



**House
Legislative
Analysis
Section**

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**VIATICAL SETTLEMENT
CONTRACTS**

**House Bill 4501 (Substitute H-5)
First Analysis (10-25-95)**

**Sponsor: Rep. Gerald Law
Committee: Insurance**

THE APPARENT PROBLEM:

A new industry has emerged in recent years featuring companies that "buy" life insurance policies at a discount from terminally ill policyholders. These transactions are known as "viatical settlement agreements." (Reportedly, the term has its origin in the Latin word "viaticum", which is said to refer to a provision or allowance for traveling.) A recent magazine article on the industry cited a transaction in which a company paid a man terminally ill with throat cancer \$150,000 for his \$200,000 life insurance policy. There are obvious advantages to both parties in this kind of arrangement. The terminally ill insured gets value out of the life insurance policy while still alive, alleviating economic hardship, improving his or her quality of life, or perhaps obtaining funds to pay for experimental treatment not covered by health insurance. The company purchasing of the policy, of course, eventually earns a return on its investment -- the difference between the amount paid for the policy and the death benefit when the original insured dies.

The practice began, it is said, with AIDS patients, but has grown to involve other policyholders with other life-threatening and terminal diseases. Some 60 companies are now engaged in the business nationwide, according to published reports, and they purchased about \$300 million in life policies in 1994. Testimony from the president of one such company located in Michigan indicated that the company would typically pay 75-80 percent of the value of the death benefit for a policy owned by a person with a life expectancy of one year. The average life expectancy of policyholders involved in the arrangements, he said, is two years, and the average price is 68 percent of the policy amount.

(Life insurance companies themselves offer accelerated death benefits. An industry representative has testified that 217 companies operating in Michigan offer this option. However, reportedly, these are usually limited to 25 percent of the policy amount. A representative of the viatical settlement industry has said that his industry has particularly found a niche in group insurance and in cases where the policyholder's life expectancy is greater than one year.)

This new industry is not addressed in Michigan insurance statutes. There have been abuses in other states, according to news reports, including delays of promised payments and anti-competitive steering by health professionals and others, and some people believe it makes sense to provide state oversight of these new transactions.

THE CONTENT OF THE BILL:

The bill would create a new act dealing with viatical settlement contracts. Such a contract is a written agreement between the owner or holder of a life insurance policy who has a catastrophic or life-threatening disease (a "viator") and a person or entity who "buys" the policy at a cost below the amount of the death benefit (a "provider"). Specifically, under the contract, the provider pays consideration that is less than the expected death benefit of the policy in return for the viator's assignment, transfer, sale, devise, or bequest of the death benefit or ownership of the policy to the provider.

Registration. Under the bill, a person could not act as a provider or enter into or solicit a viatical settlement contract without first registering with the insurance commissioner. Registration would be on a form provided by the commissioner, who could require the registrant to disclose fully the identity of all stockholders, partners, officers, and employees.

The commissioner could order a provider or applicant to produce records, books, files, or other information necessary to determine the qualifications of the applicant or whether the provider was acting or had acted in violation of the new act. The provider would have to maintain records of all transactions of contracts and make the records available to the commissioner during reasonable business hours. The provider or applicant would be required to pay the expenses incurred in conducting an examination.

Exceptions. The term "provider" would not apply to a financial lending institution that takes a policy as

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collateral for a loan; the issuer of a life insurance policy providing accelerated benefits; or an individual who enters into no more than one viatical settlement contract in a calendar year.

Notification to Insurer. Any offer to purchase a life insurance policy or certificate from a viator would have to be transmitted to the insurance company providing the policy, who would then have ten days to advise the seller of other alternatives under the policy. The notice to the insurance company would have to be provided by the provider or purchaser.

Disclosure. A provider or purchaser would have to disclose certain information to the viator or seller no later than the date the contract was signed by the viator, including that the seller had a right to rescind the contract within 30 days after the contract was executed or within 15 days after the receipt of the contract consideration by the seller, whichever was less. A copy of all disclosure information provided to a seller would have to be filed with the insurance commissioner by the purchaser. Other information to be disclosed includes:

- options other than the contract for a person with a catastrophic or life-threatening illness, including accelerated benefits offered by the issuer of the policy;
- that some or all of the contract consideration could be taxable, and that assistance should be sought from a personal tax advisor;
- that the contract consideration could be subject to the claims of creditors;
- that the receipt of the contract consideration could adversely affect the seller's eligibility for government benefits or entitlements; and
- the date by which the contract consideration will be available to the seller and the source of the consideration.

