encroachment of state authority in regulating the insurance industry as authorized under the McCarran-Ferguson Act of 1945. *Id.* The McCarran-Ferguson Act authorized states to regulate the insurance industry under the oversight of Congress. *Id.*

110. LIFE SETTLEMENTS MODEL (Nat'l Coalition of Ins. Legislators, 2000), *available at* http://www.ncoil.org/other/model6.html.

111. LIFE SETTLEMENTS MODEL ACT §§ 3–14; *NCOIL Adopts New Model Law*, *supra* note 25.

112. MODEL ACT, *supra* note 14, § 697-1(L), (R); Panko, *supra* note 52.

> the owner of a life insurance policy or a certificate holder under a group policy who enters or seeks to enter into a viatical settlement contract. For the purposes of this Act, a viator *shall not be limited* to an owner of a life insurance policy or a certificate holder under a group policy insuring the life of an individual with a terminal or chronic illness or condition . . . .[113]

A "viatical settlement contract" has been broadened to include a senior settlement sale by defining this type of contract, in pertinent part, as:

> a written agreement establishing the terms under which compensation or anything of value will be paid, which compensation or value is less than the expected death benefit of the insurance policy or certificate, in return for the viator's assignment, transfer, sale, devise or bequest of the death benefit or ownership of any portion of the insurance policy.[114]

For regulatory purposes, the NAIC now treats a senior settlement as it would a viatical settlement involving a terminally ill individual.[115] The problem, however, is that state legislatures, which do actually regulate the industry, have not all adopted this broadened definition.[116] Thus, senior settlements remain unregulated in several states.[117]

### 3. STATE REGULATION

Each state must determine its own regulatory treatment of senior settlement transactions and decide whether to adopt the Model Act and Model Regulation.[118] Several states require viatical and senior settlement providers to have a license or to be registered with the insurance commissioner in order to conduct settlement transactions in that state.[119] Some states only require the settlement company to have a license, while other states require both the settlement company and the funding company to have licenses.[120] As part of its commitment to develop consumer confidence in the viatical and senior settlement industry, VLSAA requires all member companies to pledge to obtain either a license or other authorization required by state law to perform

113. MODEL ACT, *supra* note 14, § 697-1(2)(R) (emphasis added).
114. *Id.* § 697-1(2)(L).
115. Stefanova, *supra* note 23, at B11.
116. Ray, *supra* note 12, at 339.
117. *Id.*
118. Panko, *supra* note 52.
119. VLSAA, *supra* note 102, *at* www.viatical.org/questions.html.
120. *Id.*

settlement transactions.[121] The following discussion examines state laws in California, Florida, and Illinois.[122]

In Florida, the "Viatical Settlement Act" was passed on October 1, 1996, to incorporate the Model Regulations.[123] A viatical settlement contract is defined in Florida as a written agreement

> to transfer ownership or change the beneficiary designation of a life insurance policy at a later date, regardless of the date that compensation is paid to the viator. The agreement must establish the terms under which the viatical settlement provider will pay compensation or anything of value, which compensation or value is less than the expected death benefit of the insurance policy or certificate of insurance to the viatical settlement provider.[124]

Florida's definition is written broadly enough to include a senior settlement transaction in its meaning. In contrast, California's definition, prior to revisions, was much narrower:

> [A]n agreement entered into between a person owning a life insurance policy upon the life of a person with a catastrophic or life-threatening illness or condition and another person by which the policy owner receives compensation or anything of value less than the death benefits of the insurance policy in return for an assignment, transfer, sale, devise, or bequest of the death benefits or ownership of the insurance policy.[125]

From a regulatory standpoint, Florida's definition is more encompassing and follows the Model Act more closely.[126] In 2000, California amended its code to include senior settlement language.[127] California's amended code specifically defines a life settlement (a.k.a.

