Approved: 3-12-02
Date

MINUTES OF THE HOUSE COMMITTEE ON INSURANCE.

The meeting was called to order by Vice-Chairman Rep. Stan Dreher at 3:35 pm on February 5, 2002 in Room 527-S of the Capitol.

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|---|---|
| All members were present except: | Representative John Edmonds<br>Representative Gene O'Brien<br>Chairman Robert Tomlinson |
| Committee staff present: | Bill Wolff, Legislative Research<br>Ken Wilke, Legislative Revisor<br>Mary Best, Administrative Assistant |
| Conferees appearing before the committee: | Mr. Brad Smoot, American Insurance Association<br>Mr. Matt All, Kansas Insurance Department<br>Mr. John Gann, Kansas Association of Insurance and Financial Advisors<br>Mr. David Brant, Office of Securities Commission<br>Mr. Wiley Kannar, Office of Securities Commission<br>Mr. Gary White, Kansas Trial Lawyers Association |
| Others attending: | See Attached Guest List |

Vice-Chairman Stanley Dreher directed the committee in the absence of the Chairman. Vice-Chairman Stanley recognized Mr. Brad Smoot, American Insurance Association. Mr. Smoot came before the committee to introduce a bill concerning legislation "to protect the confidentiality of internal review and evaluation records created voluntarily by insurance companies to do business in Kansas." A copy of the request (Attachment #1) is attached hereto and incorporated into the Minutes by request. Upon closing of his presentation, the Vice-Chair took the request of the committee. Representative Grant made the motion to introduce the bill and was seconded by Representative Hummerickhouse. The motion passed.

Representative Dreher then introduced a bill to amend to K.S.A. 40-276a, which "provides several reasons for non-renewal of automobile insurance policies," one of which addresses requirement of membership. It is the feeling of Farm Bureau Mutual Insurance Company, Inc. That the current statute should be changed to have the same requirements of mutual and stock companies. A copy of the proposal is attached (Attachment #2) hereto and incorporated into the Minutes by reference. The motion was made by Representative Hummerickhouse and seconded by Representative Vickery to introduce the amendment. The motion passes.

**HB 2640- NAIC model Viatical Settlements Act, was Mr. Matt All, Kansas Insurance Department.**

Next to be recognized and begin the public hearing on **HB 2640**- NAIC model Viatical Settlements Act, was Mr. Matt All, Kansas Insurance Department. Mr. All gave Proponent Testimony to the committee. A copy of the written testimony is (Attachment #3) attached hereto and incorporated into the Minutes by reference. All informed the committee the reason for the changes was that there was the feeling that the existing law should be repealed and replaced with the proposed language. The Kansas Insurance Department and the insurance industry feel with the growing market for Viatical's the need is present to amend the present language to meet today's means of doing business.

Mr. All explained the bill would amend the existing law by revising the definition, providing protection for those selling their policies, provide the unconditional right to rescind the contract for at least thirty days after the date of the contract or fifteen days from the time of receipt of the proceeds, whichever is less. It also includes a fraud section, and adds the second component of the investment area.

He also stated his testimony included letters of support for the bill from the American Council of Life Insurers and three companies who provide capital to licensed Viatical Settlement Providers, news articles, outline of the bill components. With completion of his testimony Mr. All stood for questions from the committee. Vice-Chair Dreher announced all of the testimonies would be heard first and then the committee would ask questions.

Mr. John Gann, Kansas Association of Insurance and Financial Advisors, was the next conferee to give Proponent Testimony to the committee. A copy of the written testimony is (Attachment #4) attached hereto and included in the Minutes by reference. He concurred with Mr. All and included in his statement "that there is necessity of regulation of these transactions by the Kansas Insurance Department and the Kansas Securities Commissioner." He also stated that "strict regulation of questionable transactions is the preferred method of public policy implementation." He continued on to state the reasons for this action. He also spoke of "conflicts of interest", and laid out the different industry conflicts. He also detailed why KAIFA is in support of the bill, and also stated the concern of Viatical's being sold as safe investments. Mr. Gann concluded his testimony.

Next before the committee also giving Proponent Testimony for the bill was Mr. David Brant, Securities Commissioner for the State of Kansas. A copy of the written testimony is (Attachment #5) attached hereto and incorporated into the Minutes by reference. He thanked the Insurance Commissioner and her staff for their on going cooperation in working together. He informed the committee that his testimony also included copies of letters from two concerned citizens who have experienced first had the problems with Viatical's as the bill stands now.

