HB

190

2/2/00 JUD

1-LS0576\N
Bannister
2/1/00

CS FOR HOUSE BILL NO. 190(JUD)

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTY-FIRST LEGISLATURE - SECOND SESSION

BY THE HOUSE JUDICIARY COMMITTEE

Offered:
Referred:

Sponsor(s): HOUSE LABOR AND COMMERCE COMMITTEE

A BILL

FOR AN ACT ENTITLED

"An Act relating to viatical settlement transactions; and providing for an effective date."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* **Section 1.** AS 21.36 is amended by adding a new section to read:

Sec. 21.36.055. Violation of viatical settlement provisions prohibited. A person may not violate the viatical settlement transaction provisions of AS 21.89.110 or regulations adopted under AS 21.89.110.

* **Sec. 2.** AS 21.89 is amended by adding a new section to read:

Sec. 21.89.110. Viatical settlement transactions. (a) The director shall regulate the transaction of viatical settlement contracts for the protection of viators, insureds, and insurers. The authority of the director under this subsection extends to the regulation of transactions between a viator and a viatical settlement provider and between a viator and a person acting as an agent in viaticating a life insurance policy, while the authority of the commissioner extends to the regulation of viatical settlement

New Text Underlined [DELETED TEXT BRACKETED] investments as provided under AS 45.55.905(c).

(b) A viatical settlement provider, representative, or broker must apply for a license with the director, submit information required by the director, and pay the required fee established under AS 21.06.250 with the application for licensure. A person may not act as or represent to be a viatical settlement provider, representative, or broker relative to a subject resident, located, or to be performed in this state unless licensed under this section.

(c) Viatical settlement contract forms, viator and insured disclosure statements, and viatical settlement advertising materials must be filed by the viatical settlement provider, representative, or broker with the director and must be approved by the director.

(d) The director may examine a licensed viatical settlement provider, representative, or broker, or an applicant for a viatical settlement provider, representative, or broker license. The cost of the examination shall be paid by the person examined under AS 21.06.160.

Div of Ins

New language

(e) Except as may be required in the course of conduct of the division's responsibilities, a viatical settlement provider, representative, or broker may not disclose to another person the ~~name~~ identity of the viator or insured of an insurance policy that is the subject of a viatical settlement contract. The viator may waive this prohibition against disclosure if the waiver is in writing and is signed by the viator.

(f) The director may adopt regulations to implement this section, including standards for

(1) viatical settlement provider, representative, and broker reporting requirements and records retention;

(2) viator and insured privacy protection;

(3) viatical settlement contract provisions, advertising materials, and filing requirements;

(4) payments to viators or insureds, including evaluating the reasonableness of payments under a viatical settlement contract;

(5) licensing requirements, including license qualification, disqualification, and renewal;

(6) financial accountability of viatical settlement providers;

(7) the relationship and responsibilities of insurers, viators, insureds, and viatical settlement providers, representatives, and brokers in the transaction of a viatical settlement contract;

(8) viator, insured, and insurer protection, including full and fair disclosure setting out the manner and content of required disclosures and filing requirements; and

(9) assessment of fees to cover the cost of regulating viatical settlement contracts, providers, representatives, and brokers.

(g) A violation of this section or a regulation adopted under this section is an unfair trade practice and subject to penalty under AS 21.36.

(h) In this section,

(1) "transaction" means, with respect to viatical settlement contracts,

(A) solicitation and inducement;

(B) preliminary negotiations;

(C) effectuation of a viatical settlement contract;

(D) transaction of matters subsequent to the effectuation of the viatical settlement contract and arising out of it;

(2) "viatical settlement broker"

(A) means a person that, on behalf of a viator or insured and for a fee, commission, or other valuable consideration, offers or attempts to negotiate viatical settlement contracts between a viator or insured and one or more viatical settlement providers;

(B) does not include a person acting as an attorney or accountant retained to represent a viator or insured and compensated by or at the direction of the viator or insured;

(3) "viatical settlement contract"

(A) means a written agreement between a viator or insured and a viatical settlement provider for the sale, assignment, transfer, devise, or bequest to the viatical settlement provider by the viator or insured of all or a portion of the death benefit or ownership of a life insurance policy for consideration that is less than the expected death benefit of the life insurance policy;

(B) includes a contract for a loan or other financial transaction secured primarily by an individual or group life insurance policy;

(C) does not include

(i) a loan by a life insurance company under the terms of a life insurance contract;

(ii) a loan secured by the cash value of a policy;

(iii) the assignment of a life insurance policy as collateral for a loan to a bank, saving bank, savings and loan association, credit union, or other licensed lending institution;

(iv) the exercise by the viator or insured of an accelerated benefits provision under the terms of the life insurance contract; or

(v) the sale, assignment, transfer, devise, or bequest of a life insurance policy for less than the expected death benefit by a viator or insured to a friend or family member if the friend or family member does not enter into more than one agreement in a calendar year;

(4) "viatical settlement provider" means a person, other than a viator or insured, that enters into a viatical settlement contract, including a person that

(A) obtains financing for the purchase, acquisition, transfer, or other assignment of one or more viatical settlement contracts, viaticated policies, or interests in viatical settlement contracts or viaticated policies; or

(B) sells, assigns, transfers, pledges, hypothecates, or disposes of one or more viatical settlement contracts, viaticated policies, or interests in viatical settlement contracts or viaticated policies;

(5) "viatical settlement representative"

(A) means a person that is an authorized agent of a viatical settlement provider or broker and that acts or aids in any manner in the transaction of a viatical settlement contract;

(B) does not include

(i) a person acting as an attorney or an accountant, or a person exercising a power of attorney granted by a viator or insured; or

(ii) a person retained to represent a viator or insured and compensated by or at the direction of the viator or insured;

(6) "viaticated policy" means a life insurance policy that has been acquired by a viatical settlement provider under a viatical settlement contract;

(7) "viator" means the owner of a life insurance policy insuring the life of an individual who enters or seeks to enter into a viatical settlement contract.

* **Sec. 3.** AS 45.55 is amended by adding a new section to read:

Sec. 45.55.155. Viatical settlement interests. (a) Before the sale of a viatical settlement interest, an issuer shall provide a prospective buyer with information that is sufficient to make an informed investment decision. The issuer shall also provide the information to the administrator upon request if the issuer is not otherwise required to file the information with the administrator. In this subsection, "information that is sufficient to make an informed investment decision" includes [the ~~issuer's most recent audited income and expense statement and balance sheet, a statement of risks~~] and a disclosure of any significant ~~negative~~ factor(s) that may affect the outcome of the investment.

new Language

(b) Except as may be required in the course of conduct of the responsibilities of the Department of Community and Economic Development, an issuer of a viatical settlement interest may not disclose to another person the ~~name~~ identity of the viator or insured of the insurance policy that is the subject of the viatical settlement interest. The viator may waive this prohibition against disclosure if the waiver is in writing and signed by the viator.

* **Sec. 4.** AS 45.55.905 is amended by adding a new subsection to read:

(c) The administrator shall regulate transactions between a viatical settlement provider or person acting as an agent of a viatical settlement provider and a subsequent investor, while the authority of the director of the division of insurance extends to the regulation of viatical settlement contracts under AS 21.89.110.

*** Sec. 5.** AS 45.55.990(32) is amended to read:

(32) "security" means a note; stock; treasury stock; bond; debenture; evidence of indebtedness; certificate of interest or participation in any profit-sharing agreement; limited liability company interest under AS 10.50, notwithstanding the limitations of AS 45.08.103(c); collateral-trust certificate; preorganization certificate or subscription; transferable share; investment contract; voting-trust certificate; certificate of deposit for a security; **<u>viatical settlement interest;</u>** certificate of interest or participation in an oil, gas, or mining title or lease or in payments out of production under the title or lease or in any sale of or indenture or bond or contract for the conveyance of land or any interest in land; an option on a contract for the future delivery of agricultural or mineral commodities or any other commodity offered or sold to the public and not regulated by the Commodity Futures Trading Commission; however, the contract or option is not subject to the provisions of AS 45.55.070 if it is sold or purchased on the floor of a bona fide exchange or board of trade and offered or sold to the public by a broker-dealer or agent registered under this chapter; investment of money or money's worth including goods furnished or services performed in the risk capital of a venture with the expectation of some benefit to the investor where the investor has no direct control over the investment or policy decision of the venture; or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing; "security" does not include an insurance or endowment policy or annuity contract under which an insurance company promises to pay a fixed or variable sum of money either in a lump sum or periodically for life or for some other specified period;

*** Sec. 6.** AS 45.55.990 is amended by adding new paragraphs to read:

(37) "viatical settlement interest"

(A) means the entire interest or any fractional interest in a life insurance policy or in the death benefit under a life insurance policy that is the subject of a viatical settlement contract;

(B) does not include the initial purchase from the viator by a viatical settlement provider;

(38) "viator" means the owner of a life insurance policy insuring the life of an individual who enters or who seeks to enter a viatical settlement contract.

* **Sec. 7.** This Act takes effect immediately under AS 01.10.070(c).

ALASKA STATE LEGISLATURE
HOUSE LABOR AND COMMERCE COMMITTEE

Representative Norman Rokeberg, Chairman
Representative Andrew Halcro, Vice-Chairman
Representative John Harris
Representative Lisa Murkowski
Representative Jerry Sanders
Representative Tom Brice
Representative Sharon Cissna

State Capitol
Juneau, AK 99801-1182
Telephone: (907) 465-4954
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MEMORANDUM

TO: The Honorable Pete Kott, Chairman
House Judiciary Committee

FROM: Rep. Norman Rokeberg, Chairman Norman Rokeberg/jp
House Labor & Commerce Committee

DATE: January 27, 2000

RE: HB 190 - Viatical Settlements

Thank you for scheduling HB 190 before your committee this coming Monday (January 31st).

Attached are the following:

1. HB 190
2. CSHB 190 (L&C)
3. Two zero fiscal notes, one of which is from the House Labor & Commerce Committee which we would like replaced with #4 below which arrived too late for our committee to adopt.
4. Zero fiscal note from dated 1/24/00 from Division of Insurance, Department of Community and Economic Development
5. Sponsor statement
6. Sectional analysis
7. Informative items:
   a. "Alaska Division of Banking, Securities, and Corporations Policy Statement on viatical settlement contracts"
   b. "No insurance against this loss" from Internet Site: www.msnbc.com
   c. "Making a Killing" from Time Magazine, Nov. 29, 1999
   d. January 24, 2000, proposed regulations being considered by Division of Banking, Securities & Corporations
   e. "Death Watch", Kiplinger's Personal Finance Magazine, March 1999
   f. "Life-insurance payoff not always sure thing", Anchorage Daily News May 25, 1999.
   g. "Playing the Death Pool", *Best's Review*, April 1999
   h. "Rolling the Dice on Death", *Money*, September 1999
   i. "Insurance cheating alleged", *Anchorage Daily News,* August 5, 199
   j. "Fraud Alleged for 'Death' Investors, *AP*, August 4, 1999
   k. "State Securities Cops Release New List of 'Top 10 Investment Scams", NASAA web site.
8. The following persons may be interested in testifying on this legislation:
   a. Bob Lohr, Director, Division of Insurance (offnet teleconference from Anchorage)
   b. Terry Elder, Director, Division of Banking, Securities & Corporations (in Juneau)
   c. Vince Usera, Senior Securities Examiner, Division of Banking, Securities & Corporations (in Juneau)
   d. Mr. Michael McNerney, Viatical Association of America, (from Florida) 954-522-2200 (Brinkely, McNerney, Morgan, Solomon & Tatum)

FISCAL NOTE

STATE OF ALASKA	NO.
2000 LEGISLATIVE SESSION	BILL VERSION: CSHB 190 (L&C)
	PUBLISH DATE:

Revision Date:

Title: An Act relating to viatical settlement contracts

Department Affected: Community & Economic Development

BRU: Insurance

Sponsor: Labor & Commerce

Requestor: Labor & Commerce

Component: Insurance

COMPONENT SERIAL NO: 354

Expenditures/Revenues: (Thousands of Dollars)

OPERATING	FY 01	FY 02	FY 03	FY 04	FY 05	FY 06
PERSONAL SERVICES	0	0	0	0	0	0
TRAVEL	0	0	0	0	0	0
CONTRACTUAL	0	0	0	0	0	0
SUPPLIES	0	0	0	0	0	0
EQUIPMENT	0	0	0	0	0	0
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0	0	0	0	0	0
CAPITAL	0	0	0	0	0	0
REVENUE FUND SOURCE	0	0	0	0	0	0

FUNDING: (Thousands of Dollars)

GENERAL FUND	0	0	0	0	0	0
FEDERAL FUNDS						
OTHER FUND SOURCE						
TOTAL	0	0	0	0	0	0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

Estimate of current year impact:

ANALYSIS: (Attach a separate page if necessary)

It is unknown how many registrations will be received and processed. Fees collected will cover expenses. Zero fiscal impact.

Prepared By: Janet S. Seitz, Committee Assistant Phone: 465-4954

Division: House Labor & Commerce Committee Date: 01/24/00

Approved By: Rep. Norman Rokeberg, Chairman, House Labor & Commerce Committee

Agency: Date: 01/24/00

Distribution (by preparer): Leg. Finance, Legislative Sponsor, Requestor, OMB, Gov. , & Impacted Agency(ies).

FISCAL NOTE

STATE OF ALASKA
2000 LEGISLATIVE SESSION

BILL NO. HB 190

Revision Date/Time (Note if correction)		Dept. Affected	Community & Econ. Dev.
Title	Viatical Settlements	BRU	Banking, Securities, and Corporations
		Component	Banking, Securities, and Corporations
Sponsor	House Labor & Commerce		
Requester	House Labor & Commerce	Component Serial No.	1233

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )						

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY99) cost: ______

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

Viatical settlements involve the purchase by an investor of an insurance policy covering the life of an individual diagnosed with a terminal illness. The purchase is usually for a fraction of the face value of the policy, thus the terminally ill person receives money now to cover expenses and other considerations while the investor receives the right to the face amount of the policy on the viator's death. A life settlement is functionally the same, only the insured is not burdened with a terminal illness, thus these investments are contemplated for a considerably longer time period. Sales of these investments have been tainted with considerable fraud in the past and the public requires protections that only the state can implement. The division contemplates regulations and required disclosures, together with mandatory rescission periods, will adequately protect the average investor. Since the added regulation will likely keep most bad actors out of the state, and the division currently handles these as investment contracts, the additional supervision is not expected to impose any additional significant fiscal impact.

Prepared by	Franklin T. Elder, Director	Phone	465-2521
Division	Banking, Securities and Corporations	Date/Time	12/30/99 11:30 AM
Approved by Commissioner	Deborah B. Sedwick	Date	1/7/00
Agency	Community and Economic Development		

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FISCAL NOTE

STATE OF ALASKA
2000 LEGISLATIVE SESSION

BILL NO. CSHB 190 (L&C)

Revision Date/Time (Note if correction) "01/21/00
Dept. Affected Community & Economic Development
Title: An Act relating to viatical settlement contracts
BRU: Insurance
Component: Insurance
Sponsor: Labor & Commerce
Requester: Labor & Commerce
Component No. 354

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006
Personal Services	0.0	0.0	0.0	0.0	0.0	0.0
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )	0.0	0.0	0.0	0.0	0.0	0.0

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts	0.0	0.0	0.0	0.0	0.0	0.0
1037 GF/Mental Health						
Other (Specify Type)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2000) cost: 0.0

POSITIONS

Full-time	0	0	0	0	0	0
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

Section 2 of the Committee Substitute for HB 190 at page 2, lines 30-31, adds fee authority sufficient to cover the division's costs of regulating settlement contracts, providers, representatives and brokers. Nationally, 17 brokers and 11 providers have been identified. The number that would choose to be licensed in Alaska is unknown. However, the fees would be set to cover the division's actual cost of regulation under HB 190.

Prepared by: Robert A. Lohr Robert A. Lohr
Phone 269-7900
Division: Insurance
Date/Time 1-24-00 10:22 AM
Approved by Commissioner Deborah B. Sedwick [signature] for
Date 1-24-00
Agency: Community & Economic Development

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ALASKA STATE LEGISLATURE
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SPONSOR STATEMENT
COMMITTEE SUBSTITUTE FOR HOUSE BILL 190 (L&C)
An Act relating to viatical settlement contracts

Viatical settlement contracts, essentially, are agreements by investors to purchase at a discount a life insurance policy. The viatical industry has grown rapidly in the last decade and was originally limited to policyholders that had terminal or life-threatening illnesses. The industry has now expanded to include those who are not ill but just want to sell their life insurance policy. Purchase of these policies provides an investment alternative for investors. Much of the early growth of the industry was fueled by the AIDS health crisis. As medical advances prolonged the life expectancies of viators (or insured individuals), policies did not "mature" as expected, and returns were sometimes less than expected or were even negative. Sales abuses began to surface. It appears that investors often had little idea of the risks along with the potential rewards of these investments. Good public policy requires that we take a proactive position to protect Alaska investors from sales abuses that have appeared elsewhere in the country.

This bill adds viatical settlements as items covered under state law by the Division of Insurance before a contract of sale is signed and to Division of Banking, Securities, and Corporations (DBSC) at the time a viatical settlement provider begins to market this investment to others. Currently these settlements are not specifically mentioned in law but are considered to be a security for the purpose of Alaska's DBSC. The industry, however, has no way of knowing this unless they ask the Department. This means that unregistered securities sales may unintentionally take place in Alaska. This legislation makes the status of these items explicit, and provides for an exemption mechanism that is relatively easy for the industry to meet, while also increasing the protection of Alaska investors from sales abuses that have appeared in other parts of the country.