121. *Id*. As of May 1, 2001, licenses were required for viatical settlement companies for terminally ill people in the following twenty-nine states: Alaska, California, Connecticut, Delaware, Florida, Illinois, Indiana, Kentucky, Kansas, Louisiana, Maine, Massachusetts, Minnesota, Mississippi, Montana, Nebraska, North Carolina, North Dakota, New Mexico, New York, Ohio, Oklahoma, Oregon, Tennessee, Texas, Virginia, Vermont, Washington, and Wisconsin. *Id*. The following states require licenses for companies buying policies from people with a life expectancy of two or more years: Alaska, Florida, Mississippi, Ohio, and Texas. *Id*. Some states, such as Maine, Montana, and Utah, make the sale of a healthy person's policy illegal. *Id*.

122. PROFILE 2000, *supra* note 64. In 1999, fifty-two percent of persons aged sixty-five or older lived in nine states: California had over 3.6 million; Florida, 2.7 million; New York, 2.4 million; Texas, 2.0 million; and Pennsylvania, 1.9 million. *Id.* Ohio, Illinois, Michigan, and New Jersey each had over one million elderly. *Id*.

123. FLA. STAT. ANN. § 626.991 (West 2001).

124. *Id*. § 626.9911(5)

125. CAL. INS. CODE § 10113.1(a)(1) (West 2000).

126. FLA. STAT. ANN. § 626.991; *see also* MODEL ACT, *supra* note 14, § 697-1(2)(L).

127. CAL. INS. CODE § 25023(a). The language used by the California Code actually refers to "life settlement contract" which is the same as a "senior settlement contract" for discussion purposes. *Id.*

senior settlement) contract as "an agreement other than a viatical settlement contract, for the purchase . . . transfer . . . of any portion of the death benefit or ownership of a life insurance policy . . . that is less than the expected death benefit of the life insurance policy or certificate."[128]

In comparison, Illinois does not currently conform with the language of the Model Act.[129] Illinois narrowly defines a "viator" as a policyholder with a "catastrophic or life threatening illness or condition" entering into a viatical settlement agreement.[130] A "viatical settlement contract," as defined by Illinois insurance statutes, only includes contracts between a viatical settlement provider and a policyholder who is specifically insured as a person with a "catastrophic or life threatening illness or condition."[131] This language, unless expanded to include Model Act definitions that cover senior settlement transactions, could potentially leave the Illinois elderly open to dealings with unlicensed agents and brokers.

Both the California and Florida state statutes require that senior settlement companies be licensed and follow specific reporting and disclosure rules.[132] Illinois does have similar licensing requirements to those of California and Florida for viatical settlements, but does not have licensing requirements for senior settlements.[133] In general, licensing procedures are discretionary and extensive. For example, in California, the Insurance Commissioner has the discretion to ask for any records he or she feels necessary to make an appropriate determination regarding licensing of a settlement provider.[134] The Commissioner may deny the application if it is determined that it is "contrary to the interests of the public to issue a license to the applicant."[135]

128. *Id.*
129. 215 ILL. COMP. STAT. ANN. § 158.5 (2000); MODEL ACT, *supra* note 14, § 697-1(2)(c).
130. 215 ILL. COMP. STAT. ANN. §158.5.
131. *Id.*
132. Under the state statutes, the insurance commissioner or state insurance department must license viatical companies. CAL. INS. CODE § 10113.2 (West 2002); FLA. STAT. ANN. § 626.9916 (West 2001). In California, a license application must be submitted with a fee of $2,833. CAL. INS. CODE § 10113.2(b)(1). In Florida, a license application should be accompanied by a $50 filing fee. FLA. STAT. ANN. § 626.9916(2). Illinois requires a license fee of $1,500 and an annual renewal fee of $750. 215 ILL. COMP. STAT. ANN. § 158.10(b),(c) (2000).
133. *See* CAL. INS. CODE § 10113.2(b)(1); FLA. STAT. ANN. § 626.9922.
134. CAL. INS. CODE § 10113.2(b)(1).
135. *Id.*

The Model Act disclosure requirements that California and Florida adopted are geared toward protecting an elderly person prior to selling his or her life insurance policy.[136] For example, a senior settlement provider must inform the senior that there are other alternatives to a senior settlement contract, such as an accelerated death benefit offered by the life insurance company.[137] The provider must inform the senior that the proceeds of the settlement could be taxable and that advice should be obtained from a tax expert.[138] The provider must also disclose to the senior that receipt of settlement proceeds could adversely affect the senior's government-funded aid such as Medicaid or Medicare eligibility, that there is an unconditional rescission provision that allows the senior to rescind the contract within fifteen days after receiving senior settlement proceeds, and the independent third-party escrow agent's phone number and address.[139]

