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BILL



ANALYSIS

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Senate Bill 289 (Substitute S-3 as reported)
 House Bill 4501 (Substitute S-2 as reported)
 Sponsor: Senator Dale L. Shugars (S.B. 289)
 Representative Gerald Law (H.B. 4501)
 House Committee: Insurance (H.B. 4501)
 Senate Committee: Financial Services

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RATIONALE

A new industry that has emerged in recent years features companies that purchase life insurance policies at a discount from terminally ill policyholders. These transactions are known as "viatical" settlement contracts or agreements. (Reportedly, the term has its origin in the Latin word "viaticum", which refers to a provision or allowance for a traveler embarking on a difficult journey.) An article on the industry in the August 21, 1995, issue of *U.S. News & World Report* cited a transaction in which a company paid a man terminally ill with throat cancer \$150,000 for his \$200,000 life insurance policy. In this kind of arrangement, the terminally ill insured gets value out of the life insurance policy while still alive, which can alleviate economic hardship, improve his or her quality of life, or perhaps supply funds to pay for experimental treatment not covered by health insurance. The company purchasing the policy eventually earns a return on its investment: the difference between the amount paid for the policy and the death benefit when the insured dies.

The viatical settlement practice apparently began with AIDS patients, but has grown to involve policyholders with other terminal diseases. According to the magazine article, more than 60 companies nationwide are engaged in this business and they purchased about \$300 million in life insurance policies in 1994. The typical amount of a viatical settlement contract reportedly is 60% to 80% of the value of a policy's death benefit, with a higher payout for a shorter life expectancy.

This new industry is not addressed in Michigan law. There have been abuses in other states, according to published reports, including delays of promised payments and lack of disclosure

regarding options and obligations. Some people believe that there should be some State oversight of these relatively new transactions.

CONTENT

Senate Bill 289 (S-3) and House Bill 4501 (S-2) each would create a new act to regulate the sale and purchase of "viatical settlement contracts" (i.e., agreements for the sale of a life insurance policy's death benefits). Each bill would do all of the following:

- Require a "provider" of a viatical settlement contract (i.e., the purchaser of a life insurance policy's death benefit) to disclose certain information to the "viator" of a viatical settlement contract (i.e., the policyholder).
- Specify certain requirements of a viatical settlement contract and of those entering into a contract.
- Provide civil and criminal penalties for violations of the bill.

Senate Bill 289 (S-3) also would do the following:

- Allow the Insurance Commissioner to order a provider to produce records necessary to determine the provider's qualifications or whether the provider had acted in violation of the bill.
- Require a provider to disclose certain information to a viator no later than the date the viator signed the contract.

Definitions

“Viatical settlement contract” would mean a written agreement entered into between a provider and a viator, in which the provider agreed to pay the viator consideration in an amount less than the expected death benefit of the viator’s life insurance policy or certificate in return for the viator’s assignment, transfer, sale, devise, or bequest of the death benefit or ownership of the policy to the provider.

“Provider” would mean a person who entered into a viatical settlement contract with a viator, but would not include a financial lending institution that took a policy as collateral for a loan; the issuer of a policy providing accelerated benefits under the Insurance Code (MCL 500.602); or an individual who entered into no more than one viatical settlement contract in a calendar year for the transfer of a policy for any value less than the expected death benefit.

“Viator” would mean the owner or holder of a life insurance policy or certificate, who had a catastrophic or life-threatening illness or condition and who entered into a viatical settlement contract.

Viatical Settlement Contract

A provider entering into a contract with a viator would have to obtain both a written statement from a physician that the viator was of sound mind and under no constraint or undue influence and a document, signed by the viator, that stated all of the following:

- Consent to the contract.
- Acknowledgment of the terminal illness or condition.
- Representation that the viator had a full and complete understanding of both the contract and the benefits of the life insurance policy.
- A release of the medical records and acknowledgment that the contract had been entered into freely and voluntarily. (The provider would have to keep confidential all medical records received.)

A viatical settlement contract entered into in Michigan would have to contain a provision giving the viator the right to rescind the contract for at least 30 days after the date the contract was signed, or 15 days after the viator received the contract consideration, whichever was less.

Upon receiving from the viator the documents to effect the transfer of the policy, a provider would have to deposit the contract consideration in an escrow or trust account managed by a State- or Federally chartered financial institution, pending acknowledgment of the transfer by the life insurance policy’s issuer. The financial institution would have to transfer the contract consideration to the viator immediately upon receiving acknowledgment of the transfer from the insurer. Failure by the provider to tender the contract consideration in this manner would render the viatical settlement contract void.

If a life insurance policy provided for double or additional indemnity in case of accidental death, and accidental death occurred, the provider would be entitled only to the face amount of the policy. Any amounts payable under the policy that exceeded its face amount would have to be paid to the beneficiary designated by the viator or, if no beneficiary were designated, to the viator’s estate.