The financial press in recent months has published articles describing marketing abuses in the sale of viatical settlement contracts to investors. The abuses often center on inadequate risk disclosure. Investors are lead to believe the investment is a "sure thing." Then they discover these investments, under certain circumstances,

may be illiquid and may even result in losses. One investor's story described how he invested his IRA in a viatical settlement contract. When the viator did not die, the contract became illiquid. Since the investor was reaching the age of 70 and one-half, the IRS required him to make mandatory distributions from the IRA or suffer a large penalty. But, he could not make the distributions due to the illiquid investment.

In the face of these abuses, regulatory agencies across the country have begun to take action. In February 1999, the State of California issued an order against three viatical settlement providers for viatical sales without registration under the California securities act. In April 1999, the State of Oklahoma took an enforcement action against two viatical settlement providers for selling viatical settlement contracts without registration and without making proper risk disclosures to investors. Finally, in 1998, the SEC for the first time achieved full injunctive and monetary relief in a viatical settlement case when a company agreed to pay $950,000 to settle charges that viatical settlement contracts were sold to investors without proper disclosures.

The dual nature (having two divisions involved) of this bill is not unique. Other states have a similar regulatory scheme where the "insurance" aspect is regulated under insurance and the "investment/securities" aspect is regulated by a securities regulatory office. Additionally, both Insurance and DBSC also regulate other occupations. For example, a financial planner could be regulated by both as to sales of insurance and sales of securities.

In 1998, over $1.5 million of viatical contracts were sold in Alaska.

This fast growing area of investment needs to be overseen so that Alaskan consumers can have the full benefit of disclosure, recision rights, and a regulatory body to complain to when things do not go as planned. The DBSC has been working with industry representatives and others on developing draft regulations.

We urge your support of this legislation.

ED2:01/26/00

LEGAL SERVICES

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MEMORANDUM January 26, 2000

SUBJECT: Sectional Summary of CSHB 190(L&C) (Work Order No. 21-LS0576\M)

TO: Representative Norman Rokeberg
Attn: Janet

FROM: TB Theresa Bannister
Legislative Counsel

You have requested a sectional summary of the above-described bill. As a preliminary matter, note that a sectional summary of a bill should not be considered an authoritative interpretation of the bill and the bill itself is the best statement of its contents.

Section 1. Prohibits a person from violating AS 21.89.110 or the regulations adopted under that statute.

Section 2. Sec. 21.89.110(a) requires the Director of the Division of Insurance to regulate the transaction of viatical settlement contracts. Further describes the authority of the director. States that the authority of the commissioner of community and economic development extends to the regulation of viatical settlement investments as provided under AS 45.55.905(c).

Sec. 21.89.110(b) requires a viatical settlement provider, representative, or broker to apply for a license, submit required information, and pay required fees. Prohibits a person from acting as or representing to be a viatical settlement provider, representative, or broker relative to a subject resident, located, or to be performed in this state unless the person is licensed.

Sec. 21.89.110(c) requires viatical settlement providers, representatives, and brokers to file contract forms, disclosure statements, and advertising materials with the director, and that the documents be approved by the director.

Sec. 21.89.110(d) allows the director to examine a licensed viatical settlement provider, representative, or broker, or an applicant for these occupations. Requires the examined person to pay the cost of the examination.

Sec. 21.89.110(e) authorizes the director to adopt regulations to implement this section, and identifies certain standards for which regulations may be adopted.

JAN 26 2000

Sec. 21.89.110(f) states that a violation of this section, or of a regulation adopted under this section, is an unfair trade practice and subject to penalty under AS 21.36.

Sec. 21.89.110(g) defines certain terms for the section.

Section 3. Authorizes the administrator (the commissioner of commerce and community development) to regulate transactions between a viatical settlement provider (or an agent of a provider) and a subsequent investor. States that the authority of the Director of the Division of Insurance extends to the regulation of viatical settlement contracts under AS 21.89.110.

Section 4. Expands the definition of "security" in the Alaska Securities Act to include viatical settlement interests.

Section 5. Defines "viatical settlement interest" and "viator" for the Alaska Securities Act.

Section 6. Gives the Act an immediate effective date.

If I may be of further assistance, please advise.

TLB:glc
00-031.glc

From: Division of Banking, Securities and Corporations, and Division of Insurance, January 27, 2000

Sectional Analysis of CS HB 190(L&C) (Viatical Settlement Contracts)

Overview

CS HB 190(L&C) (viatical settlement contracts) assigns the Division of Insurance oversight authority for viatical settlement transactions involving the viator, insured, insurer, viatical settlement provider, broker and representative and adds viatical settlement contracts to the definition of a security in the Alaska Securities Act (AS 45.55). A viatical settlement contract is a contract that provides for the sale of some or all of the death benefit or ownership of an insured person's insurance policy to a third party. Most often, a company called a viatical settlement provider buys these from the owner of the policy on an insured person (called the viator), and resells interests in the contracts to investors.

This bill is an abbreviated legislative scheme, which will allow maximum flexibility for the Division of Insurance and the Division of Banking, Securities, and Corporations to oversee their respective charges. Insurance will oversee the contractual relationship between the viator (owner of the policy and most often the person insured as well) and the viatical settlement provider. Securities will oversee the process between the viatical settlement provider and any subsequent investors.

Section 1 of the bill adds a new section to AS 21.36 to make a violation of section 2 of the bill an unfair trade practice.

Section 2 of the bill adds a new section to AS 21.89 to provide authority to the director of the division of insurance to regulate viatical settlement transactions involving viators, insureds, insurers, viatical settlement providers, brokers and representatives, and includes licensing, examination and contract, disclosure and advertising approval.

Section 3 of the bill sets out the limit of jurisdiction for the administrator giving the securities section authority over transactions between viatical settlement providers and any investors in viatical settlements.

Section 4 of the bill adds "viatical settlement interest" to the definition of securities. Although presently considered a security because it meets the test for investment contract, inclusion in the definition will obviate the many fights that could come up because others in the industry may disagree with us.

Section 5 of the bill adds definitions for "viatical settlement interest" and "viator."

Section 6 makes the bill effective upon signing.

INSURANCE

The Division of Insurance will primarily be responsible for regulating the purchase of a life insurance policy from the owner of a life insurance policy by a viatical settlement provider. The intended basis for regulation is the Viatical Settlement Model Act and Regulation developed by the National Association of Insurance Commissioners. The division of insurance considers it a priority to work with Banking and Securities to coordinate regulation of those areas of a viatical settlement arrangement that may overlap.

SECURITIES

The bill on the securities side adds viatical settlement interests to the definition of securities. This adds to the authority of the Division of Banking, Securities, & Corporations (division) to adopt regulations governing the oversight of viatical settlements. The division has written regulations that provide investor protection by requiring issuers such as the viatical settlement providers to file a notice of exemption from registration and to register their sales agents. This exemption may be denied or revoked for cause by the administrator of securities. Also, the exemption requires sellers to provide proper disclosures to buyers concerning the seller's financial condition and a statement of risks. Finally, the regulations provide buyers with a right of rescission if they change their mind within ten business days of the later of receipt of the final disclosure document or payment of the required purchase amount. Investors who give a viatical settlement provider money to find a suitable investment vehicle will have rescission rights if that cannot be accomplished in 90 days.

This legislation is absolutely crucial for the protection of Alaska investors. Sales of these products around the country have resulted in a list of investor complaints that have been described in the financial media. As sales of these products are made to Alaska investors, it is important that we provide these investors with a reasonable amount of protection from sales abuses. In that way, Alaska investors may be more assured that they will receive adequate disclosures about these investments, and will have their rights protected under the Alaska Securities Act.

At the same time, viatical settlement providers and their agents will know by reading the Alaska Securities Act that these investments are subject to AS 45.55. Currently, the division considers these to be securities under the "investment contract" theory. By making it explicit in the definition, all parties will be made aware of their status.

ALASKA DIVISION OF BANKING, SECURITIES, AND CORPORATIONS
POLICY STATEMENT ON VIATICAL SETTLEMENT CONTRACTS

There have been some inquiries and questions from investors and the industry generally regarding viatical settlement contracts and their treatment under the Alaska Securities Act (AS 45.55). Briefly, a viatical settlement involves the purchase by an investor of an insurance policy covering the life of an individual , usually but not always, having been diagnosed with a terminal illness. The purchase is usually for a fraction of the face value of the policy, thus the insured person receives money now to cover expenses and other considerations while the investor receives the right to the face amount of the policy on the viator's death. The social value of this arrangement is not at issue; as an investment vehicle, it is. We are aware of instances in which viatical settlements have been advertised to the public as 100% secure with rates of "guaranteed return" as high as 40% and more. These investments have not been registered with the Alaska securities division as required, and those selling them have not been registered as broker-dealers, agents, investment advisers, or their representatives.

The securities division has the statutory mandate to safeguard the investing public by enforcing the Alaska Securities Act. This statute governs the issuance, sale, and other transactions involving securities and requires that securities and those who sell them register with the securities division. Our mission is to warn Alaskan investors of any security that might run afoul of our Act's prohibition against engaging in "an act, practice, or course of business that operates or would operate as a fraud or deceit upon a person." Toward that end, following careful consideration of the applicable provisions of the Act, the regulations adopted under the Act, and

Provided to Rep. Norman Rokeberg by the Division of Banking, Securities & Corporations
January 26, 2000
RE: CHSB 190 (L&C)

relevant legal authority, the division has concluded, for the reasons laid out in this statement, that viatical settlements are investment contracts and subject to the provisions of the Act.

VIATICAL SETTLEMENTS ARE INVESTMENT CONTRACTS

The viatical settlement is governed by a written agreement between a company facilitating the transaction, an investor, and the person covered by an insurance contract. The insured or the owner of the policy agrees to sell the ownership interest in the insurance policy and the right to name a beneficiary and receive the face amount of the policy on the insured's death. The premise behind viatical settlements is 1) to give those faced with a terminal illness the monetary means to live and to pay medical expenses when, in all likelihood, the person is at a stage when continued employment may not be possible; 2) to give those who no longer need life insurance for whatever reason a means of cashing in on the policy. The policy is sold at a discount based on life expectancy of the insured, current interest rates, the premium terms due, and profit requirements of the investor and the viatical settlement company. Typically, the viatical company is named irrevocable owner of the policy and may or may not take on the obligation to make any necessary premium payments. Alternatively, the viatical company may simply match an insured with an investor who then takes over as direct owner and beneficiary, though this scenario is not usual. The point to remember is that the investor always ends up making the premium payments. The premiums can be collected up front and paid out over the life of the insured: they can be deducted from the investor's share of the profits; or some mix of the two.

The usual situation calls for the viatical company to own the policy and intervene in the activities surrounding the transaction, thus giving the insured some measure of privacy. Upon the death of the insured, the company would be notified and would collect the proceeds of insurance and pass them on to the investor, first deducting administrative costs and expenses, including premiums paid, if any, and a commission to the viatical company.

The question of whether or not this arrangement is characterized as a security is answered by referring to long-standing principles of statutory interpretation. The statutory definition of "security" is found at AS 45.55.990(12). A very comprehensive Alaska definition is virtually identical to that used in most states and the federal Securities Act of 1933, and it includes the term "investment contract." The United States Supreme Court first undertook to define an investment contract in the seminal case of *Securities & Exch. Comm'n v. C.M. Joiner Leasing Corp.*, 320 U.S. 344 (1943). Building on the *Joiner* decision, the Supreme Court, in *Securities & Exch. Comm'n v. W. J. Howey Co.*, 328 U.S. 293, 299, 66 S.Ct. 1100, 1103 (1946), the Court laid out a simple, tripartite test for determining the presence of an investment contract:

> a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party[.]

This definition has been articulated many times since as controlling, in Alaska, e.g., in *Hentzner v. State*, 613 P.2d 821, 823 (Alaska 1980), and in federal court in *Securities & Exch. Comm'n v. Life Partners, Inc.*, 898 F.Supp. 14, 19 (D.D.C. 1995). The United States Supreme Court said

> This test, in shorthand form, embodies the essential attributes that run through all of the Court's decisions defining a security. The touchstone is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others. By profits, the Court has meant either capital appreciation resulting from the development of the original investment . . . or *a participation in earnings resulting from the use of investors' funds* . . . . In such cases the investor is "attracted solely by the prospect of a return" on his investment.

United Housing Found., Inc. v. Forman, 421 U.S. 837, 852, 95 S.Ct. 2051, 2060 (1975) (emphasis added) (citations omitted) (quoted in *Hentzner, supra* at 824).

THE DIVISION'S INTERPRETATION IS NOTWITHSTANDING *LIFE PARTNERS*

The division is mindful of the decision in Life Partners, in which the D.C. Circuit held that the viatical settlement contract at issue in the case was not an investment contract. *Securities & Exch. Comm'n v. Life Partners, Inc.*, 87 F.3d 536, 543 (D.C. Cir. 1996). While the SEC won at the district court level, the Court of Appeals found that not every element of the *Howey* test was met. The appeals court concluded that the investors' return depended not on the efforts of the viatical company, but rather from the length of time the insurance remained alive, saying

> In this case it is the length of the insured's life that is the overwhelming importance to the value of the viatical settlements[.]

87 F.3d at 548. The decision in that case is almost universally viewed by state securities administrators as flawed. The court seems to have been influenced by its perception of the social utility of the viatical settlement and the court's sympathetic view of terminal AIDS patients, who make up the vast majority of viators. Alaska does not agree with the D.C. Circuit in either outcome or rationale. We believe every part of the *Howey* test is met and that social utility alone should not be the motive

driving a court's decision. Furthermore, we believe there is little support for drawing the bright-line distinction between "pre-investment " and "post-investment" managerial efforts which the *Life Partners* court attempted to draw.

HOWEY TEST MUST BE APPLIED FLEXIBLY

The *Hentzner* court indicated that the *Howey* test should not be applied rigidly or inflexibly, but that substance must take primacy over form. In other words, when one considers applying the elements of the investment contract decisions to a viatical settlement, they cannot be applied mechanically, but must be applied with common sense. The Ninth Circuit found that the securities acts of the various states, and federal legislation as well, were meant to be broadly interpreted. The protections afforded by these laws were aimed at curbing the abuses that had crept into the field prior to the Great Depression and those curbs could best be effected by liberal interpretations of the term "securities." *Securities & Exch. Comm'n v. Glenn W. Turner Enter, Inc.*, 474 F.2d 476, 481 (9th Cir. 1973).

INVESTMENT OF MONEY

There is little dispute that money is invested, thereby satisfying element one of the Howey definition for the viatical settlement situation. [1] Even Life Partners did not dispute that money was being invested. "The parties . . . do not contest that the buyers of viatical settlements are investing money." *Securities & Exch. Comm'n v. Life Partners, Inc.*, 898 F. Supp. 14, 19 (D.D.C. 1995). Moreover, the sales literature of almost all viatical companies speaks in terms of "investment" and "investors."

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[1] Money may not always be the medium of consideration. "Free stock" and other things having value also constitute "valuable consideration."

EXPECTATION OF A PROFIT

The third element of the *Howey* test, the expectation of a profit from the investment in a viatical settlement, is also easily disposed of. The buyer of a viatical settlement does so with the expectation of a profit, regardless of the motives of any other person involved in the transaction. In *Life Partners,* the Court of Appeals concluded:

> The asset acquired by an LPI investor is a claim on future death benefits. The buyer is obviously purchasing not for consumption—unmatured claims cannot be currently consumed—but rather for the prospect of a return on his investment. As we read the *Forman* gloss on *Howey*, that is enough to satisfy the requirement that the investment be made in the expectation of profits.

Securities & Exch. Comm'n v. Life Partners, Inc., 87 F.3d 536, 543 (D.C. Cir. 1996).

COMMON ENTERPRISE

There are two forms of common enterprise, horizontal and vertical. In most viatical settlement situations, there are a number of investors pooling resources to buy fractional interests in the insurance policy. There is difficulty in finding persons to invest the full amount needed to purchase a policy, and most often smaller investors put out $5,000 or more to purchase a share in the policy. This meets the horizontal test. This test requires that the funds of a number of investors be pooled and the profits and losses from the pooled investments be shared. The sale of fractional interests in life insurance policies necessarily means that the profits and losses are shared with other investors. The viatical settlement marketing materials the division has reviewed lead to the conclusion that fractional interests are being sold. Even if certain viatical companies, however, deal only in one-on-one investments in viaticals, this is not true of all viatical settlement companies and the vertical form of common enterprise is present. Moreover, only one form of common enterprise test need be met to find an investment contract. *See* 12A JOSEPH C. LONG, BLUE SKY LAW § 2A.02[2][c] (1998).

The vertical test requires that the marketer join with the investor to make the profit. If the viatical company is acting as an agent for purchasers, the test is fulfilled. Regardless of whether they actually are agents of the purchasers or not, the broad vertical test is met. The common enterprise is created by the viatical company in first finding and evaluating the insurance policies that it will market. The investor is entirely passive: the viatical company must exercise skill and care in selecting the contracts it will purchase and market. Albeit that many companies have third parties that afford the necessary post-purchase services, the venture is still initiated and put together by the viatical company. Thus, there is a passive investor and an active enterprise, exactly the sort of thing the securities laws were enacted to protect.