Depending on the state, senior settlement providers and their agents may be subject to harsh penalties for failure to conduct settlement transactions in accordance with state statutes requiring fair dealings with policyholders.[140] For example, both Florida and California impose a penalty of up to ten thousand dollars for licensed agents who fail to comply with their respective states' insurance statutes regarding viatical and senior settlements.[141] In Florida, a settlement company can have its license revoked, suspended, or not renewed if the state insurance department finds that the licensee/settlement company has committed any of the following acts: misrepresenting itself in the license application; acting fraudulently or dishonestly; being untrustworthy or incompetent to act as a settlement provider; being found guilty of any felony or of a misdemeanor involving fraud or immoral acts "regardless of whether a judgment of conviction has been entered by the court;" issuing settlement contracts that have not been approved by the insurance commissioner; dealing in bad faith; failing to honor contractual obligations it has made with its clients involving viatical and senior settlements; or demonstrating a pattern of unreasonable payments to viators.[142] In California, no licensed person

136. *See* CAL. INS. CODE § 10113.2(d); FLA. STAT. ANN. § 626.9923.
137. *See* CAL. INS. CODE § 10113.2(d); FLA. STAT. ANN. § 626.9923.
138. *See* CAL. INS. CODE § 10113.2(d); FLA. STAT. ANN. § 626.9923.
139. *See* CAL. INS. CODE § 10113.2(d); FLA. STAT. ANN. § 626.9923.
140. FLA. STAT. ANN. § 626.9914.
141. CAL. INS. CODE § 10113.2(j) (West 1993); FLA. STAT. ANN. § 626.9914(2).
142. FLA. STAT. ANN. § 626.9914(1).

or settlement company shall conduct business with "false or misleading advertising, solicitation, or practice."[143] Of the two, Florida's list of unacceptable practices is more encompassing and shows greater awareness of the type of practices the Model Act was enacted to prevent.[144]

Both California and Florida insurance laws grant the respective state insurance commissioner the authority to investigate the business and dealings of any settlement licensee or applicant for a license "whenever he or she deems it reasonably necessary to protect the interests of the public."[145] If the state commissioner finds any misconduct, he or she has the right to serve a cease and desist order upon the settlement company regarding any conduct that violates the laws regulating viatical and senior settlements.[146]

State regulations in California and Florida, pursuant to the Model Act, also protect the elderly policyholder by requiring extensive disclosures and procedures on the part of the senior settlement companies to prevent illegal activity. For instance, Florida requires the settlement provider to first obtain a document in which the elder/viator, with a witness present, consents to the senior settlement contract, represents that he or she fully understands the contract and the benefits of the life insurance policy, releases his or her medical records, and acknowledges that he or she "freely and voluntarily" entered into the agreement with the settlement provider.[147]

#### 4. TAX IMPLICATIONS

With the quick rise of viatical settlements, Congress realized that the tax laws needed to be revised to include settlement transactions. In 1996, Congress passed the Health Insurance Portability and Accountability Act (HIPAA), which allows individuals to exclude from gross income the proceeds received from most viatical settlements.[148] People who are deemed terminally ill, certified by a physician to have a physical condition which could reasonably lead to death in twenty-

143. CAL. INS. CODE § 10113.2(m) (West 1997).
144. *See* FLA. STAT. ANN. § 626.9914(1); CAL. INS. CODE § 10113.2(m).
145. CAL. INS. CODE § 10113.2(g); FLA. STAT. ANN. § 626.9922 (West 1996).
146. CAL. INS. CODE § 10113.2(i); FLA. STAT. ANN. § 626.9922.
147. FLA. STAT. ANN. § 626.9924 (West 1996).
148. Marc A. Cohen & Maurice Weinrobe, HIAA, *Tax Deductibility of Long-Term Care Insurance Premiums: Implications for Market Growth and Public LTC Expenditures (Summary of Research Findings)* 2 (Mar. 2000), *available at* http://www.hiaa.org (last visited Nov. 24, 2001).