Mr. Brant spoke of the investigations of eighteen insurance agents and their companies who have sold unregistered investments to their clients of which seven were also registered to sell securities. He spoke of the money invested by Kansans today, how much has been repaid to these people and how much money they have lost, and the remainder is at risk and outstanding with the investors uncertain if or when they will receive a return of their principal. Mr. Brant's testimony also included news articles of the problems with Viatical's as they stand now. Mr. Brant concluded his testimony.

Mr. Wiley Kannar, Associate General Counsel, Office of the Kansas Securities Commissioner, was the last conferee to give Proponent Testimony to the committee. A copy of the written testimony is (Attachment #6) attached hereto and incorporated into the Minutes by reference. His testimony also concurred with the previous conferees for the need for more regulation of Viatical's in Kansas. He then detailed the principal features of the proposed NASAA Statement of Policy as it is written now. This is detailed in his written testimony. Mr. Kannar also included a letter of testimony by Mr. LaVon H. Maxon, of Seneca, KS and loss he sustained, even though he spent twenty-one years working for an insurance agent in Kansas City, Kansas. His own experience was in the surety bond area. Mr. Kannar concluded his testimony.

As this concluded the Proponent Testimony, Representative Dreher recognized Mr. Gary White, Kansas Trial Lawyers Association, as an Opposing Conferee. A copy of the written testimony is (Attachment #7) attached hereto and incorporated into the Minutes by reference. Mr. White stated they were opposed to Sec. 7(e)(2-7) and Sec.12(e)(1) of the bill which prohibits the public from obtaining documents by subpoena or court order in civil action. It also prohibits acquiring other information felt needed to prosecute criminal cases involving embezzlement and other serious criminal proceedings. He also felt Sec.12(a)(1) which states "no person shall commit a fraudulent viatical settlement act", and identified in Sec.2(f) are designed to protect the public from anyone who knowingly or intentionally defrauds a consumer for pecuniary gain.

He stated that the bill allowed for investigation by the Insurance Commissioner's office it prohibits the aggrieved consumer or prosecutor in criminal cases from obtaining such materials from the Commissioner. They feel the provisions protect the wrongdoer by precluding disclosure. Mr. White continued on to discuss the disallowance of access to these records. Mr. White then concluded his testimony.

With the closing of the testimony, questions were given over to the committee. Questions were asked by Representatives Boston, Phelps, Grant, Vickery, Sharp, Toelkes, Kirk. The questions ranged from the number of calls to Kansas Insurance Department (response: thirty five formal or written complaints, but did not track the telephone calls), to what were other states doing (response: under the law they must be licensed), are licenses available now (response: yes), will there be a need for more staff (response: no).

It was stated by Kansas Trial Lawyers that they would make an effort to meet with the Kansas Department of Insurance with their concerns.

The meeting ended and the committee was adjourned.

Time was 4:35 pm. The next meeting will be Tuesday, February 12, 2002 at 3:30 pm.

# HOUSE INSURANCE COMMITTEE GUEST LIST

DATE: Feb 5, 2002

| NAME | REPRESENTING |
|---|---|
| | KTLA |
| | KTLA |
| | KAIFA |
| Linda Lebeouf | KS Ins Dept. |
| Brent Gaffey | Kansas Insurance Dept. |
| Wiley Rankin | Kansas Securities Commission |
| Bill Sneed | MICA |
| David Brant | Securities Commissioner |
| Brad Smoot | AIA |
| John Peterson | Ks Governmental Consulting |
| Janice Cunningham | KAHP |
| Tom Keating | Intern Rep. Phelps |
| Marilyn Breeden | Ks. Insurance Dept. |
| Scott D. Colby CLU/ChFC | KAIFA |
| Sandra Braden | G, B & B/KAIFA |
| MATT ALL | KIA |
| Rick Fleming | Securities Commission |
| LARRY THAGILL | KAIA |
| | |

# BRAD SMOOT

ATTORNEY AT LAW

800 SW JACKSON, SUITE 808
TOPEKA, KANSAS 66612
(785) 233-0016
(785) 234-3687 (fax)

10200 STATE LINE ROAD
SUITE 230
LEAWOOD, KANSAS 66206
(913) 649-6836


**Statement of Brad Smoot**
**Legislative Counsel**
**American Insurance Association**

**House Insurance Committee**
**Bill Introduction Request**

Mr. Chairman and Members:

The American Insurance Association is a trade association representing more than 300 property and casualty insurers, most of whom do business in Kansas. AIA member companies provide auto, homeowners, business liability and workers compensation insurance.