POST-PURCHASE EFFORTS

Some viatical companies have advanced the rather disingenuous argument that the company itself performs no significant post-purchase activities. This because they arrange for third parties to render such services as taking ownership of the insurance policy in trust and keeping tabs on the viator and noticing investors when the viator dies. This argument seems to ignore that, in most cases, the investor *needs* those services and cannot perform them for him- or herself. The standard is *someone* must perform those post-purchase functions. Following this logic, a viatical company would argue that, since the broker who procured stock in AT&T for a customer performs no post-purchase services, has no control over AT&T,

nor has any effect on the value of the stock, no security was the subject of the broker's efforts. This is patently specious. That others perform the service does not negate an investment contract.

Without the viatical company selecting the policies, arranging for post-purchase services, and bringing the investor into the mix, there would be no investment. There is definitely a situation where profits are made through the efforts of another.

ALASKA'S POSITION IS CONSISTENT WITH OTHER JURISDICTIONS

The position that the Alaska securities division has taken is consistent with that taken by any number of other state securities administrators. Alabama, Ohio, Washington. Wyoming, and Kansas are among those who have announced policies in keeping with Alaska's policy. The division looks with disfavor on viatical settlements because so much fraud has been associated with their sale. The division will not blanket deny these investment vehicles to Alaska residents, however, companies that market these investment contracts will have to register themselves and their product with the division at a minimum.

Adopted at Juneau. Alaska this 24th day of August. 1999.

Franklin T. Elder

Franklin T. Elder
Administrator of Securities

THIS DISCLOSURE IS MANDATED BY THE STATE OF ALASKA TO BE PROVIDED TO AN INVESTOR BEFORE A SALE IS CONSUMMATED

Viatical Settlement Disclosure Document Part A

READ IMMEDIATELY UPON RECEIPT AND BEFORE YOU PURCHASE

We are offering to sell you an investment called a **viatical settlement contract.** A **viatical settlement contract** is an agreement for the purchase of the death benefit of a life insurance policy insuring the life of an individual who has been diagnosed with a life expectancy of short duration because of illness. The individual who owns a life insurance policy is being sold is called the viator. Often, the viator and the insured are the same.

When the insured dies the investor receives a specific dollar amount that will be greater than the amount paid for the contract.

Some companies sell entire policies to investors, and others sell partial interests in policies. If you purchase a partial interest, the remaining interests in the policy will be sold to other investors.

INVESTING IN A VIATICAL SETTLEMENT CONTRACT IS RISKY. BE AWARE THAT THIS TYPE OF INVESTMENT MAY INVOLVE RISKS IN ADDITION TO THOSE EXPLAINED BELOW.

RISKS

The rate of return on your investment cannot be calculated before the insured dies. The longer the insured lives, the lower the annual rate of return on your investment will be.

No one can accurately predict the actual life expectancy of an insured. Some factors that may affect the accuracy of a prediction are:

- The experience and qualifications of the medical personnel making the life expectancy prediction.
- The nature of the insured's illness.
- Future breakthrough treatments and cures.
- If the insured has AIDS, the definition of AIDS used by the viatical company.

You may have to pay money in addition to your initial investment.

The insurance company will cancel the policy in which you have invested if periodic premium payments are not made to keep the policy in force. The insurance company will not pay the death benefit if the policy is not in force.

Some of the money you invest probably will be set aside to pay premiums. However, if the insured lives longer than expected, you may be required to pay **additional** premiums to keep the policy in force.

Being a beneficiary of a policy and not also an owner carries special risks.

A person who buys life insurance is the owner of the policy and decides who the beneficiaries of the policy will be – that is, who will receive the death benefit when the owner dies. When the policy is sold as a viatical settlement contract, investors become the new beneficiaries and therefore are entitled to receive the death benefit when the owner (usually the insured) dies.

The new **owner** of the policy may be either the investors themselves or the viatical company. Only an **owner** of a policy, **not a beneficiary**, has the right to make premium payments directly to the insurance company so that the policy will remain in force.

If the funds that have been set aside to pay premiums run out, you will be dependent on the viatical company to collect additional premium money from investors and to pay premiums promptly. If that company goes out of business or otherwise fails to collect premiums from investors, you may not be able to pay the premiums yourself if you are only a beneficiary.

Term insurance policies carry special risks.

A term policy is issued for a specific time period. The insurance company will not pay the death benefit if the insured outlives that time period. If you purchase a term policy, you will be dependent on the viatical company to renew the policy when the term expires.

Contestable policies carry special risks.

The insurance company may "**contest**" a policy for a two-year period after its issuance if the company finds a reason to cancel the policy. The insurance company **will not pay the death benefit** if:

- the insured dies within the contestability period, and
- the insurance company has a reason to cancel the policy.

One example of a reason that an insurance company might cancel a policy is that the insured did not truthfully answer a question on the policy application.

The policy may also be cancelled if the insured commits suicide within the two-year contestability period.

Group policies carry special risks.

A group policy insures the members of a specific group of people, usually the employees of an employer. The biggest risk for someone who invests in a group policy is that the policy can be terminated by the employer or the insurance company. Although the policy will contain a provision allowing your interest to be converted to an individual policy, there may be limits or restrictions on the right to convert.

Also, the insurance company may charge additional premiums once the policy is converted.

Investing IRA money in a viatical settlement contract carries special risks.

Internal Revenue Code section 408(a)(3) requires that "no part of trust [IRA] funds will be invested in life insurance contracts." This means that the Internal Revenue Service may not allow you the tax benefits of an IRA if you invest in a viatical settlement contract.

Even if such an investment is allowed, you should carefully consider your age, the life expectancy of the insured, and the difficulty in predicting life expectancy before investing IRA funds in a viatical settlement contract. Since death benefits are not paid until the insured dies, **you may encounter a problem taking annual distributions from your IRA that are mandatory beginning at age 70½.** If the funds are not available to take the mandatory distribution, you will be penalized by the IRS.

An investment in a viatical settlement contract is not a liquid investment.

The death benefit on a viatical settlement contract will not be paid until the insured dies, and there is no established secondary market for viatical settlement contracts. This means that you will probably not be able to sell your contract in an emergency to raise money for your immediate needs.

Check any promises of guarantees carefully.

The viatical company from which you purchase your viatical settlement contract may provide a performance or fidelity bond, or another similar instrument with your purchase. The purpose of these instruments is to "guarantee," or "insure," your investment. Ask exactly what is being guaranteed. Also ask the salesperson for a copy of the guarantee instrument.

If the company issuing the "guarantee" does not have the necessary financial resources to make payments under the "guarantee," you will not receive any benefit from the "guarantee."

You should do a background check on the company issuing the guarantee instrument. Contact the appropriate regulator to verify that the company exists and is in good standing. Obtain a copy of the company's most recent financial statements.

The terms of the contract between the company issuing the "guarantee" and the viatical company may also affect how valuable, or useful, the "guarantee" is to you. Ask for a copy of this agreement.

You could lose some of the death benefit you have purchased if the insurance company that issued the life insurance policy goes out of business.

Insurance companies are rated based on their financial safety and soundness. A lower rating means that the company is more likely to go out of business.

Each state maintains an insurance guarantee fund for the benefit of policyholders of insurance companies that have gone out of business. The guarantee fund may impose a limit on the amount that can be recovered on each policy.

Also, the payment on your viatical settlement contract would be delayed if you needed to seek funds from this guarantee fund or from the receivership of the insurance company. This delay would reduce the annual rate of return on your investment.

You should seek legal advice to help you understand the nature of this investment, the terms and conditions of any contract you are asked to sign, and the tax consequences of your decision to invest.

Right to Rescind

Under Alaska law, you have the right to rescind—that is, **cancel**—the purchase of this investment by giving written notice of your intention to rescind. To be effective, your written notice of rescission must be postmarked no later than **10 business days** following the later of the date on which you executed and the seller accepted the purchase agreement. You will also be offered a chance to cancel the transaction if an acceptable, suitable policy is not closed by the 60th day after you make the purchase.

You may rescind this transaction by sending notice of your intention to rescind no later than ____________ to:

Name:
Address:

The viatical company ☐ will pay interest at the rate of _____ % APR on the money you give them until the transaction closes.

☐ No interest will be paid on the money you give the viatical company to purchase a viatical settlement.

The Alaska Securities Division is the agency of state government responsible for the licensing of brokerage firms, investment advisers and their employees, the registration of investment products, and enforcement of the State's securities laws. Anyone with questions or concerns about viaticals or other investments may call the **Alaska Securities Division at (907) 465-2521**. We may be reached by mail at **Alaska Securities Division, P.O. Box 110807, Juneau, Alaska 99811-0807**, and E-Mail at **dbsc@dced.state.ak.us**

You can also visit our website at www.dced.state.ak.us/bsc.htm.

VIATICAL SETTLEMENT DISCLOSURE PART B

This part of the disclosure tells you exactly what you are buying.

What you are purchasing

You are investing $ ________ and will receive, subject to certain possible deductions for premiums (see above), on the death of the insured.

The life expectancy of the insured in whose policy you are investing is estimated to be ________________.

You are purchasing (check one):

- ☐ ________ % (percent) ownership of a life insurance policy with a $ ______________ death benefit
- ☐ the entire ownership of a life insurance policy with a $ ___________ death benefit
- ☐ ____________% (percent) of the death benefit of a life insurance policy with a $ ______________death benefit
- ☐ the entire death benefit of a life insurance policy with a $ __________death benefit

The insurance policy

The life insurance policy was issued by:

Company:
Address:

Telephone Number:

The policy number is ________________. It was issued on ______________________.

The policy is (check all that apply):

☐ A term policy
The term of the policy is: _________.

☐ A group policy
Name of the Group
Address

☐ **A CONTESTABLE POLICY (See above in Part A)**
The policy is contestable until (date)________________.

Ownership

After you make your purchase, you will be (check one):

☐ an owner and beneficiary of a life insurance policy.

Other owners of the policy will be:

(attach list of names and addresses of other investors)

☐ a beneficiary only of a life insurance policy.

The owner(s) of the policy will be:

(attach list of names, addresses, and telephone numbers)

Other beneficiaries of the policy will be:

(attach list of names and addresses of other investors)

Premiums

Premiums on the policy are (check one):

☐ Paid up and no additional premium payments will ever be required.

☐ Required to be paid periodically.

Premiums are:

$ __________ annually

Payments of $ __________ are due to be paid:

☐ Monthly ☐ Quarterly ☐ Semi-annually ☐ Annually

Term of premium payments (check one)

☐ If premium payments are made as required the policy will be fully paid up on (date) ______________.

☐ Premium payments must be made until the death of the insured.

Funding of premium payments (check all that apply)

☐ A portion of your investment has been set aside to pay premiums. This amount will fund the payment of premiums until (date) ________________.

☐ These funds have been placed in an escrow account.

Name of Escrow Agent
Address

Telephone Number
Bank Name, address, and Account Number

☐ You will be obligated to pay additional money to fund premium payments after (date)________________. Payments of $ _________ will be due to be paid:

☐ Monthly ☐ Quarterly ☐ Semi-annually ☐ Annually

☐ Before these additional payments are due, you will be notified of when and to whom to make your premium payments.

Use of your investment funds
Of the amount you are investing:

$ ______will be used to purchase the policy from the insured.

$ ______will be set aside to pay premiums on the policy.

$ ______will be used to pay a commission to the seller.

$ ______will be used to pay administrative expenses and other transaction costs.

Notice of Exempt Securities Transactions
Under 3 AAC 08.710 covering viatical settlement contracts
(To be filed along with the fee required by 3 AAC 08.715)

Please fill out this form and submit to:

Administrator of Securities
Alaska Division of Banking, Securities, and Corporations
P.O. Box 110807
Juneau, AK 99811-0807
(907) 465-2521

1. Name, Address, and Telephone number of viatical company filing this notice and contact person:

Full Name of Company	Address	Phone
Contact:		

2. Agents:

Name of Agent	Date of Registration	Application enclosed ✔	Affiliation

3. Specify type of organization of company (corporation, LLC, etc.) ____________________.
State of organization: __________. Date of organization: _________. Company has been in operation continuously since: ____________.
COMMENTS:

4. Please provide a brief description of terms of the offering, including types of programs:

5. Date sales are to commence:______________ (may not be sooner than 10 business days after the filing date of the exemption notice or as determined by the administrator)

6. **Describe any special circumstances you ask the administrator to consider. Waiver requests must include all pertinent information.**

7. The following are filed with this application:

- ❑ prospectus
- ❑ pamphlet, circular, or other marketing material
- ❑ contract, form letter, or other sales document
- ❑ disclosure material to be used in addition to Form 08-114 Parts A & B and Form 08-117 Parts A & B
- ❑ other, describe: ______________________________

____

____

FOR OFFICE USE ONLY

I certify that all the terms and conditions of 3 AAC 08.710 have been met and will continue to be met during the term of this exemption.

Signature	Title	Date

Additional space (Please refer to ¶ number being amplified):

COMMISSION SCHEDULE

(include information on any finders' fees or other remuneration received or to be received by soliciting agents)

THIS SCHEDULE MUST BE DISCLOSED AT THE TIME OF SALES PRESENTATION WITH ALASKA FORM 08-114A OR ALASKA FORM 08-117A

Commissions for the sale of viatical settlement and life settlement contracts will be paid according to the following schedule:

As part of the exemption process, the viatical or life settlement company has provided to the Administrator of Securities the most recent copies of the company's audited income and expense statements and balance sheet. These document are public and will be provided to you upon your written request.

THIS DISCLOSURE MUST BE PROVIDED TO INDIVIDUAL INVESTORS AT THE TIME OF SALES PRESENTATION

RESCISSION NOTICE

To be issued to the investor on the passage of 90 days from the date on which the investor paid for the investment.

TO:

Because we have not found a policy matching the terms specified in the purchase agreement, you have the right to rescind--cancel your purchase–until

_________________________.
DATE

IF YOU DECIDE TO RESCIND—CANCEL YOUR PURCHASE—NOTICE MUST BE MAILED, POSTAGE PREPAID, TO: Name Address

Name of sales agent:

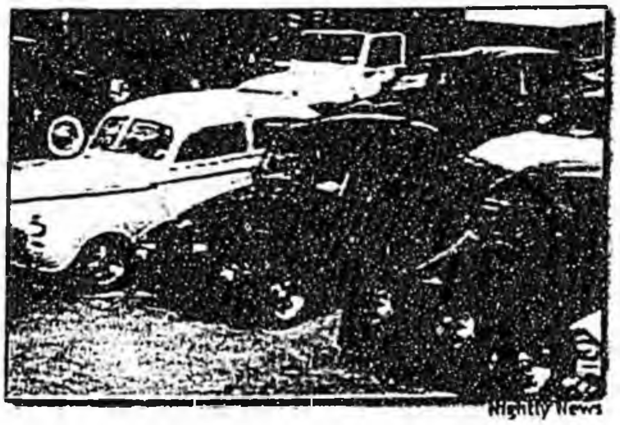
Name of settlement company.

The Alaska Securities Division is the agency of state government responsible for the licensing of brokerage firms, investment advisers and their employees, the registration of investment products, and enforcement of the State's securities laws. Anyone with questions or concerns about viatical settlements, life settlements, or other investments may call the **Alaska Securities Division at (907) 465-2521.** We may be reached by mail at **Alaska Securities Division, P.O. Box 110807, Juneau, Alaska 99811-0807,** and E-Mail at dbsc@dced.state.ak.us

You can also visit our website at **www.dced.state.ak.us/bsc.htm.**

08-118 (11/99)

No insurance against this loss



With the money Frederick Brandau took from unsuspecting investors, he bought a fine collection of collector cars.

Video

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Vilma Zimmer lost $33,000 in one insurance sale scam. NBC's Bob Dotson reports.

By Bob Dotson

St. Petersburg, Fla., Nov. 22 — There's one investment idea that sounds like the perfect way to do well by doing good. It involves buying someone else's life insurance policy. But a problem comes when the man in the middle has other ideas. NBC's Bob Dotson reports.

COMPLETE STORY

NBC NIGHTLY NEWS WITH TOM BROKAW NBC "Nightly News" home page

Bob Dotson
NBC CORRESPONDENT

DONNA HERLONG takes 48 pills a day, fighting to keep her body from rejecting a transplanted heart. Her medication costs $2,600 a month, far more than she can afford. Desperate, she sold the one real asset she had — her life insurance policies.

"It is the only way I could get the help I needed," she said.

When she dies, those policies will be worth $280,000. She sold them to Scott Page at a discount — for $200,000. Page pioneered a growing business aimed at helping the terminally ill get money they need to live.

"You're making a difference in someone's life who is faced with knowing they're gonna die," said Page, an investment advisor. Page then sold shares of Herlong's policies to investors who will make a profit when she dies.

'The problem is that, just as in any other new financial industry, it attracts lots of scam artists.'
— SCOTT PAGE
Investment advisor

That's how it's supposed to be done.

Vilma and Max Zimmer, a retired Florida couple, liked the idea of investing in life insurance.

"If I could be of help to somebody; help them out for a year or two, and then benefit later on, then that would be fine," said Vilma Zimmer.

Though well-intentioned, experts call the investments among the "riskiest," and warn they are ripe for fraud. "The problem is that, just as in any other new financial industry, it attracts lots of scam artists," said Syver Vinje, securities commissioner.

Why? Investors are not told whose life insurance they're buying — the records are confidential. So, there's no way to know exactly what you are getting.

The Zimmers found out the hard way. They believed that they were buying insurance policies. But what did they end up buying?

"A worthless piece of paper," Zimmer said.

INSURANCE BROKER INDICTED

The Zimmers invested almost $33,000 with Frederick Brandau. A federal indictment claimed he brokered life insurance policies and collected more than $100 million from investors all over the country, but only used $6 million to buy policies and spent most of the rest on fast cars and fancy homes.

"The things you wouldn't do for yourself with your own money, somebody else — a stranger — is doing with your money. It hurts," Vilma Zimmer said.