four months or less, or chronically ill, as certified by a physician, can treat the amount they received via a viatical settlement contract as an amount paid by reason of the death of the senior.[149] Chronically ill individuals face a dollar cap exclusion amount of $175 per day, reduced by reimbursements; however, "if payments exceed the cap, the excess is excludable to the extent of costs for long-term care services and to the extent that the Section 72 basis recovery rules do not apply."[150] The Internal Revenue Code (Code) does not allow for the exclusion of senior settlements that fall outside the definition mentioned above, and the cash received is taxable at the senior's tax rate.[151] Due to the significant tax issues involved, the Model Act requires settlement providers to inform the elderly consumer that "proceeds of the viatical settlement may be taxable under federal income tax and state franchise and income taxes, and assistance should be sought from a professional tax advisor."[152]

## B. Arguments Against Senior Settlements

### 1. LACK OF REGULATION

In 1996, the viatical industry, which directly affects the senior settlement industry, faced major changes leading to the problems that contaminated the industry in the late 1990s.[153] In that year, the District of Columbia Circuit Court ruled in *SEC v. Life Partners, Inc.*[154] that viatical investments are not securities within the meaning of the Securities Act of 1933.[155] The Securities and Exchange Commission (SEC) argued that the purchase of a fractional interest in a viatical settlement is a security, and therefore falls within its regulatory powers.[156] Such a

149. 26 U.S.C. § 101(g) (2002).

150. Julia K. Brazelton & Rebecca Kaenzig, *Accelerated Death Benefits Finally Afforded Exclusion*, TAXES, Jan. 1997, at 61, *available at* 1997 WL 24686235; *see also* 26 U.S.C. § 7702B(d) (2002).

151. *See* 26 U.S.C. § 101(g) (2002).

152. MODEL ACT, *supra* note 14, § 697-1(8)(2).

153. Eisenberg, *supra* note 20. Between 1999 and 2000, federal and state authorities issued seventy-eight indictments relating to fraudulent activity in the viatical settlement industry, fifty-seven of which resulted in convictions. Carole Fleck, *Buying This Insurance Can Leave You Poorer*, AARP BULL., Sept. 2001, at 7.

154. *SEC v. Life Partners, Inc.*, 87 F.3d 536, 549 (D.C. Cir. 1996).

155. *Id.*

156. *Id.* at 545–48. To determine the issue of whether the fractional interests purchased as part of a viatical settlement are securities within the meaning of the Securities Act of 1933, the court applied a three-part test set forth in *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946). *Life Partners*, 87 F.3d at 540. The Supreme Court in

classification would have required viatical companies to register with the SEC and comply with its strict filing and disclosure requirements.[157] The court's ruling allows unlicensed sales agents to sell viatical settlements.[158] There have been no cases relating to the classification of senior settlements, but it can be presumed that the *Life Partners* ruling applies to them. Currently, the elderly consumers and investors must rely on state insurance laws to regulate senior settlement providers.

According to the NAIC, the licensing and disclosure laws that apply to viatical settlements are not applicable to senior settlements, "leaving them unregulated in many states."[159] As discussed above, many states are now expanding the definition of viatical settlements to include senior settlements in an effort to increase regulation of the industry.

### 2. PONZI SCHEMES

Critics of senior settlements argue that the lack of regulation allows unscrupulous agents to defraud investors in what are known in the industry as Ponzi schemes.[160] One type of Ponzi scheme occurs when a viatical or senior settlement company creates false life insurance policies and then entices investors to contribute money with promises of high returns to the investor.[161] Of course, these imaginary life insurance policies have little or no payouts and the investor is

*Howey* held that "an investment contract is a security if the investors (1) expect profits from (2) a common enterprise that (3) depends upon the efforts of others." *Id*. Because viatical settlements fail the third part of the *Howey* test, the court in *Life Partners'* held that viatical settlements are not securities. *Id*. For a more in-depth analysis of the *Life Partners* ruling and its effect on the viatical settlement industry see Michael R. Davis, Note, *Unregulated Investment in Certain Death:* SEC v. Life Partners, Inc., 42 VILL. L. REV. 925 (1997), and Shanah D. Glick, Comment, *Are Viatical Settlements Securities Within the Regulatory Control of the Securities Act of 1933?*, 60 U. CHI. L. REV. 957 (1993).