Any offer to purchase a life insurance policy or certificate from a viator would have to be transmitted to the insurer that provided the life insurance policy. The insurer could advise the viator of other alternatives that might be available under the policy. The notice would have to be transmitted by the provider of the viatical settlement contract.

Civil and Criminal Penalties

The Insurance Commissioner could issue an order prohibiting a provider from entering into a viatical settlement contract in Michigan if the Commissioner found any of the following:

- 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 that involved criminal fraud.
- The provider had violated a provision of the bill.

In addition to the criminal penalty specified in the bill and an order prohibiting a provider from entering into a viatical settlement contract, the Commissioner could do any of the following:

- Order payment of a civil fine of up to \$500 for each violation.

- If the person knew or reasonably should have known that he or she was in violation of the bill, order payment of a civil fine of not more than \$2,500 for each violation.
- Issue a cease and desist order.

A violation of the bill would be a felony, punishable by up to one year's imprisonment, a maximum fine of \$5,000, or both.

Provider's Records

Senate Bill 289 (S-3) would allow the Insurance Commissioner to order a provider to produce records, books, files, or other information necessary to determine the provider's qualifications or whether the provider was or had acted in violation of the bill. The provider would have to maintain records of all transactions of contracts and make the records available to the Commissioner for inspection during reasonable business hours. The provider would have to pay the expenses incurred in conducting an examination under this provision.

Disclosure

Senate Bill 289 (S-3) would require that a provider disclose all of the following information to a viator no later than the date the contract was signed by the viator:

- Options, other than a viatical settlement contract, for a person with a terminal illness or condition, including accelerated benefits offered by the issuer of the life insurance 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 receiving the contract consideration could adversely affect the viator's eligibility for government benefits or entitlements.
- The viator's right to rescind the contract within 30 days after the date the contract was executed or within 15 days after receiving the contract consideration, whichever was less.
- The date by which the contract consideration would be available to the viator and the source of the consideration.

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The

Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

The bills aim to provide 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 late stages of life. Among the bills' key provisions are requirements that the promised payment be put into an escrow or trust account to be paid out upon transfer of the policy.

Providers 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 insurance company that issued the policy, so that the insurer could have an opportunity to offer alternatives as well. Policyholders would be granted a period in which to rescind the contract for any reason.

The bills would not subject those involved in viatical settlement contracts to excessive regulation. The bills would not require licensure or registration, would not interfere in the contract between parties, would not impose limits based on life expectancy, and would not regulate the prices paid for policies. They only specify what documents would have to accompany a contract (e.g., statements from a physician and consent of the policyholder) and what information would have to be disclosed to the terminally ill insured.

Response: The bills should include more thorough oversight. As passed by the House, House Bill 4501 would have required providers of viatical settlement contracts to register with the Insurance Commissioner. Under the current version of the bills, in which registration is not required, the Commissioner could require a provider to make its records available. With no registration requirement, however, the Commissioner might not know who is involved in the practice of providing viatical settlement agreements. In addition, according to the *U.S. News & World Report* article, there have been problems involving conflict of interest in some states. Health professionals apparently have steered patients to particular viatical settlement providers in exchange for a fee, pitting their duty to provide treatment and save life against their financial interest in their patients' death. Lawyers and financial planners also apparently have received fees from providers in exchange for recommending their services. According to the magazine, in 1994 the National Association of

Insurance Commissioners approved a model law that explicitly would forbid a viatical settlement firm from offering a finder's fee to anyone providing medical, legal, or financial planning services to a policy seller. Michigan's law should contain such a provision.

Opposing Argument

The current version of the bills would require that a viator have a "terminal" illness or condition, rather than a "catastrophic or life-threatening" illness or condition as the House-passed version of House Bill 4501 would have required. While "life-threatening" may have been too broad a description and should properly be replaced with "terminal", the bills should also apply to "catastrophic" conditions or illnesses. Some patients who suffer from catastrophic conditions could be in need of the services of a viatical settlement contract, without actually being diagnosed as being terminally ill.

Legislative Analyst: P. Affholter

FISCAL IMPACT

The bills would allow the Insurance Commissioner to order the payment of civil fines against a provider who was found to be in violation of the proposed act. Any additional revenue realized from the imposition of these fines would revert to the Insurance Bureau to be used to fund its administration. It is difficult to determine the exact amount of revenue these fines would generate as there is no way to predict the number of providers who would be found in violation.

The bills are expected to have only a minimal fiscal impact, if any, on the criminal justice system. To the extent that violators were prosecuted, convicted, and sanctioned, costs would increase. While there are no data available on the number of potential violators, it is not expected to be significant.

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.