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VIATICAL SETTLEMENT CONTRACTS

House Bill 4501 as enrolled
Public Act 386 of 1996
Second Analysis (10-17-96)

Sponsor: Rep. Gerald Law
House Committee: Insurance
Senate Committee: Financial Services

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 were said to be engaged in the business nationwide in an August 1995 article in U.S. News and World Report, and they reportedly purchased about \$300 million in life policies in 1994. The magazine said the typical amount paid was 60 to 80 percent of the death benefit with the seller getting more money the shorter the life expectancy. 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 over 200 companies operating in Michigan offer this option. However, benefits 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 terminal illness or condition (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.

Qualifications of the Provider. The commissioner could order a provider to produce records, books, files, or other information necessary to determine the qualifications of the provider 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 would be required to pay the expenses incurred in conducting an examination.

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Exceptions. The term "provider" would not apply to a financial lending institution that takes a policy as 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 could advise the seller of alternatives under the policy. The notice to the insurance company would have to be provided by the provider.

Right to Void Contract. A viatical settlement contract would have to give the viator or seller the right to void the contract for at least 30 days after the date it was signed or 15 days after the receipt of the contract consideration, whichever was less. The provider would have to notify the insurer of a rescission within 30 days of the date it was rescinded.

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 void the contract (as referred to above). Information to be disclosed includes:

- options other than the contract available to a person with a terminal illness or condition, 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; acknowledgment of the terminal illness or condition; 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 acknowledgment 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.

Prohibit Providers From Entering Contracts. The commissioner could issue an order prohibiting a provider from entering into a viatical settlement contract in the state if he or she found that:

- 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; or
- the provider had violated a provision of this new act.

Penalties. In addition to the order cited above, the commissioner could:

- order payment of a civil fine of not more than \$500 for each violation;
- if the person knew or reasonably should have known that he or she was in violation of the act, order the payment of all death benefits and other proceeds paid by a viator affected by the violation and a civil fine of not more than \$2,500 per violation; or
- issue a cease and desist order.

FISCAL IMPLICATIONS:

The Senate Fiscal Agency notes that the act would allow the insurance commissioner to levy civil fines against violators with the proceeds to go to the bureau; however, it is difficult to determine how much revenue would be produced because there is no way to predict the likely number of violations. (SFA analysis dated 5-13-96)

condition. An earlier version of the bill would have applied to "catastrophic or life-threatening" illnesses and conditions. Some people with catastrophic conditions might want to be able to attempt to "sell" their policies without being diagnosed as terminally ill.

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 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. 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). The insurance commissioner is granted the ability to step in when abuses occur.

Response:

The bill ought to provide the state with more oversight tools. An earlier version of the bill would have required those dealing in viatical settlement contracts to register with the insurance commissioner. Although the commissioner is granted powers to prevent individuals or companies from engaging in this enterprise if they engage in abusive practices, to make them provide records of their business dealings, and to fine violators, the commissioner is not, under this new act, routinely informed of who is engaging in the business. Further, some people have recommended provisions to prohibit conflicts of interest, such as the steering of patients to viatical settlement companies by health care providers for a fee and the payment of a finder's fee to lawyers and financial planners providing services to terminally ill clients.

Further, the new act applies only to owners of life insurance contracts who have a terminal illness and

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■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.