On behalf of AIA and its member companies, we respectfully ask this committee to introduce legislation to protect the confidentiality of internal review and evaluation records created voluntarily by insurance companies licensed to do business in Kansas. Similar measures have been enacted in other states and will be considered this year in several more. A copy of the model draft is attached to the Chairman's copy of this statement. The draft may require your Revisor of Statutes to make cross references to existing statutes and we would be pleased to assist in preparation of the final version.

Thank you for entertaining this request.

*HOUSE INSURANCE*
DATE: February 5, 2002
ATTACHMENT #1

An Act Concerning An Insurance Compliance Self-Audit Privilege
(Draft – December 13, 2001)

Be it enacted by the Senate and House of Representatives in General Assembly convened:

Section 1. (NEW) (a) As used in this act,

(1) "Agency" means all federal and state boards, commissions, departments or officers and includes the commissioner.

(2) "Commissioner" means the Insurance Commissioner of the State of _____.

(3) "Communication or communications" mean all oral and written communications and information relating to an insurance compliance self-audit and includes an insurance compliance self-audit document.

(4) "Hearing officer" means an individual appointed by an agency to conduct a hearing in an agency proceeding. Such an individual includes the commissioner and may be a staff employee of the agency.

(5) "Insurance compliance self-audit" means a process of internal evaluation, review, assessment, or audit not otherwise expressly required by law of an insurer, of an activity regulated under the insurance laws or other laws of _____ or other state or federal law applicable to an insurer, or of management systems related to the insurer or the regulated activity, which process is designed to identify and prevent noncompliance or to improve compliance with such statutes, regulations, bulletins, rules, orders or systems.

An insurance compliance self-audit may be conducted by the insurer, its agents, officers or employees, or by independent contractors.

(6) "Insurance compliance self-audit document" means any document prepared as a result of, or in connection with an insurance compliance self-audit. Insurance compliance self-audit document does not include documents existing prior to the inception of an insurance compliance self-audit, nor shall the collection of such documents in the course of an insurance compliance self-audit subject any such document to the privilege set forth in sections 2 and 3 of this act. An insurance compliance document includes a written response to the findings of an insurance compliance self-audit, findings, opinions, conclusions, drafts, memoranda, computer-generated or electronically recorded information and phone records, provided this information is collected or developed for the primary purpose and in the course of an insurance compliance self-audit . An insurance compliance self-audit document also includes any of the following:

a. A report prepared by an auditor, who may be an agent or employee of the insurer or an independent contractor, which may include the scope of the audit, the information gained in the audit, and conclusions and recommendations, with exhibits and appendices;

b. Memoranda and documents analyzing portions or all of an insurance compliance self-audit and discussing potential implementation issues;

c. An implementation plan that addresses correction of past, current or future compliance or noncompliance; and

d. Analytic data generated in the course of conducting the insurance compliance self-audit.

(7) "Insurer" shall mean any "insurer" as defined in section __ of the Insurance Code, any "health care center" as defined in section __ of the Insurance Code, and any "person" that is part of an "insurance holding company system" as defined in section __ of the Insurance Code.

(8) "Person" shall have the same meaning as defined in section __ of the general statutes and includes an agency.

Section 2. (NEW) An insurance compliance self-audit is privileged and no communication relating to an insurance compliance self-audit shall be discoverable or admissible as evidence in any civil, administrative or similar case or proceeding except as otherwise expressly provided in this act. The privilege set forth in this section is a matter of substantive law.

Section 3. (NEW) If the privilege set forth in Section 2 applies, no insurer or person may be examined in any civil, administrative or similar case or proceeding as to any insurance compliance self-audit or any communication pertaining thereto.