"When you [have] individuals come into this industry and cause the problems they cause, it makes it much more difficult to help individuals for tomorrow," said investment advisor Page.

Brandau is now in jail, awaiting trial. He was arrested with four associates and faces 43 counts of fraud and money laundering. He denied the charges, and declined to talk to NBC News.

Vilma Zimmer suspects she won't see her money again. "I'm still hoping, you know," Zimmer said. "Where there's life there's hope. But I doubt it. I really do."

For the Zimmers, and thousands of others, there is nothing to insure that a feel-good investment won't become a painful Fleecing of America.

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Making A Killing

Viaticals let sick people sell their life insurance. But investing in death may not always be the best bet

BY DANIEL EISENBERG

Michael Lee Davis is probably the last guy from whom you'd want to buy life insurance. True, he does have some experience in the field. Davis, a.k.a. Walter Waldhauser Jr., spent most of the 1980s in prison for hiring a hit man to wipe out a friend's family in order to get a share of their life-insurance proceeds. But after being released on parole, Davis found a new line of insurance work: a largely unregulated offshoot of the business called viaticals.

A viatical is not another impotence wonder drug. Rather, a viatical (from the Latin viaticum, a payment given to Roman officials before embarking on a journey) is a way for a terminally ill or elderly person (the viator) to get money before he dies by selling his life-insurance policy at a discount. The discount, usually 10% to 40% of the policy's face value, is based on the viator's life expectancy; once the viator dies and a broker takes a commission, the investor collects the rest of the benefits. A decade ago, viaticals were embraced by the AIDS community as an ingenious way for patients to get some cash for their final days.

Then in 1996 Congress made the proceeds from most viatical settlements tax exempt, and the business really took off. Increasing numbers of terminally ill people, including those suffering from cancer or heart disease, have sold their life-insurance policies to enjoy their death benefits while they're still alive. This year alone, more than $1 billion in viatical settlements, only about half related to AIDS, will be brokered, according to the National Viatical Association (NVA), roughly 20 times as much as when the business began. Relatively healthy elderly people are also hawking their policies for some additional income; $3 billion in so-called senior settlements will be brokered this year.

Tom Volz, president of the Columbia, S.C., visitors' bureau, has advanced prostate cancer; he's been given two to three years to live. A few months ago, he received the funding for his months ago, he received the funding for his viatical settlement, which handed him $58,500, or roughly 40% of his $150,000 policy. "There are some things I'd like to do, but I didn't have the resources for, like a trip to Hawaii or herbal remedies not covered by insurance," says Volz.

Unfortunately, viaticals have attracted con artists the way blood does leeches, and regulators are contemplating halting, or at least restricting, the practice. The problem is with folks like Davis, indicted on fraud and other charges by a Dallas County grand jury last summer. He persuaded scores of unsuspecting Texans to shell out millions on supposedly low-risk, guaranteed investments in viaticals offered by his Dallas-based company, First American Fidelity Corp. But authorities say the policies were fraudulently obtained for the express purpose of reselling them, an increasingly common practice dubbed cleansheeting. Davis allegedly solicited HIV-positive men to lie about their medical condition and buy multiple $50,000-to-$100,000 policies, which usually require no medical exams or blood tests. His lawyer denies the charges. As Davis awaits trial, his victims are stuck holding some $10 million worth of policies that are probably worthless.

Last May the North American Securities Administrators Association cited viatical scams as one of the country's top 10 financial cons. "I like a lot of people in this industry, but I don't trust a lot of them, and that's sad," says Carole Fiedler, of Sausalito, Calif., an established viatical broker who each year helps about 100 people find buyers for their policies. "I hope there's a weeding-out process."

There will be, if regulators and prosecutors in states from Florida to California get their way. Late last summer a federal grand jury in Florida indicted Frederick Brandau and his company, Financial Federated Title & Trust, for allegedly defrauding thousands of viatical investors across the country in an elaborate, $115 million Ponzi scheme. Brandau's attorney denies the allegations. Just a month ago, two officers of Justus Viatical, a Pompano Beach, Fla., firm, were charged with selling investors $2 million worth of fraudulently obtained life-insurance policies. Their lawyer calls the indictment a farce. And insurance heavyweights like American General and John Hancock Mutual Life have recently fought in the courts to rescind bogus policies.

As the number of would-be viators has increased, the industry has gone into hard-sell mode, promising fail-safe, above-market returns. The harsh reality, though, is that investors are in some measure betting on the death of the sellers. If the person whose policy you buy dies in a year, it's a great investment, but if he lives five, it's a dud. "Profitability is related to the predictability of death, which has proved to be singularly unpredictable," says Bill McDonald, chief of enforcement for the California Department of Corporations, who thinks viaticals may need to be outlawed. In Florida, Mutual Benefits Corp., a Broward County viatical provider, was recently sued by investors for misrepresenting the life expectancy of AIDS patients, and therefore the return on the investment, by providing inaccurate information about new treatments. The company denies the charges. MORE>>

Many viatical deals are marketed to seniors looking for a slightly better return on their retirement income. Ursula Linke, 60, of Silver Spring, Md., and her husband, tired of earning a relatively paltry 4% to 6% on their annuities, moved their entire life savings of $700,000 into viaticals sold by Liberte Capital Group of Toledo, Ohio, which claimed to pay 14% on a one-year maturity. "We wanted to have a sound investment, retire and have some peace and tranquillity," says Linke. After the first few quarterly payments arrived from the company, the money suddenly stopped coming. Liberte Capital blames its escrow agent for the problem. Now Linke and her fellow investors' money is frozen while a court-appointed receiver tries to resolve the dispute.

There are other pitfalls. In many cases, if the viator lives longer than expected, investors can end up having to pay premiums to maintain the policy. And unlike stocks or bonds, these are highly illiquid investments. That means that in the event of an emergency, there's no quick, easy way to get your money back.

Viators can be victims too. There are brokers who reap hefty, 18% commissions without getting the sellers—often ill, vulnerable people—the best deal available. One viator who went through Alpha Capital Group, a viatical provider that is fighting a cease-and-desist order from Washington State, ultimately received $5,400, or 6% of the policy's $90,000 face value.

Industry representatives support uniform regulation but hope officials don't go too far in their zeal to crack down. "It's a critical option that every terminally ill person should have," says Valerie Cooper, executive director of the NVA, who claims scam artists don't represent the bulk of law-abiding viatical providers, like Page & Associates and the Ardan Group. Gloria Wolk, chief consumer advocate for viaticals http://www.viatical-expert.net), is worried that money for legitimate viatical settlements could disappear: "Fraud can destroy this industry and leave patients high and dry."

Competition may provide an alternative. To help slow the growing appeal of viaticals, more insurance companies are offering so-called accelerated death benefits, which, like viaticals, award a certain portion of the policies' face value to terminally ill patients before they die. That way, people can take it with them, and there's little chance that investors will be taken.

Viaticals: a Primer

It sounds like the perfect investment: realize a great return while helping the sick get some money for their final days. That, at least, is the selling point of viaticals, a multibillion-dollar-a-year business that lets the terminally ill or senior citizens sell their life-insurance policies at a discount, leaving buyers to collect the benefits when they die. But with a host of viatical scam artists preying on unsuspecting investors, such a good deed doesn't always make such a good investment. Below, a look at some of the pitfalls.

--No matter what brokers claim, these are not low-risk investments. You're betting on how long someone will live, and the longer they do, the smaller your annual return.

--Many shady brokers have been selling investors fraudulently obtained policies, which means your investment could well turn out to be worthless.

--If viators live longer than expected--a very distinct possibility--investors may have to pay premiums just to keep the policies valid.

--Unlike stocks or bonds, viaticals are illiquid investments. In the event of an emergency, you may have a hard time trading them in for your money.

--A broker can charge a viator an excessive commission, leaving a vulnerable, sick person with just a fraction of the face value of a policy.

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CHAPTER 08 SECURITIES.

Chapter 08 is amended by adopting new sections to read:

ARTICLE 7. VIATICAL SETTLEMENTS

3 AAC 08 is amended by adding new sections to read:

3 AAC 08.701. FINDING. The administrator finds, in the policy statement adopted concurrently with and incorporated by reference in these regulations, that an investment contract known as a viatical settlement interest in a viatical settlement contract is a security and subject to the provisions of AS 45.55 and these regulations. (Eff. / / ; Register)

Authority: AS 45.55.950

3 AAC 08.702. SCOPE. (a) The applicable provisions of 3 AAC 08.701 – 3 AAC 08.740 set out the regulatory standards for the exemption from the registration requirement of AS 45.55.070, renewal of the exemption from registration, fees, effective dates, and related matters for a viatical settlement interest.

(b) Nothing in this section

(1) provides an exemption from the anti-fraud provisions of AS 45.55;

(2) relieves broker-dealers or agents from the due diligence, suitability, or "know your customer" standards, or any other requirements of law otherwise applicable to persons registered under AS 45.55; or

(3) prohibits an issuer using this section from using the registration procedures in AS 45.55 or from claiming the availability of any other exemption from registration available under AS 45.55. (Eff. / / ; Register)

Authority: AS 45.55.010 AS 45.55.025 AS 45.55.027 AS 45.55.028 AS 45.55.950

3 AAC 08.710. EXEMPTION FROM REGISTRATION. (a) Except as provided by (b) of this section, an offer or sale of a viatical settlement interest, or a security that represents or is

secured by a viatical settlement interest is exempt from the registration requirement of AS 45.55.070 if

(1) at least 10 business days before the initial offer or sale is made the issuer files with the administrator, in compliance with 3 AAC 08.090(b), an application on State of Alaska Form 08-102 to engage in the transaction, the fee established in this section, and the consent to service of process required by AS 45.55.980(g); the application required in this paragraph must contain

(A) the name, address, and telephone number of the issuer and a brief description of the general character and location of the issuer's business;

(B) a statement demonstrating eligibility for notice filing under the exemption in this subsection;

(C) a description of the security being offered or sold; in this subsection, "description of the security" means a general description of the program offered by the issuer such as viatical settlement interest sales of a certain maturity secured by proceeds from the death benefit of an insurance contract.; "description of the security" does not mean details of specific policies or contracts;

(D) a description of the kind and amount of commissions, finders' fees, or other remuneration paid directly or indirectly in connection with soliciting a prospective viatical settlement purchaser in this state; and

(E) notwithstanding AS 45.55.150, the following must be filed with the application: any prospectus, pamphlet, circular, form letter, advertisement, or other sales literature used or intended to be used in connection with the offer or sale of a security, and such other information or documents as the administrator may by regulation or order establish; unless waived by the administrator, the issuer's most recent audited income and expense statement and balance sheet must be provided to the administrator and the provision of those documents will be disclosed to a purchaser who can obtain copies on written request to the administrator;

(2) the offer or sale is made by, and commissions or other remuneration in connection with making the sale are made only to, persons registered or required to be registered under AS 45.55.030(a) or (c) and 45.55.040;

(3) before a sale, each prospective individual viatical settlement purchaser is furnished written information that is sufficient to make an informed investment decision; this information shall be furnished to the administrator at the time of application; in this paragraph, "information that is sufficient to make an informed investment decision" includes the state-mandated viatical settlement disclosure document, State of Alaska Form 08-114, Part A; "sale" for purposes of this section occurs when the viatical settlement purchaser executes and the seller, or its representative, accepts the purchase agreement;

(4) on or before the time of closure of a sale, defined as the date when the viatical settlement provider locates and proposes to the viatical settlement purchaser an acceptable, specific viatical contract under the executed purchase agreement, an individual investor receives a completed State of Alaska Form 08-114, Part B (viatical settlement disclosure document); and

(5) unless waived by the administrator, the issuer and the issuer's predecessors have been in continuous operation for at least three years and there has been no default during the current fiscal year or within the two preceding fiscal years in the payment of principal, interest, dividends, or other obligation on a security of the issuer or a predecessor of the issuer with a fixed maturity or a fixed interest, dividend, or other provision.

(b) The exemption in (a) of this section is not available to an issuer if the issuer, a predecessor of the issuer, an affiliate of the issuer, a director of the issuer, an officer of the issuer, a general partner of the issuer, a beneficial owner of 10 percent or more of a class of the issuer's equity securities, a promoter of the issuer presently connected with the issuer in any capacity, an underwriter of the securities to be offered, a partner of an underwriter of the securities to be offered, a director of an underwriter of the securities to be offered, or an officer of the underwriter of the securities to be offered

(1) has filed within the last five years a registration statement that is the subject of a currently effective registration stop order entered by a state securities administrator or the SEC;

(2) within the last five years has been convicted of

(A) a felony;

(B) a criminal offense involving fraud or deceit; or

(C) a criminal offense in connection with the offer, purchase, or sale of a security;

(3) is currently subject to a state or federal administrative enforcement order or judgment entered within the last five years finding fraud or deceit in connection with the purchase or sale of a security; or

(4) is currently subject to an order, judgment, or decree of a court of competent jurisdiction entered within the last five years, temporarily, preliminarily, or permanently restraining or enjoining the person subject to the order from engaging in or continuing to engage in conduct or a practice involving fraud or deceit in connection with the purchase or sale of a security. (Eff. / / ; Register)

Authority: AS 45.55.070 AS 45.55.950

3 AAC 08.715. EFFECTIVENESS DATES AND FEE. Unless made effective earlier by the administrator, an application for exemption from registration under this section becomes effective 10 business days after the administrator receives the complete application, the fee, and

the required documents, unless the administrator contacts the filer within 10 business days after the receipt of the complete filing to seek additional information or clarification. In that case, the application becomes effective when the administrator issues an order of effectiveness. The order of effectiveness issued under this section expires one year from the date of effectiveness. The notice filing fee under this section is $250 for each application, payable to the State of Alaska. (Eff. / / ;Register)

Authority: AS 45.55.070 AS 45.55.110 AS 45.55.950.

3 AAC 08.720. REVOCATION OR DENIAL OF EXEMPTION. The administrator may by order deny or revoke an exemption specified in 3 AAC 08.710(a) with respect to a specific viatical interest or transaction. The order may not be entered without appropriate prior notice to all interested parties, opportunity for hearing, and written findings of fact and conclusions of law, except that the administrator may by order summarily deny or revoke any of the specified exemptions pending final determination of a proceeding under this subsection. Upon the entry of a summary order, the administrator shall promptly notify all interested parties that it has been entered and of the reasons for it and that within 15 days of the receipt of a written request the matter will be set down for hearing to be held in accordance with AS 45.55.935. If no hearing is requested and none is ordered by the administrator, the order remains in effect until it is modified or vacated by the administrator. If a hearing is requested or ordered, the administrator, after giving notice and opportunity to be heard to all interested persons, may modify or vacate the order or extend it until final determination. (Eff. / / ; Register)

Authority: AS 45.55.950

3 AAC 08.730. RIGHT OF RESCISSION APPLICABLE TO SALES OF VIATICAL SETTLEMENT CONTRACTS. (a) In addition to any other rights provided for under this chapter or otherwise, a person who buys a viatical settlement interest or a security that represents

or is secured by a viatical settlement interest may rescind the purchase by giving, by ordinary mail, postage prepaid, within 10 business days following execution of the purchase agreement, written notice of rescission to the entity designated for the rescission notice in the disclosure documents.

(b) The notice required under (a) of this section is sufficient if addressed to the entity designated for the notice at the address given in the disclosure statement provided a viatical settlement purchaser before executing a purchase agreement. The rescission notice is effective when deposited in the United States mail. The rescission notice is not required to be in a particular form and is sufficient if it expresses the intention of a purchaser to rescind the transaction.

(c) The disclosure document provided a viatical settlement purchaser before the execution of a purchase agreement shall include a clear notice of the right to rescind, the address to which a rescission notice is to be sent, and the time within which the notice must be sent.

(d) Notwithstanding the time limit in (a) of this section, if the issuer has not found an acceptably suitable viatical settlement contract and closed the transaction within 90 days of the execution of the purchase agreement, on the ninetieth day following the execution of the purchase agreement, the issuer shall provide the viatical settlement purchaser with a rescission offer using State of Alaska Form 08-118, and the viatical settlement purchaser will have 10 business days from its receipt to either accept or reject the rescission offer. The issuer shall keep a record of the rescission offer and its acceptance or rejection for at least three years, and provide this information to the administrator at the administrator's request. (Eff. / / : Register)

Authority: AS 45.55.950

3 AAC 08.735. SALES AGENTS. In addition to other requirements for agents under AS 45.55, sales agents licensed to sell viatical settlement interests

(1) shall not misrepresent or fail to clearly and affirmatively disclose the nature of the return or the duration of time to obtain the return of any investment related to one or more viatical settlements sold by a viatical settlement provider or other seller whom they represent; and

(2) shall not fail to provide the required disclosure documents to the purchaser in a timely manner. (Eff. / / : Register)

Authority: AS 45.55.950

3 AAC 08.740. WAIVER. The administrator may by regulation or order waive a term, condition, or requirement of this article if the administrator determines the waiver to be in the public interest and no danger to investor protection. An issuer may request a waiver and will bear the burden of proof to satisfy the administrator that the waiver will not injure investor protection. (Eff. / / : Register)

Authority: AS 45.55.950

3 AAC 08.750. PRIVACY. Except as may be required in the course of conduct of the division's responsibilities, a viatical settlement provider or issuer may not divulge to another person the name of either a viator or an insured of any insurance policy that is the subject of a viatical settlement interest.