157. *See* Ray, *supra* note 12, at 340.

158. John Murawski, *Laws Sought to Protect Viatical Investors*, PALM BEACH POST, Aug. 22, 1999, at 2F.

159. Fleck, *supra* note 153, at 7.

160. http://www.invested-inc.com/cgi-bin/MORE.cgi?id=28&box=16 (last visited Aug. 20, 2002). A Ponzi scheme has its origin from a man by the name of Charles Ponzi who executed this type of fraud, which is defined as "a form of fraud in which belief in the success of a fictive enterprise is fostered by payment of quick returns to the first investors from money invested by later others." 12 THE OXFORD ENGLISH DICTIONARY 101 (2d ed. 1989).

161. http://www.invested-inc.com/cgi-bin/MORE.cgi?id=28&box=16, *supra* note 160.

cheated out of his or her cash investment.[162] A large-scale Ponzi scheme was recently put to a halt when Florida's Department of Banking and Finance filed a cease and desist order against American Benefits Services, Inc. (American Benefits), a Florida-based viaticals product firm with a nationwide group of brokerage firms and individuals.[163] Between 1996 and 2001, American Benefits funneled $117 million from Florida residents to the company's parent, Financial Federated Title & Trust (Financial Federated), to purchase viatical settlements.[164] In reality, Financial Federated only invested six million dollars of that amount into viatical settlements; the rest of the money went into the pockets of the scheme's operators.[165] American Benefit's products were a "Ponzi scheme in which money from new investors went to pay returns to existing investors."[166] The defrauded investors will most likely not recover their invested money, but the operators of this scheme face criminal charges, with one person having already been sentenced to fifty-five years in prison.[167]

### 3. PREYING ON THE ELDERLY AND ETHICAL CONCERNS

There are arguments that the elderly are easy prey for deceitful insurance agents because many elderly are often home, have time to listen, and will welcome a visitor, even if it is an insurance agent.[168] This argument is based on the theory that "many of the elderly suffer from cogitative deficits, depression, or social isolation that makes them vulnerable to financial exploitation."[169] The Model Act requires that the senior settlement provider disclose to the elderly policyholder

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162. *Id*.
163. *Id*.
164. *Id*.
165. *Id*.
166. *Id*.
167. *Id*. American Benefit's investors can anticipate to recover no more than ten to fifteen cents for each dollar invested. *Id*. In an April 2001 report published by state securities regulators, viaticals were deemed to be one of the top ten investment scams in the United States. Fleck, *supra* note 153, at 8. As more states adopt regulatory safeguards, fraudulent activity that once tainted the viatical industry should dissipate, leaving the elderly protected by the regulatory safeguards upholding the senior settlement industry. *Id*.
168. Lawrence A. Frolik, *Insurance Fraud on the Elderly*, TRIAL, June 2001, at 48.
169. *Id*. (arguing that some of the common problems associated with aging, such as bad vision, poor hearing, and short-term memory losses, contribute to the vulnerability of the elderly when it comes to financial deception).

that there are other financial alternatives and that a senior settlement may have state aid and/or tax implications.[170]

One of the biggest ethical criticisms of the senior settlement industry is the morbid notion that investors are waiting for a person to die, and the sooner that person dies, the greater the investor's rate of return.[171] On the other hand, there are those that argue that investors are in fact helping those who can no longer afford their high premiums by providing them with a financial alternative to long-term care.[172] This Note is not advocating that the elderly go out and sell their life insurance policies, but is instead advocating that a senior settlement is a viable financial alternative for those seeking one. As the elderly consumer becomes more educated and the senior settlement companies become more regulated, the types of fraudulent activities that infected the viatical industry in the 1990s should be remedied.