Section 4. (NEW) (a) The provisions set forth in sections 2 and 3 of this act shall not apply:

(1) To the extent that the insurer that conducted or caused to be conducted the insurance compliance self-audit expressly waives the privilege by so stating its intent in writing; or

(2) To the extent that, in a civil, administrative or similar case or proceeding, the court or hearing officer determines that the insurance compliance self-audit privilege is asserted for a fraudulent purpose, provided that the court or hearing officer shall review the communication in camera before making such a determination.

(b) In ordering disclosure under this section, the court or hearing officer shall only compel the disclosure of communications that are relevant to the issues in dispute in the underlying proceeding. A party unsuccessfully opposing disclosure may apply for an appropriate order protecting the communication from further disclosure. There shall be an immediate right of appeal of any order under this section.

(c) An insurer asserting the insurance compliance self-audit privilege in response to a request for disclosure under this section shall provide at the time of filing of any objection to the disclosure all of the following information:

(1) The date of the communication;

(2) The identity of the person conducting the audit;

(3) The general nature of the activities covered by the insurance compliance self-audit; and

(4) An identification of the communications for which the privilege is being asserted.

(d) A party seeking disclosure under subsection (a)(2) of this section has the burden of proving that the privilege is asserted for a fraudulent purpose.



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(e) The parties may at any time stipulate to entry of an order directing that specific communications pertaining to an insurance compliance self-audit are or are not subject to the privilege created by this act.

Section 5. (NEW), An insurance compliance self-audit document or communication that is submitted by a company to the commissioner, or his or her designee, in connection with examinations conducted pursuant to chapter __ of the Insurance Code, shall be afforded the following additional protections:

(a) All such communications shall be treated as confidential;

(b) Disclosure of any communication to the commissioner shall not constitute a waiver of the privilege. In the event that any communication is disclosed to a third person, that communication shall be entitled to the privilege:

(c) Any provision of law or rule permitting the commissioner to make information, records and reports public, as well as provisions permitting the commissioner to exchange information and data with the National Association of Insurance Commissioners shall not apply to any communication pertaining to an insurance compliance self-audit disclosed to the commissioner under this section. Any communication so disclosed to the commissioner shall remain the property of the insurer;

(d) As long as a company has informed the commissioner of a pending or completed insurance compliance self-audit and undertakes reasonable corrective action within 60 days following the completion of the self-audit, the commissioner may not impose any type of administrative fine, penalty, or other sanction based upon any



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communication disclosed to him; provided, however, that this subsection 5(d) shall not apply where the self-audit has been undertaken and the statutory privilege asserted for a fraudulent purpose as determined under subsection 4(a)(2) of this act. The imposition of any administrative sanction shall be subject to applicable hearing procedures provided by the state administrative procedure act.

(e) Any communication disclosed to the commissioner under this section remains subject to all applicable privileges existing under statute, common law or rule, such as the work product doctrine, attorney-client privilege, or the subsequent remedial measures exclusion. Any communication disclosed to the commissioner under this section is not subject to any disclosure under any other section of the general statutes; and

(f) Disclosure of a communication to an agency, whether voluntary, pursuant to law, or otherwise, does not constitute a waiver of the privilege with respect to any other person. To the extent any provision of law shall permit the commissioner to disclose to another agency any communication obtained under this section, such disclosure shall not be made without first verifying that the recipient agency agrees and has the legal authority to protect the communication consistent with this act, and in the case of a criminal law enforcement agency, shall not be made in the absence of a duly issued subpoena.

Section 6. (NEW) (a) The privilege created by this act shall not extend to any of the following:

(1) Documents, data, reports, or other information required to be collected, developed, maintained, or reported to an agency pursuant to state or federal law or order. However, any disclosure under sections 4 and 5 of this act shall not in and of itself make this exception applicable;

(2) Information obtained by observation, investigation or monitoring by any agency; or

(3) Any communication obtained by examination or investigation authorized by the commissioner, or designee, when such communication is obtained independently from the insurance compliance self audit and even though such communication duplicates information, in whole or part, contained within the insurance compliance self-audit.

Section 7. (NEW) Nothing in this act shall limit, waive, or abrogate the scope or nature of any privilege existing under statute, rule or common law including but not limited to, the work product doctrine, the attorney-client privilege, or the subsequent remedial measures exclusion.