Documentation. A purchaser entering into a contract with a seller would have to obtain a written statement from a physician that the seller was of sound mind and under no constraint or undue influence and a signed document from the seller stating consent to the contract; acknowledgement of the catastrophic or life-threatening illness; representation that the seller had a full and complete understanding of the contract and a full and complete understanding of the benefits of the policy; a release of medical records and acknowledgement that

the contract had been entered into freely and voluntarily. The purchaser would have to keep all medical records received confidential.

Deposit of Proceeds. Upon the receipt from the seller of the documents to effect transfer of the policy, the purchaser would deposit the contract consideration in an escrow or trust account managed by a state or federal chartered financial institution, pending acknowledgment of the transfer by the issuer of the policy (the insurance company). The financial institution would transfer the consideration to the seller immediately upon receipt of acknowledgment of the transfer of the policy from the insurance company. Failure to tender the contract consideration as required would render the contract void.

Double Indemnity. If a policy provided for double or additional indemnity in case of accidental death and the accidental death occurred, the purchaser would only be entitled to the face amount of the policy. Any amounts payable under the policy exceeding the face amount would be paid to the beneficiary designated by the seller or, if no beneficiary had been designated, to the seller's estate.

Revocation of Registration. The commissioner could revoke the registration of the provider upon a finding that:

- there was a misrepresentation in the application for registration;
- the provider had been fraudulent or engaged in dishonest practices;
- the provider demonstrated a pattern of unreasonable payments to policy owners;
- the provider had been convicted of a felony or any misdemeanor involving criminal fraud.

Penalties. A violation of the act would be a felony punishable by imprisonment for more than one year, or by a fine of not more than \$5,000, or both.

FISCAL IMPLICATIONS:

The House Fiscal Agency has pointed out that all fines collected for any breach of the penal laws are exclusively applied to the support of public libraries and county law libraries. Any fines collected as a result of this bill would provide an indeterminate increase in revenue. (Fiscal Note dated 10-9-95)

ARGUMENTS:***For:***

The bill aims at providing state oversight of the purchase of life insurance policies belonging to terminally ill policyholders without over-regulating this new and growing industry. The practice allows the catastrophically and terminally ill to get the value of a life insurance policy before death, reducing or eliminating financial worries in the last years or months of life. Among the bill's key provisions are a requirement that the promised payment be put into an escrow or trust account, to be paid out upon transfer of the policy. The bill also would require companies engaged in this business to first register with the insurance commissioner, who could revoke the registration for certain offenses. Companies would be required to make certain disclosures to policyholders about the possible consequences of selling a policy and about alternatives. (They also would have to notify the insurer company that issued the policy, so that the insurer could offer alternatives as well.) Policyholders would be granted a period in which to rescind the contract for any reason. The bill does not interfere in the contract between parties; it doesn't impose limits on life expectancy or regulate the prices paid for policies. It only specifies what documents must accompany a contract (e.g., statements from a physician, consent of the policyholder).

Response:

Several concerns have been raised and amendments suggested. Several parties have recommended that administrative penalties be added to the bill instead of (or in addition to) the criminal penalties. This will more likely lead to enforcement of the bill's provisions. Further, the bill's definition of "physician" makes that term refer only to physicians licensed in Michigan, which is unnecessarily restrictive and could cause problems for Michigan residents being treated out of state. The issue of whether the bill applies only to Michigan residents also needs to be addressed. Those already engaged in the viatical settlement business have asked how the transition will be handled. Will companies be able to get registered and be eligible to continue operations by the time the bill takes effect?

POSITIONS:

The Insurance Bureau supports the bill, although it recommends the penalties in the bill be administrative penalties rather than criminal penalties. (10-24-95)

The Life Insurance Association of Michigan supports the bill. (10-24-95)

The Michigan Association of Life Underwriters supports the bill. (10-24-95)

A representative of the State Employees Retirement Association (SERA) testified in support of the bill as written. (10-24-95)

Accelerated Benefits Capital supports the bill. (10-24-95)