Three categories of ethical issues have been identified in the settlement industry: conflicts of interest, confidentiality issues, and fraud.[173] The conflict of interest category relates to the strong financial incentives that are created between competing parties.[174] For example, a nursing home that is paid more by private patients than by Medicaid "has a strong financial incentive to pressure patients" to enter into a senior settlement agreement, in effect benefiting the nursing home's best interests, and not necessarily the policyholder's best interests.[175] Another potential conflict of interest could arise in relationships between health care providers and senior settlement compa-

170. MODEL ACT, *supra* note 14, § 697-1(8). A settlement provider or broker must at least disclose the following information: (1) there are alternatives to viatical settlement contracts, such as accelerated benefits offered by the insurance company; (2) assistance should be obtained by a tax advisor because the proceeds may or may not be taxable; (3) proceeds could be subject to the claims of creditors; (4) government benefits or entitlements may be adversely affected by receipt of senior settlement proceeds; (5) after receipt of the proceeds, the insured has fifteen calendar days to rescind the contract (if insured dies during rescission period, contract deemed rescinded); (6) funds will be sent to the insured within three business days after the policy has been transferred; (7) other rights or benefits may be affected, including conversion rights and waiver of premium benefits; (8) disclosure to the policyholder shall be made in the form of a brochure describing the senior settlement process; (9) disclosure language forewarning inquiries into the senior's health status will be made periodically; and (10) contact regarding the senior's health is limited to once every three months. *Id.*

171. Albert, *supra* note 18, at 362 n.46.

172. *Id.*

173. *Id.* at 363.

174. *Id.*

175. *Id.* at 364.

nies.[176] If a doctor invests in the purchase of a life insurance policy of one of his or her own patients, the doctor's rate of return would be linked to the length of the patient's life.[177] The Model Act, in an effort to address this concern, added a section providing that 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 a senior settlement contract.[178]

The second category of ethical concerns deals with the tension between protecting seniors' confidential medical records and providing senior settlement companies with enough information to properly determine life expectancy.[179] The Model Act has adopted language to address this issue by requiring settlement providers to deem all information obtained from a senior as confidential and personal.[180] If states adopt the language of the Model Act, seniors would be provided with additional protection, while settlement providers would still be allowed the necessary information they need to adequately price a policy.

Fraud is the third and strongest ethical concern prevalent in the senior settlement industry.[181] The NAIC is aware of the impact that fraud has had on the viatical industry and has dedicated an entire section to the prohibition of fraudulent activity.[182] The Model Act requires that viatical and senior settlement contracts contain the following 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."[183] The Model Act also requires reporting fraudulent acts. Any person or business having knowledge or a reasonable belief that a fraudulent act concerning a viatical or senior settlement is being, or has been, committed

176. *Id.*
177. *See id.*
178. MODEL ACT, *supra* note 14, § 697-1(F)(1).
179. Albert, *supra* note 18, at 366.
180. MODEL ACT, *supra* note 14, § 697-17(E)(1) (requiring that all of the senior's information obtained by the senior settlement company be considered private and confidential).
181. Albert, *supra* note 18, at 367; *see* MODEL ACT, *supra* note 14, § 697-12.
182. MODEL ACT, *supra* note 14, § 697-12(B)1.
183. *Id*.

must report the act to the state's insurance commissioner.[184] Furthermore, the Model Act provides for immunity from liability for individuals that provide information "concerning suspected, anticipated or completed fraudulent insurance acts" if the person meets other statutory requirements.[185]

#### 4. RISKS TO INVESTORS

Apart from the risks to the elderly policyholder, there are also risks involved on the investor/purchaser side of the transaction that need to be addressed.[186] One risk is that the insured may live longer than was originally estimated, thereby reducing investor return and requiring payment of more premiums than anticipated.[187] If fraudulent activity is detected, the life insurance company can contest the policy, and refuse to pay out death benefits.[188] Relatives of the insured could cause delays in receiving the death proceeds if they challenge any changes made to the insurance policy.[189] Furthermore, the investor's money is not liquid while tied up in a senior settlement agreement.[190] Senior settlements are not liquid investments because investors do not have access to the death benefits until the senior dies and the life insurance company pays the benefits.[191]