Section 8. (NEW) The commissioner shall maintain the confidentiality of information protected under this act, subject to the specific exceptions set forth in section 6 of this act. Any disclosure by the commissioner, or his or her designee or staff, of a communication protected under this act, whether inadvertent, willful, or otherwise, shall not waive the privilege attached to that communication. No person who receives a communication through inadvertent or improper disclosure under this section shall be permitted to use that communication in any civil, administrative or

similar proceeding, or to examine any insurer or person in any civil, administrative or similar case or proceeding as to any insurance compliance self-audit or any communication pertaining thereto .

Section 9. (NEW) This act shall take effect on January 1, ____.

**Farm Bureau Mutual Insurance Company, Inc.**
**KFB Insurance Company, Inc.**
2627 KFB Plaza, Manhattan, Kansas 66503-8155 / (785) 587-6000

February 4, 2002

**FAX – 785/368-6365**

The Honorable Stanley Dreher
Vice-Chairman, House Insurance Committee
State Capitol Building
Topeka, KS 66612

RE: Proposed Amendment to
K.S.A. 40-276a

Dear Representative Dreher:

I am a registered lobbyist with the Kansas Legislature, and as such, I am enclosing a proposed amendment to K.S.A. 40-276a for consideration by the Kansas House of Representatives Insurance Committee. I would appreciate your review of this proposed legislation and introduction to the Committee.

K.S.A. 40-276a provides several reasons for non-renewal of automobile insurance policies, one of which is if the Articles of Incorporation or Bylaws of the insurance company require a membership in the company prior to such renewal. Farm Bureau Mutual Insurance Company has this requirement in their Bylaws, which conditions membership in Farm Bureau Mutual Insurance Company on a membership in a county Farm Bureau organization. We currently write insurance through two stock insurance companies, and the current status of the law does not allow us to require a membership in the County Farm Bureaus for those policies. It is our feeling that the statute should be changed so that we can have the same requirement for the mutual and stock companies.

*HOUSE INSURANCE*
DATE: February 5, 2002
ATTACHMENT #2

The enclosed statute is patterned after one passed by the Arizona Legislature and currently being implemented in Arizona. The proposed new paragraph (g), allows for an insurance company to require memberships in a bona fide organization as set forth in the statute. If the Kansas Legislature would pass this legislation, we would be able to require memberships in the County Farm Bureaus in order to renew automobile policies in stock companies. This would allow Farm Bureau to have additional resources to provide programs for agriculture. It would also allow for fairness amongst all Farm Bureau automobile policyholders.

We have been working with the Kansas Insurance Department on this legislation and have provided them with a copy of this proposed legislation. They have not given us a final opinion, but their initial reaction was favorable.

I would appreciate your review and assistance on this matter and timely introduction to the Insurance Committee, if you feel that is appropriate, and keeping me advised as to this matter. I am working with our General Counsel, Terry Arthur as well. He would most likely appear before the Insurance Committee as my guest to explain the legislation.

I will look forward to hearing from you in this regard. Thank you for your help in this regard.

Very truly yours,

Tony Kimmi
Research and Development
Analyst

TK/vl

**Proposed Amendment to K.S.A. § 40-276a**

**New Paragraph (g)**

1. In addition to any other reason provided in this section, an insurer may refuse to renew an insurance policy issued pursuant to this act if all of the following conditions apply:

   (a) The insurer clearly discloses to the applicant and the insured in the application for insurance and insurance policy that both the payment of dues and current membership in the bona fide organization are prerequisites to obtaining or renewing the insurance.

   (b) Any money paid to the bona fide organization as a membership fee:

      (i) Is not used by the insurer directly or indirectly to defray any costs or expenses in connection with the sale or purchase of the insurance.

      (ii) Is set independently of any factor used by the insurer to make any judgment or determination about the eligibility of any individual, including the member, an employee or a member or a dependent of a member, to purchase or renew the insurance.

   (c) The bona fide organization has filed a certification with the Commissioner of Insurance verifying the eligibility of the insurer to refuse to renew an insurance policy based on membership in the bona fide organization.