3 AAC 08.790. DEFINITIONS. As used in this chapter, unless the context clearly means otherwise

(1) "financing entity" means an underwriter, placement agent, lender, purchaser of securities, purchaser of a policy or certificate from a viatical settlement provider, credit enhancer, reinsurer or any person that may be a party to a viatical settlement contract and that has a direct ownership in a policy or certificate that is the subject of a viatical settlement contract but whose sole activity related to the transaction is providing funds to effect the viatical settlement and who

has an agreement in writing with a viatical settlement provider to act as a participant in a financing transaction;

(2) "financing transaction" means a transaction in which a viatical settlement provider or a financing entity obtains financing for viatical settlement contracts, viaticated policies, or interests in the contracts or policies including, without limitation, any secured or unsecured financing, any securitization transaction or any securities offering either registered or exempt from registration under federal and state securities law, or any direct purchase of interests in a policy or certificate, if the financing transaction complies with federal and state securities law;

(3) "issuer" means a person who, in addition to the terms of AS 45.55.990(7), is a viatical settlement provider with respect to the viatical settlement contract relating to the life insurance policy or certificate comprising the viatical settlement interest, or is a person that purchases or otherwise acquires a viatical settlement contract for the purpose of selling a viatical settlement interest in the contract, but does not include a broker-dealer, agent, or viator;

(4) "owner" means the person that is the original owner or subsequent assignee or transferee, that has had a bona fide insurable interest in a life insurance policy insuring the life of an individual that has the right to assign, transfer, sell, devise, or bequest the benefits of the life insurance policy, and enters or seeks to enter into a viatical settlement contract; but does not include a viatical settlement purchaser or a viatical settlement provider or any person acquiring the policy or interest in a policy from a viatical settlement provider, and does not include an independent third party trustee or escrow agent;

(5) "viatical settlement contract" means a written agreement between a viator and a viatical settlement provider for the sale, assignment, transfer, or bequest to the viatical settlement provider by the viator of all or a portion of the death benefit or ownership of an insurance policy, under the terms of which contract the purchaser is to pay compensation or other valuable

consideration that is less than the expected death benefit of a particular insurance policy or certificate in return for the viator's assignment, transfer, sale, or bequest of all or a portion of the death benefit or ownership of a life insurance policy or certificate for consideration that is less than the expected death benefit of a life insurance policy or certificate to the purchaser; "viatical settlement contract" includes a contract for a loan or other financial transaction secured primarily by an individual or group life insurance policy, but does not include

(A) a loan by a life insurance company pursuant to the terms of the life insurance contract;

(B) a loan secured by the cash value of a policy;

(C) the assignment of a life insurance policy as collateral for a loan to a bank, saving bank, savings and loan association, credit union or other licensed lending institution;

(D) the exercise by the viator of an accelerated benefits provision under the terms of the life insurance contract; or

(E) the assignment, transfer, sale, devise, or bequest of a life insurance policy, for less than the expected death benefit, by the viator to a friend or family member if the friend or family member does not enter into more than one agreement in a calendar year;

(12) "viatical settlement interest" means the entire interest or any fractional interest in a life insurance policy or certificate, or in the death benefit thereunder that is the subject of a viatical settlement contract, and constitutes a security for purposes of AS 45.55, and does not include the initial purchase from the viator by a viatical settlement provider;

(13) "viatical settlement offering" means the offer or sale of one or more viatical settlement interests derived from the same viatical settlement contract;

(14) "viatical settlement provider" means a person who is an issuer, has satisfied all requirements of this state to allow the person to do business in this state, and enters into a viatical settlement contract with a viator for the purpose of purchasing or selling viatical settlement interests and includes a person that obtains financing for the purchase, acquisition, transfer or other assignment of one or more viatical settlement contracts, viaticated policies, or interests in viatical settlement contracts or viaticated policies, and that sells, assigns, transfers, pledges, hypothecates, or disposes of one or more viatical settlement contracts, viaticated policies, or interests in viatical settlement contracts or viaticated policies;

(15) "viaticated policy" means a life insurance policy or a certificate of life insurance under a group life insurance policy that has been acquired or transferred under a viatical settlement contract;

(16) "viator" means the owner of a life insurance policy or the holder of a certificate under a group life insurance policy insuring the life of an individual who enters into a viatical settlement contract, but does not include a viatical settlement provider or a person that acquires a viaticated policy or a fractional interest in a viaticated policy from a viatical settlement provider or a subsequent purchaser.

(17) "viatical settlement purchaser" means a person that gives a sum of money as consideration for a life insurance policy or an interest in the death benefits of a life insurance policy that has been or will be the subject of a viatical settlement contract for the purpose of deriving an economic benefit; it does not include an applicant or issuer under this section, or a financing entity, or a special purpose entity that is created solely to act as a financing source for the viatical settlement provider;

(18) "viatical settlement purchase agreement" means a contract or agreement, entered into by a viatical settlement purchaser to which the owner is not a party, to purchase a life

insurance policy or an interest in a life insurance policy on the life of an individual for an amount that is less than the death benefit payable under the policy, that is entered into for the purpose of deriving an economic benefit. (Eff. / / : Register)

Authority: AS 45.55.950

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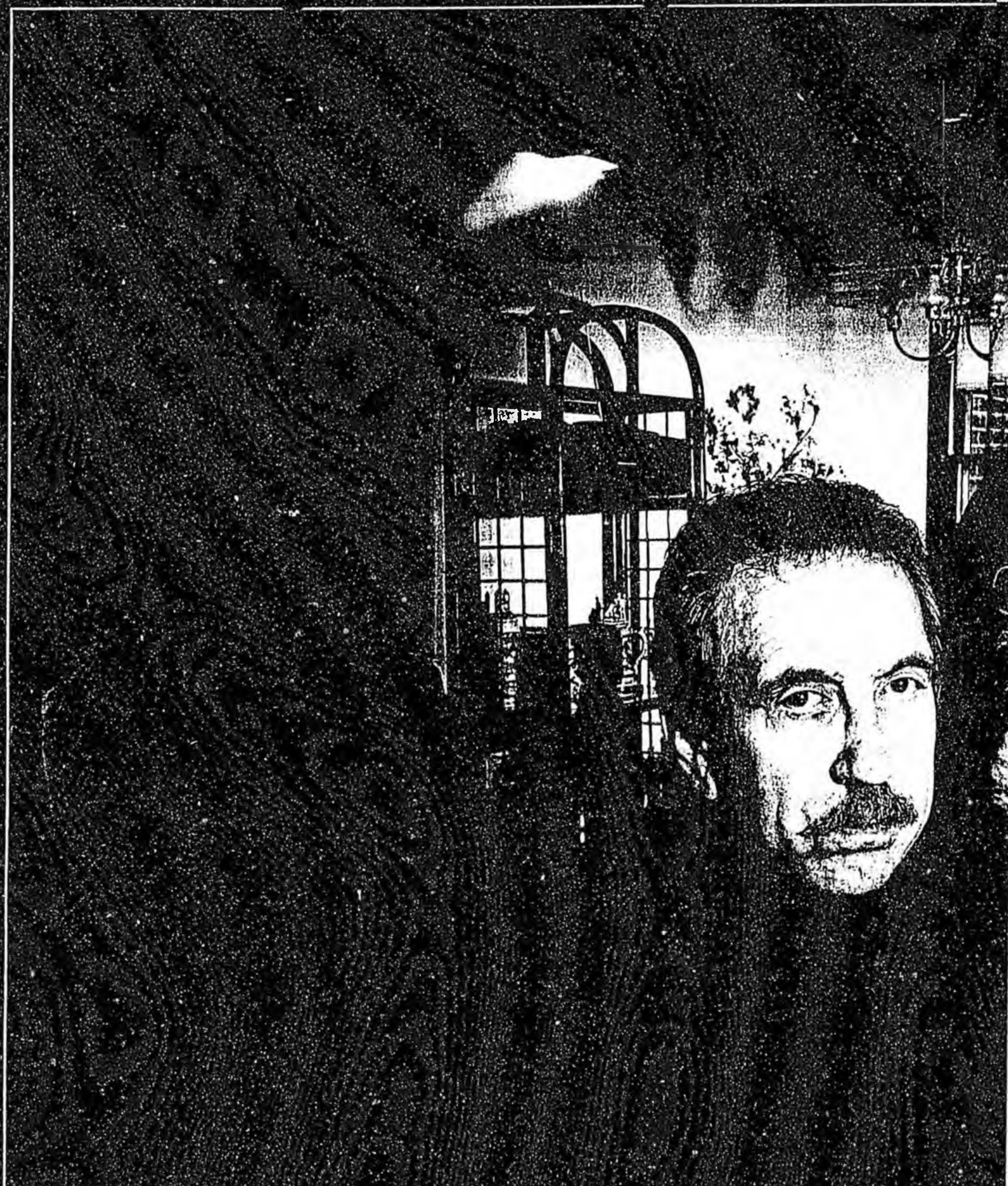

Jerry Warner and his mother, Vera, invested more than $45,000 in viatical settlements, then received an early payoff when the viatical company sold its policies. They lost more than $15,000.

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By buying life insurance poli[illegible]
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By Kimberl[illegible] Lankford
Photog[illegible]

For more than a decade after her husband died, Betty Paxton barely touched her savings, other than to reinvest CDs and savings bonds when they matured. But two and a half years ago, Paxton, then 78 and worried about her health, filled out a card she'd received in the mail requesting more information about probate and estate planning.

A few weeks later, an insurance agent arrived at the door of her Ohio apartment. Initially he sold Paxton an annuity. Then, a little over a year later, the agent was back. He urged her to cash in her savings bonds and buy a viatical settlement—a life insurance policy that a terminally ill person sells to receive part of the death benefit early. The agent told Paxton she would earn a guaranteed 24% by investing in policies of people expected to live 24 months or less. When the insured person died, she would receive the death benefit.

Paxton felt uncomfortable about profiting from someone's death, but the agent reassured her that her investment would give terminally ill people money to help them live during their final days. He said *60 Minutes* had called viaticals "a perfect no-risk investment." The agent would not leave, Paxton says, until she promised to sell her savings bonds and buy a viatical investment—even though she'd lose four months of interest by cashing in early.

As Paxton's CDs and savings bonds matured over the next five months, she bought a total of $33,000 worth of viatical-settlement investments on three people who, she was told, had life expectancies of 24 months or less.

For several years, viatical-settlement companies have been pushing these investments as a risk-free way to get a guaranteed return. With viatical settlements, terminally ill patients sell their life insurance policies before they die and get a fraction of the death benefit in cash. The policy remains in force and investors can buy portions of the policy at a discount to the death benefit. The investors become the beneficiaries and get their share of the full death benefit when the insured dies or, in the industry's terms, when the policy "matures."

Longer life expectancies aren't the only problem. Quick-buck artists have poured their efforts into selling viatical settlements (which are unregulated as investments), concentrating on elderly investors looking for a higher return on their fixed-income investments. Several viatical companies and their owners have been charged with fraud or misrepresentation; two such cases involved nearly $100 million each. More than 35 state securities regulators are now investigating viatical-settlement companies, estimates John Ellis, securities counsel with the Missouri Securities Division.

"There's a lot of fraud almost inherent in these," says Bill McDonald, assistant commissioner of the California Department of Corporations' enforcement division. "Viaticals are unique because legally you're not entitled to know much about the insureds," he says. "You're completely at the mercy of the broker."

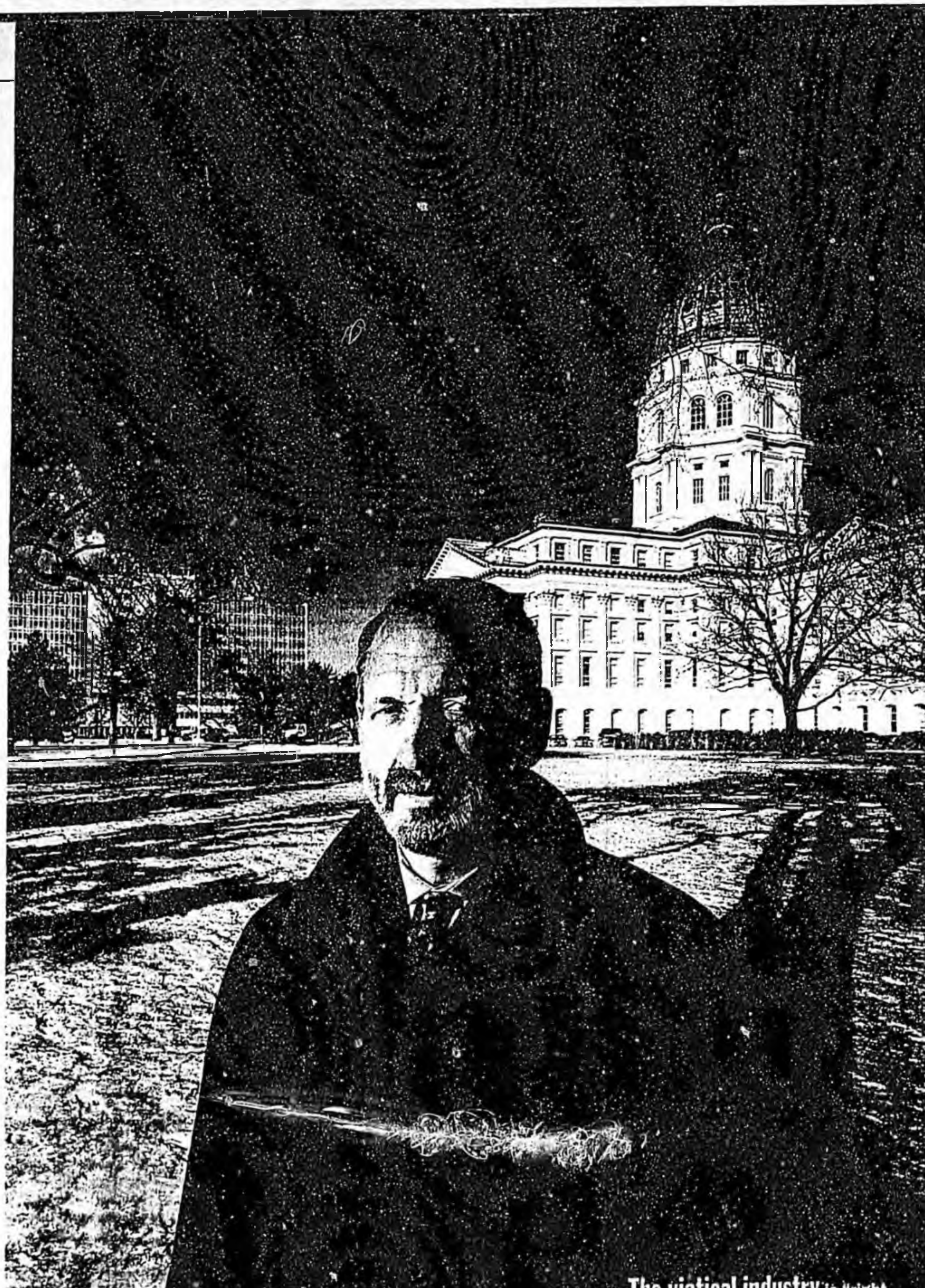
Now that several years have passed since a lot of policies were sold and the payoffs aren't forthcoming, the industry is "right on the edge of collapsing," says Roger Walter, general counsel for the Kansas Securities Commissioner and chairman of a national task force of securities regulators who are investigating viatical investments. The national organization of insurance commissioners is also searching for ways to regulate viaticals.

We had little trouble finding people who invested in viatical settlements and now wish they hadn't. Some have lost thousands of dollars; others haven't seen a cent yet because the policyholders have lived years longer than expected. Many investors are risk-averse seniors—a prime target of viatical sellers—who, like Paxton, have cashed in their savings and are still waiting for their money.

Quick-buck artists have poured their efforts into selling viatical settlements, concentrating on elderly investors looking for a higher return.

Viatical-settlement investments really took off when terminal AIDS patients began selling their policies to viatical firms in the early 1990s. But when protease inhibitors and other medical advancements started extending patients' lives, viatical investors found themselves waiting longer than expected for a payout. Many are still waiting. Others, such as Jerry Warner of Independence, Mo., and his mother, Vera—who together invested more than $45,000 in viatical settlements—found themselves with an unexpected payout, but for much less than they'd put in. They lost more than $15,000 between them.

Some were told lies or half-truths and strong-armed. When they expressed reluctance to participate in this admittedly morbid investment, they were assured that viatical settlements are humane instruments that give the terminally ill much-needed cash. What they weren't told is



The viatical industry is "right on the edge of collapsing," says Roger Walter, a Kansas regulator who's heading a national task force investigating viatical settlements.

Some investors feel intimidated by the salespeople and fear they'll never get their money back if their names appear in print.

that there are actually more investors than there are policies. In some cases, investors have had to wait for several weeks before the viatical company could find policies for them to buy. At least one viatical company has urged terminally ill people to hide their medical conditions from life insurance companies so they could buy policies that the company could immediately resell to investors. And several insurers are willing to buy back policies themselves or offer to pay death benefits while policyholders are still alive, so terminally ill people aren't dependent on individual investors for cash.

Almost everyone we talked with is embarrassed and angry. Some are intimidated by the salespeople and afraid they'll never get their money back if their names appear in print. Among the investors we interviewed, only Jerry and Vera Warner agreed to let us use their real names.

When Betty Paxton's son learned about her viatical investments, he was suspicious. After he and his financial adviser did some digging, the suspicion turned to anger.

Paxton's son discovered many risks that his mother hadn't been warned about—such as that the policyholders could outlive their life expectancies and leave Paxton without access to her money for years to come. (The insureds could live even longer than the 80-year-old Paxton.) If she tried to resell the policies before the policyholders died, she'd probably get 25% to 50% less than her original investment—if she could find a buyer.