## IV. Recommendations

Based on the discussion above, and the increased regulatory safeguards that states continue to implement, senior settlements are becoming a safer financial transaction. This Note does not recommend that the elderly sell their life insurance policies. As an alternative to allowing a policy to lapse, or to obtaining the cash surrender

184. *Id*. § 697-12(C)(1).
185. *Id.* § 697-12(D)(1). The following individuals are immune from liability for providing information about fraudulent viatical/senior settlements activity: the commissioner; federal, state or local law enforcement or regulatory officials; a person involved in the prevention and detection of fraudulent settlement acts; the NAIC; the National Association of Securities Dealers (NASD), the North American Securities Administrators Association (NASAA); and the life insurer that issued the life insurance policy. *Id*.
186. Fleck, *supra* note 153, at 7 (citing the Washington-based Coalition Against Insurance Fraud).
187. *Id.* (citing the Washington-based Coalition Against Insurance Fraud).
188. *Id.*
189. *Id.*
190. *Id.*
191. *Id.*

value of the policy, however, senior settlements offer the elderly one financial option among several.

### A. Legal Counsel Requirement

State regulations like those discussed in Florida and California should encourage the legal community's involvement. Senior settlement providers in those states may be required to inform the elderly client that a tax advisor should be sought to discuss tax implications.[192] A provision should be added to the Model Act requiring a senior settlement provider to recommend obtaining advice of legal counsel or an estate planner prior to proceeding with a senior settlement contract. The attorney would be responsible for ensuring that the settlement provider is properly licensed and in good standing within the industry. Additionally, the attorney would make the elder aware of his or her rights as the seller of a life insurance policy to a third party.

Furthermore, the elder should be made aware of the various implications of entering into a senior settlement. For example, an attorney would be required to explain to the elder that creditors may claim his or her proceeds from the sale of the policy. Another controversial consideration elderly individuals should be informed of is that the personal and medical records provided to the senior settlement provider might be shared with third parties who may later sell the policy and pass along the seller's confidential information to others.[193] Consultation with an attorney could alleviate some of the questions and concerns an individual may have about the senior settlement process.

### B. Tax Incentives

To help with the long-term care crisis facing our elderly, the Internal Revenue Code should incorporate language that would allow for cash received as part of a qualified senior settlement transaction to be excluded from taxable income. The money is going to elderly individuals who are sixty-five or older and are likely to only have a three- to five-year life expectancy, as determined by the senior settlement company based on the senior's medical information. By revising the Code to include such language, the government is in effect saying to

192. *See* FLA. STAT. ANN. § 626.9923 (West 1996).
193. Fleck, *supra* note 153, at 7.

the elderly population that senior settlements are a viable financial option, just as they did for viators when they finally included the benefits received in viatical settlement contracts with the passing of the HIPAA in 1996.

### C. State Uniformity

Insurance is regulated by the individual states. With regard to the treatment of senior settlements, wide disparity exists among the states. There are some states on one end of the spectrum like California and Florida that have closely adopted the Model Act and the Model Regulation. In the middle, there are states like Illinois, which only regulate viatical settlements and have not expanded statutory language to include the regulation of senior settlement transactions. At the other end are states like Alaska that have not adopted any regulation regarding viatical or senior settlements. Until every state adopts a version of the Model Act and Model Regulation as law, there will be elderly policyholders and innocent investors who may not be protected from fraudulent activity. Additionally, uniformity in senior settlement insurance law would make the terms and conditions of selling and buying life insurance policies more consistent among the parties involved.

## V. Conclusion

Senior settlements provide the elderly with a viable financial alternative for long-term care. Despite criticism associated with the viatical industry of the 1990s, the senior settlement industry of the new millennium is a modern and improved system. As states continue to monitor and update statutes to emulate the Model Act and Model Regulation, the elderly can be assured of heightened protection from fraudulent activity. Strict licensing and disclosure requirements by all senior settlement providers should prove to be a strong shield in protecting both investors and elderly policyholders, making senior settlements a feasible investment option. John would feel protected from fraudulent business practices when he sells his $500,000 life insurance policy and uses that money for a care facility and/or therapy treatments without putting a financial strain on his loved ones.