The salesman didn't explain that the 24% total return would become a smaller annualized return each year the insured people lived beyond their life expectancy—or that Paxton could even be forced to pay additional premiums to keep the policies in force. And if anyone who invested in the same policies didn't pay the premiums, the policies could lapse and she'd lose her investment.

Paxton wasn't given any medical information about the policyholders until after she had invested her money. Because the policyholders wanted privacy, there was no way she could get a second opinion and verify that their life expectancies were reasonable.

Paxton's son and his financial adviser even looked up the full *60 Minutes* quote and discovered it was taken out of context from a 1995 program about AIDS—before medical advancements extended patients' life expectancies—but none of the people Paxton invested in had AIDS.

After the Ohio Department of Insurance told Paxton's son that the agent had been the subject of several complaints for misrepresentation, he sent certified letters to Beneficial Assistance, the Baltimore, Md., company that sold the policies, asking to have his mother's money refunded because this was clearly an unsuitable investment for her. So far, he has received no response.

Perhaps the biggest drawback of viatical investments is that the return depends on when the policyholder dies. Miscalculations are inevitable, but some companies have deliberately filed false medical reports. Life Options International, a Tuscaloosa, Ala., company that drew close to $5 million in investments from 250 Missouri residents, was issued a cease and desist order by the Missouri Commissioner of Securities, which charged the company with misrepresenting insureds' medical conditions and falsely underestimating

Big commissions, big compromise

MARK CORTAZZO, a financial planner in Denville, N.J., receives at least one letter a month trying to recruit him to sell viatical investments. The companies usually offer him 7% to 12% of the investment amount. "It would take me ten years with a client to earn the same money these people make from selling one viatical," says Cortazzo.

But Cortazzo won't sell viaticals. And he wonders whether many of the salespeople, who don't need to be licensed in most states, really understand how the investments work. One solicitation for prospective salespeople, for example, includes a "Pyramid of Safety," which shows viatical settlements, insurance and annuities on the bottom layer as the safest investments. CDs and money-market accounts are listed on the next layer up, as riskier investments.

Chris Gemignani, the lawyer for a life insurance agent who was offered 15% commissions to sell viaticals, researched the business for his client and discovered that so many people were taking a cut of the sale that there was little money left to help the terminally ill person. Additional money is used to pay premiums and to track the insured (if you can't find the insured and don't get a death certificate, there's no payout). His client decided not to bite.

Some viatical salespeople have been trying to be responsive to their clients. Karl Hanke, who sold half a million dollars in viaticals to about 50 of his clients from 1995 to 1997, probably earned about $40,000 in commissions, but now he calls the investments a "service nightmare." He's tried in vain to get information for clients who expected payouts several years ago. "The companies won't even take my phone calls," he says. He doesn't sell viaticals anymore.

life expectancies. In one case, an independent doctor estimated the insured's life expectancy to be four to ten years, but the company told an investor it was 36 to 48 months.

Patty Norton was one Life Options investor. As the 55-year-old Missouri woman's certificates of deposit matured in late 1994 and early 1995, she was disappointed with her investment options. "When the CDs came due, the new rate was just zilch," she says. A broker recommended that she buy viaticals instead. He told her that even if the person didn't die after the second or third year, the company would still offer to give back her money with a small return; but she'd get the big bucks if she waited until the person died. He also told her the policies were paid up—no matter how long the policyholders lived, she wouldn't owe any money to pay premiums. Both statements were untrue.

Within a year, Norton owned portions of seven policies from Life Options. Some promised a 10.5% return when the insured died, which she was told should be in about six to 12 months. Others promised 56% returns on life expectancies of two to three years and 95% for life expectancies of three to four years. "You think that didn't look good?" she says.

One of the insureds did die a year after Norton bought the policy, and she made $525 on her $5,000 investment. But she had to give back her $500 gain on another $5,000 policy. According to Norton, Life Options said that the insured's family claimed he didn't have the right to sell the policy and wanted the insured's son to receive the death benefit. The company told her she could get back her original investment, but she'd have to return her gains to avoid a lawsuit.

Four years later, the five remaining insureds are still alive. Norton has about $50,000 in the viaticals but has not received any updates from the company.

Sometimes the life-expectancy problem can turn returns into big losses. In 1996, Jerry Warner, 53, of Independence, Mo., purchased part of two life insurance policies belonging to terminally ill people for nearly $19,000. His 76-year-old mother, Vera, from Lake of the Ozarks, Mo., invested $27,000. Vera, who had had a friend who died of AIDS, says, "I just wanted to invest my money and thought, why not help someone at the same time?"

The Warners were told the patients were expected to live about three to five years. They both thought the lump sum they'd receive after the patients died would equal a 12% to 20% return for each year.

More than two years later, their investments unexpectedly paid off—but at far less than they had invested. Jerry received a check for $12,000—nearly $7,000 less than the amount he had invested. His mother lost nearly $8,700. The company, Aide the Living, told investors that because medical advancements had extended the life expectancies of the insureds, the company needed to sell the policies as soon as possible and had accepted an offer from the highest bidder. "They didn't give us any choice," says Warner, who hadn't been warned that Aide the Living could sell the policies for less than the invested amount.

About 70 Missouri residents had invested more than $4 million with Aide the Living, the Missouri Securities Division discovered. It charged the company with misrepresentation and issued a cease and desist order prohibiting it from doing business in the state. Other states have also issued orders against the company.

Anne Jones's nephew—a viatical salesman—convinced her that she'd get better returns from viatical investments than she would from an annuity. At his urging, she cashed out a recently purchased annuity, paid $24,000 in surrender charges and bought portions of insurance policies on seven terminally ill people. By the end of 1995, she had invested more than $214,000 in viatical settlements. She expected to receive $309,000 when the people died—which she was told should be no more than 24 to 36 months later.

Jones received one payout, for $24,000. Jones, who is 70, still has nearly $193,000 tied up in the other six policies. One person, who had a 12- to 18-month life expectancy in 1995, is still alive 43 months later. The 15% return Jones was to receive on that policy has dwindled to less than 4.2% per year—and is still falling.

The viatical company recently sent her a letter claiming that, because the insureds had outlived their life expectancies, she'd either have to pay premiums to prevent the policies from lapsing or sell them back to the company for half of her original investment. If she did that, she'd lose more than $96,000.

Despite the company's threat to start charging her for premiums, the insurance companies told the Kansas Securities Commissioner's office, which is investigating her case, that premiums had been waived on some of the policies because the policyholders were considered disabled.

There's another complication. The viaticals are in an IRA, and since Jones turned 70½ recently, she needs to begin taking withdrawals. Other than the $24,000 payout she received, the rest of her IRA money is trapped in the viaticals. Any required distributions she can't take will be considered excess accumulations and subject to a 50% penalty for every year they're not distributed.

The uncertain wait for the payoff could have more dire repercussions for Janice Cannady, 75. Five years ago, a salesman from her hometown in Nebraska recommended that she cash in her CDs and buy a viatical for $12,000. The investment was to pay out $20,000 when the insured

After five years, Janice Cannady hasn't received a payout. Meanwhile she's been diagnosed with Alzheimer's disease and her husband has died.

In one large court case, a viatical company owner pleaded guilty to fraud after he and his colleagues pocketed $95 million in investments.

died which, she was told, should be in 18 to 36 months.

Five years later, she still hasn't received a payout. Janice's daughter, Sally, requested an updated medical report, but the company hasn't responded. Since she bought the policy, Janice has been diagnosed with Alzheimer's disease and her husband has died. Sally wonders what will happen if her mother needs to enter a nursing home. She'll need the money to cover the bills. But if she doesn't have it, she'll have to apply for medicaid—which might be difficult because of the viatical. "It complicates eligibility if you have an asset you can sell only at a tremendous discount," says Cynthia Barrett, an elder-law attorney in Portland, Ore.

Dick Hausten's in-laws were 78 years old when they saw a newspaper ad offering "guaranteed returns." A salesman came to their home, told them they were "burning their money by leaving it in CDs" and sold them $92,000 in viatical settlements. (Hausten let us use his real name but not the names of his in-laws.)

When Hausten found out, he called the two doctors' phone numbers printed on the insureds' medical evaluations and got two wrong numbers. He couldn't find any evidence that they really were doctors. Plus, the medical report for one of the policyholders was from 1989, when he was said to have a life expectancy of 48 months. Yet the investment was made in 1998.

Nine months later, Hausten's father-in-law asked the company to return their money and received 88% of their original investment. They lost $11,000.

The company that sold the policies, Accelerated Benefits Corp., continues to run advertisements that say, "With the stock market plummeting and interest rates falling, isn't it nice to know there is still an investment that offers your clients fixed high profits with safety?" (Regulators cannot discuss current investigations, but at least one state is looking into Accelerated Benefits Corp.)

Several lawsuits have been won against viatical-settlement companies, and more have been filed. In the largest viatical case so far, David Laing, owner of Personal Choice Opportunities, of Palm Springs, Cal., pleaded guilty to fraud. More than 1,100 investors had given Laing's firm a total of $95 million to purchase viatical investments, which were advertised as a "risk-free" way to earn 25% per year. Laing and his colleagues pocketed the money and never bought the viaticals.

After an investigation that included the FBI, several states' securities regulators and the U.S. attorney for the Southern District of New York, a receiver was appointed to track down the money and return it to investors.

The Securities and Exchange Commission brought a separate suit against Laing and has gone after other viatical firms for misrepresentation. Civil suits are also starting to appear. Mitchell Perlstein of Investors' Law Center and Scott Link of Ackerman, Link & Sartory have filed class-action lawsuits in Florida against three viatical-settlement companies, alleging that they misrepresented insureds' life expectancies because they knew protease inhibitors had extended the lives of AIDS patients. Yet they continued to tell potential investors that "death is certain and measured only in a matter of months." The plaintiffs are still waiting for payouts they expected several years ago. •

REPORTER: MARGARET RINGER

What to do if you've invested in a viatical

WHAT IF YOU already own a viatical settlement and suspect the company of misrepresentation or wonder whether you should accept an offer to sell back the policy? First contact the securities administrator, insurance department and attorney general in your state and the state where the company is located. (Find your state's Web site and contact numbers at www.piperinfo.com/state/states.html.) They may be investigating the firm and usually have leverage to get more information from the insurance company and the viatical company. Also contact the Securities and Exchange Commission's Office of Investor Education and Assistance at 202-942-7040.

You'll need to contact that many people because viatical settlements aren't regulated by one central agency. The securities commission takes the lead in some states; in others, it's the insurance department. And some states haven't figured out yet what to do with viaticals—which makes it easy for unscrupulous sellers.

"One of the things con artists do is rely on jurisdictional gaps—they have the advantage of confusion," says Bill McDonald of the California Department of Corporations, which is currently participating in about ten viatical investigations.

But few consumer organizations know how to help viatical investors. The best one-stop resource is Gloria Grening Wolk's *Viatical Settlements: An Investor's Guide* (Bialkin Books) and her Web site (www.viatical-expert.net). She learned about viatical investments while writing a financial guide for people with terminal illnesses.

The Florida Department of Insurance also offers a free booklet that discusses the risks related to viatical-settlement investments. Call the department's consumer help line at 850-922-3132.

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Life-insurance payoff not always sure thing

By MARCY GORDON
The Associated Press

YOUR MONEY

WASHINGTON — One of the hottest new investment scams involves people who think they can earn money by helping terminally ill people get an early payoff on their life-insurance policies.

Investors buy the policies through a broker and a portion of the money is paid to the policyholder, who often has AIDS or cancer, to help with medical bills. The investor is supposed to get paid when the person dies, but in some cases, the policyholders aren't really dying. In other cases, the policyholder doesn't exist.

State securities regulators added the scams Monday to their annual list of the "top 10" investment frauds. Also added were high-priced seminars in "day trading," in which inexperienced investors are convinced they can get rich quick by rapid-fire buying and selling of stocks.

"Today we have an ideal climate for fraud," said Peter Hildreth, president of the North American Securities Administrators Association and director of securities regulation in New Hampshire. "Millions of new investors, many of whom expect unrealistically high returns, are looking for places to put their money. At the same time, we're living through an Internet-driven technology revolution that is a boon to investors and con artists alike."

Investing in insurance policies of the terminally ill is legal and has been around for a decade. Advocates call it viatical investing, which takes its name from the Latin "viaticum" — a purse

Please see Page F-4, SCAM

COMMON INVESTMENT SCAMS

- **ON-LINE:** Investment fraud over the Internet.
- **SEMINARS:** Includes the seminars promising to teach people how to become day traders of stocks.
- **AFFINITY GROUP:** Fraud that targets religious, ethnic and professional groups.
- **ABUSIVE SALES:** Practices include aggressive, unsolicited telephone calls to consumers by people selling small-company stocks.
- **TELEMARKETING:** Fraud by telephone promoting bogus investments.
- **PROMISSORY NOTES:** Notes sold as insured investments with high interest rates.
- **VIATICAL INVESTMENTS:** Scams that take advantage of investors who thought they could earn money by helping the terminally ill get an early payoff on their life insurance.
- **ENTERTAINMENT FRAUD:** Scams offering bogus investments in movies, cable TV shows, video games and other products.
- **FRANCHISE:** Bogus business franchise offerings.

SCAM: Economy is 'ideal climate for fraud'

Continued from Page F-1

given to a traveler in preparation for a journey.

Viatical companies arrange for the sales of the policies and take a share of the proceeds.

As an example, a group of investors may pay a terminally ill person $80,000 for the person's $100,000 life insurance policy. When the person dies, the group will make a $20,000 profit, minus premiums and fees to the viatical broker.

While many brokers operate legally, the practice isn't regulated, which "creates a situation that could be ripe for fraud," said Scott Lane, assistant enforcement director of Pennsylvania's Securities Commission.

Gloria Wolk, an expert cited by Lane, estimates that investors have lost more than $400 million in viatical investments since the industry sprouted in the late 1980s.

One problem occurs when people who aren't really sick take out policies.

In some cases, Lane said, people can get life insurance policies worth as much as $100,000 without medical exams or blood tests.

In other cases, the viatical company promises big returns of 25 percent or more to investors, but never has any insurance policies to back them up.

Even when someone is terminally ill, the state securities regulators caution, viatical investing is risky because of the uncertainty in predicting when the person will die. New AIDS drugs have compounded the risk for investors because they keep people with AIDS alive longer.

Deborah Rhoades, a vice president of the National Viatical Association, said fraud is not widespread in the $1 billion-a-year industry. She said it has occurred in a few instances, as happens "in any other industry that is unregulated."

"We believe it should be regulated," Rhoades said, noting that the trade group has been working to that end with the National Association of Insurance Commissioners.

Playing the DEATH POOL

As investors step up the buying of life policies of the healthy and the ill, some observers are having second thoughts about the secondary life insurance market.

by Ron Panko

A highly entrepreneurial secondary market for life insurance policies that has taken shape in the past two years is causing uncertainty and concern among regulators and insurers. With the help of brokers, healthy insureds are selling their life policies for cash. Other individuals are investing into pools of cash created and maintained by brokers to make the purchases. The business is largely unregulated.

The secondary market for life policies grabbed a foothold 10 years ago with the advent of viaticals—the buying and selling of policies owned by the terminally ill. The justification for viaticals was—and is—that some terminally ill people and their families need money to help them through their last difficult months. The new market is based on the proposition that some insureds no longer want, need or can afford their coverage. These deals are known in the business as "senior settlements" or "high-net-worth transactions."

Critics see many problems with the budding industry.

"It sets up the situation in which people are gaining when other folk are dying," said Thomas Foley, former life and health actuary in the North Dakota Department of Insurance. "To my mind, that's inappropriate activity."

Assuming they sell their policies to reputable parties initially, insureds still have no assurances about who ultimately will come to own them. "I think it gets back to the most fundamental question of all—the transfer of a policy to a person without an insurable interest," said Joseph M. Belth, a semi-retired insurance professor at Indiana University. "That's creating a powerful incentive for homicide."

Investors face dangers to their financial health. "I would be skeptical about investing without knowing the basis of the scheme intending to make money," said James Hunt, a life insurance actuary in Concord, N.H., who consults with the Consumer Federation of America. In some brokered deals, the investor faces odds about as good "as going to Las Vegas," he said.

"It's a totally unregulated market," said Belth, who also publishes a monthly newsletter, *The Insurance Forum*. "There are no standards, no rules, and they [brokers] can do anything they want. You talk about your cowboys out there; this is a totally unregulated market, and it's open season."

In extreme cases known as "wet-ink" transactions, the sick and elderly are offered financial incentives to secure life policies for immediate resale. The transactions may involve deceptive applications or misleading answers to health questions. The buyers receive a payoff, usually 5% or so of the face amount of the policies, the intermediaries get a slice of the action, and the investors hope the insureds die soon enough that they can make a healthy profit.

Help on the Way?

Some states have laws that provide safeguards for sellers of policies, known as "viators." A model act passed by the National Association of Insurance Commissioners in 1993 outlined licensing requirements for brokers and viatical companies as well as disclosures that must be provided to viators. This year, the NAIC is likely to extend the disclosure protections to the chronically ill. (See "Regulators Try to Keep Up," on page 23.)

The Viatical Settlements Working Group is charged this year with taking up issues associated with healthy people selling their policies.

The NAIC doesn't address the protection of investors in viatical settlements. Belth says many of those are also seniors who are lured by advertisements promising high returns and guarantees. "These investors are getting scammed," he said. "There are situations in which investors put in their money, and nothing's happening. The insureds are not dying, and these investors are getting wiped out financially."

Investors don't get much protection because viatical settlement transactions currently fall through regulatory cracks. In 1995, the U.S. Securities and Exchange Commission alleged that Life Partners Inc., a large viatical firm in Waco, Texas, was selling unregistered securities. A federal district court judged sided with the SEC, but Life Partners appealed and won. The

A Look at the Secondary Market

Life insurance transactions in the secondary market fall into four general categories.

Traditional viaticals	The insured's life expectancy is two years or less. This segment makes up the bulk of viatical purchases.
Chronically ill	The insured's life expectancy is shorter than normal but more than two years.
Senior settlements and high-net-worth settlements	The insured's life expectancy is normal. Targets people over 65. Often involve transactions for policies with high face values.
Wet-ink transactions	Transfers of newly issued policies. Individuals may be recruited to buy policies and sell them immediately. Raises the most alarms for regulators and insurers.

appeals court ruled in July 1996 that a viatical transaction is not a security.

Though the Life Partners case was not binding on the states, the company was able to use the verdict to fend off regulatory efforts, said Roger Walter, general counsel for the Kansas securities commissioner and chairman of a viaticals task force with the North American Securities Administrators Association.

The decision's chilling effect may be over, however. "We're saying we don't believe that decision is binding, and most states are now reasserting their authority," Walter said.

Viaticals and the transactions involving healthy insureds are best handled under the purview of both the SEC and state securities regulators, Walter said. "This problem needs a uniform national response because so much of this has been sold," he said. "So many people are in these things, we don't even know how much has been sold. And because this has been to a large extent outside regulation, a lot of fraud has poured into the market."

Most states do not have legislation that defines the secondary market for life insurance policies as securities transactions. Maine, Missouri, Arizona, Alabama, Oregon, North Dakota, South Dakota and California are among the estimated 13 to 19 states that do, Walter said.

The controversy about the healthy-lives transactions stems from the fact that the industry "has gotten way ahead of regulators and given more visibility to the question of whether they're securities," said William Kelley, executive director of the Viatical Association of America, based in Washington, D.C.

Risky Business

The definition may depend, in part, on the sophistication of the buyer. "Clearly, there is no way" that life policies purchased in the secondary market by investment-savvy corporations or limited partnerships should be considered securities, Kelley said. "They may be securities if you fractionalize pieces and sell them in $2,000 chunks, but we have no case law to define that," he said.

Regulators are more concerned about small, less sophisticated investors who may not be able to accurately evaluate the risks they would assume in the secondary market.

Viatical companies are free to advertise outlandishly, and some of them do. In the March issue of his newsletter, Belth devotes a full page to excerpts from promotional materials of viatical firms to investors. Many others can be viewed on the Internet. Some of these advertisements misrepresent the risk an investor might assume. Some falsely claim guaranteed investment gains, no risk and a guaranteed return of principal. Some say the investment is secured by the insurance company that underwrote the policy or the state guaranty association set up to protect policyholders from insurer insolvencies.

The risks, however, are many, the most obvious being that the insured may live much longer than expected. In general, guarantees are only as good as the management of the viatical company. How accurately has the company assessed the longevity of the insured, for example? How well has it priced the policy? What arrangements has it made to be notified of the insured's death? Can it be counted on to make all of the premium payments on time? Will it simply run off with the investor's money?

Insurers at Risk

Insurers, too, are at financial risk. In a recent wet-ink scam, Columbian Mutual Life Insurance Co., Binghamton, N.Y., would have gotten burned by an agent soliciting fraudulent applications were it not for an alert underwriter.

"One of our underwriters noticed that policies issued with no medical information were being assigned to non-relatives," said Lauren Wise, vice president and associate general counsel. "What tipped us off was that one was a viatical company. Our medical information showed there were no health problems, but the viatical company said the insured was terminally ill."

Seventy-one policies, each for $100,000, were involved. All were written by an agent in New York City. Columbian Mutual wound up rescinding 68 due to material medical misrepresentation. Two are still in force because the company couldn't prove its case, and one remains in dispute over whether the insured has died.

Columbian terminated the agent's contract on the grounds that his ratio of policies rescinded to policies written was too high. "We weren't able to prove he defrauded us," Wise said. "That's hard to prove." The New York State Department of Insurance was still looking into the case in March, but Wise said she had not yet heard whether the department had stripped the agent of his insurance license.

The company has terminated agents for similar reasons in Texas, she said. In response to the alleged frauds, the company has tightened underwriting by lowering the policy face amounts that trigger blood tests, Wise said.

Columbian is small enough for its underwriters to spot any unusual activity. That may not be the case, however, for larger insurers. Prudential Insurance Co. of America, Newark, N.J., for example, could not identify any specific measures in place to deal with secondary market issues. "They're relatively new developments," said spokesman Bob DeFillippo. "As a company, we're all very concerned, especially about the healthy-lives transactions. Where people are being solicited to give up their coverage, we advise them it may not be appropriate."

Northwestern Mutual Life Insurance Co., Milwaukee, prohibits its agents from accepting fees to help clients sell their life policies, said spokesman Tom Towers. The insurer also offers accelerated benefits up to 50% of face amount if the insured has no more than six months to live.

Transamerica Life Cos., Los Angeles, is approaching the issue cautiously. "With respect to the narrow subset of viatical settlements known as 'wet ink' viaticals, our company position is that we will not participate in these transactions until there is clarity on the regulatory front," said Joel Seigle, vice president, life product development and support.

The special viatical edition of Belth's newsletter generated a lot of reaction from insurers. "Quite a number of companies have expressed concerns with what is going on," he said.

But a lack of will, interest or concern on the part of most insurance companies allow their policies to be moved around in ways that will lead to major trouble, he said. It's fine to say people should be able to do what they want with their personal property, Belth said, but public policy considerations outweigh the free transfer of some kinds of property.

Efforts at Self Regulation

Viatical companies and professionals working with them have attempted to regulate themselves. Trade groups representing the industry ask members to abide by certain standards.

The National Viatical Association, which was formed in 1993, has about 20 members, including viatical brokerage firms and professional firms, such as physicians, accounting and escrow service. The Viatical Association of America is an offshoot of the National Viatical Association that grew out of differences of opinion about membership qualifications, according to NVA spokesman Paul Permison.

The NVA requires a lengthier application process, including criminal background checks, Permison said.

The 39 viatical settlement companies that belong to the Viatical Association of America fall into three categories: funders or providers, which directly purchase from policyholders; viatical settlement brokers, which rep-

Regulators Try to Keep Up

Innovations can occur so fast in the financial services industry that regulators are hard-pressed to keep up. That appears to be the case in the emerging secondary market for life insurance policies on healthy individuals.

The National Association of Insurance Commissioners has had a working group on viatical settlements since 1992 and a model act since 1993. In 1997 and 1998, the working group expanded the definition of viator to the chronically ill so that all of the protections of the act would also apply to those selling policies due to chronic illness, said Lester Dunlap, assistant commissioner in Louisiana and chairman of the working group. In March, the group submitted the finished product to its parent committee, the Life and Annuity Committee. These changes will be considered by the NAIC Executive Committee at a future meeting.

This year, the working group is charged with looking at the sale of policies of healthy individuals, the so-called "senior-settlement" and "wet-ink" transactions.

Among the issues the group will address are who is brokering the transactions, who is investing in them, whether there should be suitability requirements, and whether the actors should be licensed, Dunlap said.

"It's driven by concerns that some undesirable elements could get involved that could result in murder-for-profit type schemes, though there's no evidence so far that anything like that has ever happened in the U.S.

"With traditional viaticals, when insureds are near the end of their lives, there is no real incentive for anyone to expedite cessation of their lives," Dunlap said.

Some form of the model act's statutory framework has been adopted by at least 22 states, Dunlap said. Most states have adopted at least some of the model language in the act, he added.

The model act requires that people working as viatical-settlement providers, representatives or brokers be licensed by the state insurance commissioner. They are also subject to business-practices rules, Dunlap said.

The act also requires that a prospective viator—one who sells a life policy—be informed of pertinent information, including:

- Possible alternatives to viatical settlements, including accelerated death benefits offered under the viator's life policy.
- That some or all of the proceeds of the proposed settlement may be free from federal income tax, but a professional tax advisor should be consulted.
- Proceeds could be subject to the claims of creditors.
- Proceeds may adversely affect the viator's eligibility for government benefits or entitlements, including Medicaid.
- The viator has the right to rescind the settlement within 15 days of receiving proceeds.
- Funds must be sent to the viator within two business days after an insurer acknowledges transfer of ownership.

The original act and regulation also provided a table of minimum viatical settlement payouts based on life expectancy, Dunlap said. "These are important because you're talking about terminally ill people who are vulnerable to scams and victimization," he said.

—Ron Panko

Turning Life Policies Into Cash

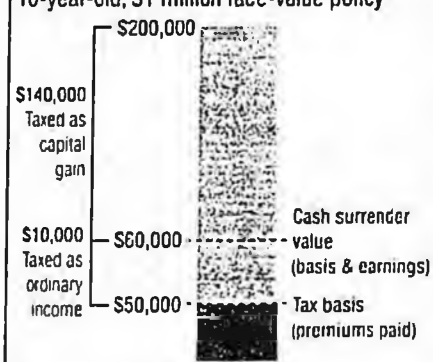
To some in the insurance industry, the secondary market not only has a rightful place, but fills a genuine need. Chicago-based Viaticus, a subsidiary of the CNA Insurance Group, began as a viatical company, but it's now active in the high-net-worth market. The company is funded by CNA, so it doesn't prospect for investors.

"When we started Viaticus in early 1994, we believed we could develop an actuarial approach to put values on policies based on traditional standards," said Gary Chodes, president. "We do the underwriting, the traditional things you do for life underwriting. We believed back then we could develop an approach and market it."

The Tax Situation

Typically, any amount paid for a policy in excess of the cash surrender value is treated as a capital gain. This graph shows how $200,000 in proceeds would be taxed from the sale of a policy with a total face value of $1 million, a cash surrender value of $60,000 and cumulative premiums of $50,000.

10-year-old, $1 million face-value policy



Source: Viaticus Inc.

Viaticus entered the high-net-worth market in the fourth quarter of 1997, and in 1998, the company bought policies with a total face amount of $2.8 billion. The typical policy purchased had a death benefit of $1.3 million vs. only $75,000 for its viatical business. High-net-worth policies now account for about 80% to 90% of Viaticus' business.

One of the criticisms of policies sold in the secondary market is that the investor doesn't have an "insurable interest" in the person whose life is insured. But insurable interest is not an issue when the policy no longer serves a need, Chodes said. "You need to have an insurable interest at the time a policy is issued," he said. "The contract can't be a guise for a wagering contract. It needs a legitimate insurance need."

As time passes, however, policies are often reassigned. Co-owners of a business may own policies on their partners, but if the business breaks up there is no longer an insurable interest, Chodes said. The same is true for a husband and wife who divorce. "These things have happened as long as life insurance has been owned," he said. "We don't believe there are insurable interest issues. Tens of thousands of people have availed themselves of viaticals, and there haven't been any conflicts."

Financial planner Andy Bluestone tells clients they need not worry about a stranger owning a policy on their life. "It's not a stranger; it's a financial institution," said Bluestone, a principal of Selective Benefits Group, Whippany, N.J. "It shouldn't be an issue if it's a financial institution."

Five independent corporations serve as Viaticus' marketing arm. Gregory Albers, president of Life Insurance Buyers Inc., Kansas City, Mo., has recruited more than 3,000 producers. He began his life insurance sales career 30 years ago and has no regrets about his switch to the buying side.

"It's simply the evolution of our business, and one of the positive evolutions," he said.

One of Albers' clients was a 78-year-old man who went through a personal and corporate bankruptcy. "He had nothing left but a $5 million life policy, which was exempt from his creditors," Albers said. "He had no means to pay premiums, but we bought it from him for $2 million. It changed his life."

When a financial institution in a medium-sized town in the Midwest purchased six banks, it came to own 54 life policies that no longer served a purpose, mostly for key executives. The policies' cash value was $900,000, but they had a combined face amount of $14 million. "This institution bought them for $900,000, and then they sold them to Viaticus for $3.5 million," Albers said.

A 78-year-old man recently retired from a company that had provided him with a term insurance policy worth $8 million. The company would not pay the next premium, and he could not afford to pay it himself, Albers said. Viaticus bought the policy for $400,000. "Suddenly, you're a hero to this family," he said.

Selling an in-force life insurance policy can create liquidity from an otherwise dormant asset, provide funds that can be reinvested into other financial vehicles, and eliminate costly premium payments on a policy no longer wanted or needed, according to Viaticus. It allows insureds to receive more than the cash surrender value of a policy.

While proceeds from a sale are not exempt from income tax, like death benefits are, they can be tax-efficient. Only the interest on principal is taxed as regular income. The return of principal is not taxed again, and capital gains are taxed at a lower rate than regular income.

Proceeds are often used to fund the purchase of a survivorship life policy, to fund a deferred compensation program, or to buy back stock from a business partner. They can pay for long-term care insurance or other asset-protection tools, or to fund a charitable gift, tax-favored charitable trusts or gift annuities. They are also put to work in longer-term investments with the potential for gains greater than the life policy was providing, or to pay gift taxes.

Albers believes that the availability of the secondary market will further growth of the primary life industry. "The more we can educate life producers about the value of the high-net-worth transaction, the more insurance he's going to sell," he said. Consumers are more likely to value a life contract if they understand that in addition to lapse and surrender for cash value, they now have a third option, he said.

Albers sees benefits for both the insurance company and the agent that wrote the policy. Agents get to keep their renewal commissions and may earn persistency bonuses. Insurers can rely on a constant cash flow to keep up their very slim margins, he said.

—Ron Panko

States That Regulate Viatical Settlements

State	Provider License Required	Brokers License Required
Arkansas	✔	✔
California	✔	✔
Connecticut	✔	✔
Florida	✔	✔
Illinois	✔	
Indiana	✔	
Kansas	✔	
Kentucky	✔	✔
Louisiana	✔	✔
Maine	✔	✔
Michigan		
Minnesota	✔	✔
Montana	✔	✔
New York	✔	✔
North Carolina	✔	✔
North Dakota	✔	
Oklahoma	✔	✔
Oregon	✔	✔
Texas	✔	✔
Vermont	✔	✔
Virginia	✔	✔
Washington	✔	✔
Wisconsin	✔	✔

States With Legislation Pending

Massachusetts
Ohio
Pennsylvania
Utah

As of March 17, 1999
Source: Viatical Association of America

resent insureds trying to find buyers; and firms that raise money from private investors and buy policies from funders or providers.

"We favor disclosures," said Kelley of the VAA. "We have a full page of information on our Web site warning that these transactions are not guaranteed and that, in fact, investors could lose all of their money." The Web site information goes beyond the scope of NAIC model regulation, Kelley said. "Our disclosures on our Web page are what association members have agreed to comply with in their offerings to investors," he said. "They address such things as not using the term *guaranteed*. It warns that if viators are not terminally ill and outlive their life projections, then premiums still have to be paid and they would lessen the return on the investment. It also warns of risks associated with group life policies. What happens, for example, if an employer changes insurance companies?"

Permison, a partner in The Ardan Group Ltd., Woodbridge, N.J., said the Internet sites touting "guaranteed, rock-solid, safe investments" and agents that sell viatical investments to mom and pop across the kitchen table threaten the legitimacy of the secondary market. Senior settlements, improperly represented, constitute "a form of arbitrage" in which investors are gambling that an insurer's underwriting is wrong, he said.

"Judging by what's popping up in newspapers, investors are led to believe, or just want to hear, there's a three-year prognosis on the insured," said John Mandel, also a partner in The Ardan Group. "But there's nothing in our contract to require the viator to hand in a death certificate by then."

Permison predicts more regulations for the secondary market. "You have some now in certain states, and there are legislative changes in progress that can limit viatical broker fees and settlement company fees," he said. "This is a very viable industry, but over-regulation will destroy the marketplace."

A shakeup in the industry might tighten the amount of money flowing into it, which would bring prices down and hurt the person selling the policy, Mandel said. Investors who buy policies typically receive payouts that amount to a 12% annual rate of return, he said, and the number of dissatisfied investors is small.

"The way it's evolving, they'll be trying to make us into insurance companies—overstaffed and with lots of paperwork," he said. "That's not where this business should be." BR

The Business of a Broker

Unlike Viaticus, the CNA subsidiary that receives funding for the purchase of life policies from its parent, The Ardan Group handles transactions on both ends: with investors and with viators. The Woodbridge, N.J., company keeps the identities of viators confidential, and it collects investors' money before it buys life policies.

The company follows guidelines the National Association of Insurance Commissioners has set for viaticals, and it follows disclosure regulations, including the seller's right to rescind a contract within 15 days of receiving payment.

Ardan Group clients are referred by certified public accountants and financial planners, and they are all represented by attorneys. In most cases, the investments are defined by certain parameters so investors can stipulate how much risk they are willing to take, said Ardan Group partner Paul Permison.

About one-third of the 400 new cases initiated monthly are completed. Before any deal is struck, each case is subjected to a great deal of scrutiny, including an independent medical review and an assessment of proposed premium expense, Permison said.

A small investment with The Ardan Group is $25,000, but usually the investments are much larger and come from groups. Currently, the company has about $40 million of face amount in its portfolio.

The company is also involved in wet-ink transactions, or the "new-issue stuff," as partner John Mandel puts it. "We don't buy a lot, but it is transacted," he said, adding that both investors and insureds are "very sophisticated."

"Some may think it's a kick. They get $40,000 on a $1 million new policy. For them, it's like picking up a nickel on the street. They don't need it, but it's something to talk about with their golfing buddies. There are plenty of willing participants."

Some insurers will enact a change of ownership for a policy in three days, but others make it difficult unless the insured is terminally or chronically ill, Mandel said. Some uncooperative insurers refuse to verify coverages, and some take a month to respond.

"And at the bottom, they'll add a disclaimer saying that the information provided may not be correct," he said. "They sold a contract that offers a transfer of value, and then they make it difficult."

—Ron Panko

by Peter Keating

Rolling the Dice on Death

The viatical market may be booming, but it's no place for investors.

Viaticum—it's not where the Pope lives or the latest wonder drug for male pattern baldness. It's a Latin word that can refer to provisions supplied to a departing traveler or to the holy Eucharist placed upon the lips of a dying person. Either way, it means something that helps you move safely to a better place. That's why, when patients facing the crippling costs of AIDS first began selling their life insurance for cash a decade ago, the market that developed was called the viatical industry. Terminally ill people got immediate help to ease their final days, and investors who bought the policies ultimately turned a profit. It looked like a win-win business, if a rather ghastly one.

Well, now it's the end of the '90s. A new class of brokers is using all sorts of aggressive tactics—Internet sites, radio ads, funeral home promos, alliances with financial planners—to pump viaticals to investors eager for big scores. At the same time, new treatments are extending the lives of people with AIDS, making speculation about when they will die more uncertain (and driving down the selling price of their life insurance). So viatical firms are offering settlements to healthy seniors, thereby creating whole new categories of risk for investors. Meanwhile, the industry—in particular, the wildly misleading advertising of many viatical companies—remains haphazardly policed. "Viaticals are falling right through the regulatory cracks," says Joseph Belth, editor of the *Insurance Forum*, an Ellettsville, Ind. trade journal.

The viatical business may be booming—since 1991, the market for viaticals has zoomed from $50 million a year to more than $1 billion—but it's no place for individual investors. "The viatical industry started out marketing legitimate policies," says Deborah Bortner, director of securities for the Washington State Department of Financial Institutions. "But now we are seeing a new breed of individuals taking advantage of people who are interested in doubling their money, and we are seeing fraud."

Buying a terminally ill person's life insurance is a dangerous bet.

Most viaticals work like this: An insured person, called the viator, sells his or her policy to a viatical settlement company for a percentage of its face value—usually between 30% and 80%, depending on the viator's life expectancy. The viatical company, sometimes working through a broker, then sells the policy to an investor, who stands to gain when the viator dies and the policy is paid. Commissions and fees typically run about 10%, but they're sometimes much higher and aren't always disclosed. In some deals, the viatical company assumes payment of the insurance premiums; in others, they get passed on to the investor.

Now, this sort of investing always has entailed certain risks. What happens, for instance, if your special someone shows a zest for life? If your viator is expected to live for two years but survives for five, your annual rate of return would plummet. You could also be on the hook for extra premium payments. And since the viatical market isn't liquid, you may have to sell your policy at a loss if you need to cash out.

Another danger for investors: policies whose face values decline. "Investors should know that some insurance is written so that if a person's job or salary changes, benefits can decrease," says Anna Grinstead, COO of Accelerated Benefits Corp., an Orlando viatical firm. "We pass on more than 70% of the policies that cross our desk because of underwriting issues." Grinstead says that almost half the policies her firm rejects are sold by other viatical companies.

Photo illustration by Dennis Galante

Unfortunately, a federal court ruled in 1996—foolishly, in my opinion—that viaticals are not securities. Thus the Securities and Exchange Commission cannot compel the companies that sell them to disclose material risks, or even minimally standardized data such as annualized returns, to investors.

Most viatical ads read as if they were written by alchemists who can turn lead into gold. "Been thinking about the best way to profit with investment funds over the next few years? How about a 70% return on investment?" asks Investments First of Winter Park, Fla. "Looking for a secured rate of high returns at no risk?" blares Services International of Agoura Hills, Calif.

Investors get the best rate of return if the insured person dies quickly.

Conrad Jablonski of Anderson Township, Ohio is a living contradiction of these claims. In 1991, Jablonski was given three to six months to live because of advanced prostate cancer. The cancer spread, and in 1995 Jablonski sold a term life policy for two-thirds of its face value. Jablonski and his wife Kandi used the proceeds to cover bills, pay for their daughter's wedding and prepay his funeral. "First it sounded good," Jablonski says of his settlement, "then it sounded morbid, then it sounded like we could pay bills and for the wedding. It was as natural as that."

Four years later, Jablonski, now 63, still hasn't had that funeral. Great news for him; bad news for viatical investors who, to put it bluntly, need their viators to die quickly in order to achieve high annual rates of return.

Indeed, it's because HIV-positive viators are living longer that the industry is expanding beyond its traditional base. Viatical firms now trade policies owned by older people who are not terminally ill but are interested in "senior settlements" for estate planning. Estimating life expectancy, however, is an imprecise science even in the presence of terminal illness. Investing when the payoff date involves the death of a healthy person? "It's a wager," says Gloria Grening Wolk, a Laguna Hills, Calif. financial planner who runs a viaticals website (viatical-expert.net).

Viatical companies are also stepping up sales of "contestable" policies—policies that can be challenged by insurers because they are less than two years old. Viatical firms can buy these riskier policies at steeper discounts, then market them as offering higher returns.

Contestable policies carry extra hazards for investors: Buy one and it could get canceled at any time for up to two years, and you'll lose your investment. Of course, your viatical company can roll you into another policy—but that one might be contestable too.

Furthermore, trafficking in contestable policies creates incentives for fraud.

A Dallas grand jury recently indicted Michael Lee Davis, vice president of Southwest Viatical Corp., for allegedly getting patients at a local AIDS clinic to falsify applications for more than $10 million in life insurance. Davis bought those policies on the cheap, then turned around and marketed them to investors. (Davis, by the way, used to be named Walter Waldhauser. In 1981, he confessed to being the middleman in a murder-for-hire that involved killing a Houston family, in part for their life insurance benefits. After being convicted and paroled, he moved, changed his identity—and got a job as a viatical executive. Davis evaded arrest last month and remains at large.)

Contestable policies invite fraud. Take the case of Michael Lee Davis.

Al Woodard, 78, of Bellingham, Wash. was ambushed by a contestable policy scheme. In July 1998, he invested $25,000 with Alpha Capital Group, a New York City viatical company, through a financial planner named Linda Stull. Woodard's viator first tested positive for HIV in 1984; by the second half of 1998, his life expectancy was 42 to 48 months. Last November he somehow bought a $50,000 policy with an annual premium of just $2,124. That policy was transferred to Woodard in December. According to Washington State investigators, Stull and her cohorts "failed to disclose to investors that the insured was terminally ill prior to being insured" and that "life insurance policies were fraudulently obtained, and thus subject to cancellation by the insurer."

For now, Woodard is still holding his viatical, but he doesn't expect to see his money again. "Linda said it would help the sick person, and it could double, especially if the guy died quickly," he recalls. "But now it's just a tangled-up mess." (Stull declined to comment. Alpha Capital declined to comment on the state's findings. The state of Washington has ordered Stull to stop selling viaticals. A federal grand jury is investigating Alpha Capital's activities.)

Bottom line: Congress should declare that viaticals are securities—then the SEC could require firms to disclose risks more fully and stop making misleading claims. State governments should follow suit—currently, only seven states regulate viaticals as securities, while 21 don't regulate them at all. Insurers should make accelerated death benefits more easily available to terminally ill policyholders, and should stop raising the amounts of life insurance that they issue without medical exams. And viatical companies that help people legitimately—and they do exist—should cooperate. It's cleanup time.

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Insurance cheating alleged

The Associated Press

TALLAHASSEE, Fla. — Two South Florida companies may have defrauded investors who bought life-insurance policies from terminally ill people, say investigators, who believe that in some cases the policies didn't actually exist.

The odd but legal practice known as "viatical settlements" gives the terminally ill a chance to get much-needed cash while they are still alive. Investors buy the life insurance policies at a fraction of their value, giving the policyholder money up front, and then profit when the seller dies. Viatical companies arrange for the sales of the policies and take a share of the proceeds.

The state, and reportedly the FBI, is investigating American Benefit Services Inc. and Financial Federated Title and Trust Inc. to determine if they cheated investors out of tens of millions of dollars by selling fake policies.

FBI agents have already seized assets — including 40 cars — belonging to Financial Federated owner Frederick C. Brandau, according to a recent report in The Wall Street Journal. About 5,000 people have invested between $115 million and $125 million, the newspaper reported, citing unnamed sources.

AUGUST 04, 19:06 EDT

Fraud Alleged for `Death' Investors

By DAVID ROYSE
Associated Press Writer

TALLAHASSEE, Fla. (AP) — Two South Florida companies may have defrauded investors who bought life-insurance policies from terminally ill people, say investigators, who believe that in some cases the policies didn't actually exist.

The odd but legal practice known as ``viatical settlements'' gives the terminally ill a chance to get much-needed cash while they are still alive. Investors buy the life insurance policies at a fraction of their value, giving the policyholder money up front, and then profit when the seller dies. Viatical companies arrange for the sales of the policies and take a share of the proceeds.

The state, and reportedly the FBI, is investigating American Benefit Services Inc. and Financial Federated Title and Trust Inc. to determine if they cheated investors out of tens of millions of dollars by selling fake policies.

A Florida judge on Wednesday ordered American Benefit Services in Lake Worth, Fla., to turn over records to investigators with the state Department of Insurance. Investigators also are reviewing documents from Sunrise-based Financial Federated Title

FBI agents have already seized assets — including 40 cars — belonging to Financial Federated owner Frederick C. Brandau, according to a recent report in The Wall Street Journal. About 5,000 people have invested between $115 million and $125 million, the newspaper reported, citing unnamed sources.

Brandau told the Journal that he and his companies have done nothing wrong and that he is fighting the accusations. He also said that none of the investments were at risk.

Neither Brandau nor American Benefit owner Raphael Ray Levy could be reached for comment, and FBI officials declined to comment about their investigation.

American Benefit lawyer Houston Park told Circuit Judge Ralph Smith Jr. in Tallahassee Wednesday that American Benefit would cooperate but believed the insurance department did not have the authority to subpoena all the documents it wants from the company.

Park said the company would not comment on the allegations.

Brandau's lawyer, Thomas Sclafani, said he will propose a settlement to federal prosecutors meant to assure the investors that their investments are safe.

Sclafani said Wednesday that an offshore multinational mining company called CSI Ag Ltd., which has bought Financial Federated's assets, will cover the investments.

``This is not a scam,'' said Sclafani, a former federal prosecutor. ``CSI will be more than able to fully guarantee all of the investors on the schedule they are supposed to be repaid on. ... They have as assets a number of gold mines that are very lucrative.''

American Benefit and Federated Financial are related, though separate, companies. Essentially, Federated Financial lined up the terminally ill patients and bought the policies, supplying them to American Benefit, which sold the products to investors.

An internal state insurance department memo in February says that American Benefit maintains it solicits investors to buy into viatical settlements offered by Financial Federated. American Benefit said there wasn't any formal agreement between the two companies, according to the memo.

``This statement is not plausible as all funds solicited by ABS are forwarded to FF&T,'' the department memo said.

The insurance department was looking into American Benefit before the agency received dozens of complaints from investors this spring. A financial specialist recommended the state investigate the company after it refused to document that the policies it was selling existed.

Several investors have sued American Benefit in state court in Palm Beach County, claiming they asked to see the policies but were not provided them.

A short time after the FBI apparently began looking into Brandau's business last fall, he put an ad in the newspaper looking to buy viatical policies.

W. Scott Page, the owner of Wm. Page and Associates, the first licensed viatical company in Florida, and the president of the National Viatical Association, answered the ad.

Brandau gave him $1 million to keep in escrow to hold onto to show he was interested in buying some of the policies Page already had, Page said.

``They gave it to me with a blanket 'Use it for anything I could get.' All they wanted was a policy,'' Page said. ``That's why my suspicions started to rise.''

Asked if he thought Brandau wanted policies because he wanted something to show investigators, Page said his lawyer advised him not to comment.

``Everyone can assume what they like,'' he said.

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FOR IMMEDIATE RELEASE

State Securities Cops Release New List of "Top 10 Investment Scams"
—'Day-trading' seminars, promissory notes, viatical investments make ranking—

WASHINGTON (May 24, 1999) – State securities regulators today released a list of the Top 10 Scams they are combating, adding pricey day-trading seminars, supposedly high-yielding promissory notes and investments in viatical settlements (interests in the life insurance policies of supposedly terminally ill people) to the second-annual rankings.

"Today we have an ideal climate for fraud," warns Peter C. Hildreth, New Hampshire's Director of Securities Regulation and President of the North American Securities Administrators Association (NASAA), which released the list of scams. "Millions of new investors, many of whom expect unrealistically high returns, are looking for places to put their money. At the same time we're living through an Internet-driven technology revolution that is a boon to investors and con artists alike."

Securities fraud costs Americans billions of dollars each year, state securities regulators estimate.

The list of scams also includes Internet fraud, affinity group fraud, investment seminars, Ponzi and pyramid schemes, illegal franchise offerings and entertainment scams.

State and national securities cops are doing their best to protect investors, but given their limited resources, investors must do their share to prevent fraud," Hildreth said. "By the time the regulators are notified, the investor's money is usually gone and is rarely recovered. As always, investors are the first line of defense against fraud. The best weapons investors have to protect themselves and their money are skepticism and common sense," said Hildreth.

Here is a list of the Top Ten Scams, ranked roughly in order of seriousness or prevalence:

1. Internet fraud. Con artists are using the Internet to "pump and dump" small stocks, peddle bogus offshore "prime bank" notes and perpetrate fraudulent pyramid schemes. About half of the states have programs to monitor the Internet for fraud and they regularly team up with other regulators for Internet "Surf Days." The Internet is like a big city, with good neighborhoods and bad neighborhoods and investors need to be careful about taking advice from strangers. Never invest based on a "tip" on the Internet without doing independent research. You never know who's offering you the "help."

2. Investment seminars. Investors should be very wary about expensive seminars where self-anointed gurus imply you can get rich quick. Some people do get rich but usually they're the ones running the seminar, making money from admission fees, and selling their books and audiotapes. Seminars are marketed through newspaper, radio and TV ads and "infomercials" on cable television. Recently promoters have begun offering seminars and courses promising to turn investors into successful stock "day traders." Day trading, more akin to gambling than investing, is inappropriate for the vast majority of investors.

3. Affinity group fraud. Members of closely knit religious, political or ethnic groups are targeted by con artists of the same religion, ethnicity or political orientation. The crooks seek to take advantage of our natural trust of people who are like us. Targeted media advertising is used to identify potential victims, often with offers of employment or financial advice. California's Asian communities, for example, have been victimized by scammers promoting bogus foreign exchange investments. Typically promoters steal the money and no investments are made.

4. Abusive sales practices. State and other securities regulators report progress in the fight against "microcap" stock fraud by suspending, barring and criminally prosecuting brokers who specialize in the manipulation of low-priced securities. Nevertheless investors need to be on guard and should hang up on aggressive cold callers.

5. Telemarketing fraud. New "boiler rooms" (high-pressure telephone sales operations), open all the time, selling illegal or fraudulent investments. Promoters try to capitalize on the headlines—from fears over the Year 2000 problem to the Asian currency crisis or breakthroughs in computers or biotechnology. One way vulnerable investors can protect themselves is to use their telephone answering machine to screen their calls and not even answer solicitations by cold-calling salespeople.

6. Promissory notes. A growing area of fraud, these notes are supposedly "insured" and backed by real assets. In fact, they are backed only by an often worthless promise to repay. They offer high interest rates to investors who may be struggling to get by on income from money market funds or certificates of deposits. These "investments" are often sold by life insurance agents, lured by high commissions, who may know nothing about the promoters of the investments beyond what they're told. The agents also may not realize they have to be licensed as securities brokers with state securities regulators to sell these notes. In most cases, the notes also must be registered with regulators. Multi-state investigations have revealed that a number of the promoters of these notes have had problems with regulators in the past. Some notes are issued on behalf of companies that don't even exist. Even if the companies are legitimate, investors should realize that the reason these notes are being offered directly to small investors is because banks and venture capitalists have declined to invest in the companies.

7. Viatical investment scams. One of the hottest new investment products and one of the riskiest, viatical contracts are interests in the death benefits of terminally ill patients such as AIDS and cancer victims. The insured gets a percentage of the death benefit in cash, supposedly to improve the quality of their lives in the last days. Investors get a share of the death benefit when the insured later dies, after a fee is paid to the viatical investment broker. Because of uncertainties in predicting when even a terminally ill person is going to die, these investments must be considered extremely speculative.

8. Entertainment fraud. Con artists zero in on investors hoping to hit it big by buying a piece of the next "Titanic." Besides movies, investment vehicles include cable television shows, video games and other entertainment products.

9. Ponzi/pyramid schemes. Always in style, these swindles promise high rates of return to investors, but the only people who really make a killing are the promoters who set them in motion, at the expense and out of funds from later investors, who end up losing their money when the house of cards inevitably collapses.

10. Illegal franchise offerings. States have taken actions relating to inadequate disclosure and fraud involving franchise investments, often marketed at business opportunity and franchise trade shows where promoters target people attracted by the prospect of owning their own business.

Before making an investment or doing business with a stock broker or investment or franchise promoter, call your state securities regulator to find out if they are properly registered or have a disciplinary history. When checking out a stock broker, ask for their CRD record, which gives their employment and disciplinary history. To find your state regulator, visit the NASAA website at www.nasaa.org/regulator or call 202/ 737-0900.