2. To qualify as a bona fide organization pursuant to this subsection, the organization shall meet all of the requirements of this paragraph. The organization shall file a statement with the Commissioner of Insurance at least thirty days before the commencement of the offer or sale of insurance as provided by this subsection verifying that the organization meets the requirements of this paragraph. The organization shall update the filing required by this paragraph at least thirty days before the effective date of any material change in the information contained in the statement, and shall file a separate notice with the Commissioner of Insurance if the insurance described in the statement is no longer available through the organization. The statement shall include the following information:

   (a) That the organization has been in active existence for at least five consecutive years immediately before the filing of the statement.

   (b) That the organization has been formed and maintained in good faith for purposes other than obtaining or providing insurance and does not condition membership in the organization on the purchase of insurance.

   (c) That the organization has articles of incorporation and bylaws or other similar governing documents.

(d) That the organization does not condition membership in the organization or set membership fees on the eligibility of any individual, including the member, an employee of the member or a dependent of the member, to purchase or renew the insurance, or on any factor that the insurer could not lawfully consider when setting rates.

(e) That the organization has a relationship with a specific insurer or insurers and identifies the insurer or insurers.

3. Membership fees collected by the bona fide organization are not premiums of the insurer that issued the coverage unless the bona fide organization:

(a) Uses any portion of the membership fees directly or indirectly to defray any costs or expenses in connection with the sale or purchase of the insurance.

(b) Sets or adjusts membership fees for any member of the bona fide organization based on any factor used by the insurer that issues the insurance to make any judgment or determination about the eligibility of any individual, including the member, an employee of the member or a dependent of the member, to purchase or renew the insurance.

4. If the membership fees constitute premiums pursuant to paragraph 3 of this subsection, an insurer shall not refuse to renew a policy as otherwise permitted by this subsection.

**Kathleen Sebelius**
Commissioner of Insurance
**Kansas Insurance Department**

TO: House Committee on Insurance

FROM: Matthew All
Assistant Insurance Commissioner

RE: HB 2640– Viatical settlements law update

DATE: February 5, 2002

Mr. Chairman and members of the committee:

I wish to thank you for the opportunity to discuss this important consumer protection issue with you. My name is Matthew All, and I am here on behalf of the Kansas Insurance Department. This bill was introduced at the request of Insurance Commissioner Sebelius.

HB 2640 contains the same language as HB 2306 of last year. Discussing the drafting of this bill with the revisor, we again came to the conclusion that existing law should be repealed and replaced with this proposed lanaguage. I have a copy of the changes to the existing law to show exactly where the law is being changed. I will leave a copy with you, Mr. Chairman, should your committee members request a copy.

The first NAIC model act was adopted in 1993. Because problems surrounding viaticals did not seem severe in Kansas, we did not pass the model act immediately after the NAIC adopted it. But because problems with viaticals increased as the 1990s progressed, we asked for passage of the NAIC 1998 model act in 1999, and you passed it.

A viatical settlement is a transaction in which an individual sells his or her life insurance policy to a third party for cash and receives less than the full amount of the death benefit. The buyer becomes the new owner and/or beneficiary, may have to pay future premiums, and collects the full amount of the death benefit when the insured dies.

The reason for making these changes in our viatical law is that the viatical industry has grown and changed dramatically. The NAIC responded to this change with an update to the NAIC model law adopted in December 2000.

As pharmaceuticals and other medical therapies have advanced dramatically in recent years, patients once though to be near death are now living longer. Their policies, as a result, are not as profitable to the viatical settlement providers. In response, the viatical settlement industry is now moving to "senior settlements" or "life settlements" whereby an individual, usually an older



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individual who is no longer in need of their life insurance policy, sells their policy to a viatical settlement provider. Unfortunately, the present law has become outdated for this development, as well as other emerging issues. This new development has reinforced the department's commitment to protecting the rights of Kansas citizens, especially the seemingly targeted senior population.

This bill seeks to amend the existing law in a number of different ways:

- Amends the definition of viatical settlement to include and regulate all sales of life insurance policies.
- Provides protection for those selling their policies by requiring certain disclosures no later than the time of application by the viatical settlement provider or broker.
- Provides the unconditional right to rescind the contract for at least 30 days after the date of the contract or 15 days from the time of receipt of the proceeds, whichever is less.
- Includes a fraud section that defines a fraudulent settlement act to include brokers and providers accepting policies that have concealed information for the purpose of viaticating the policies. This bill also prevents a broker or provider from entering a viatical settlement contract within two years from the issuing of a life insurance policy. <u>These two sections are important because of the fraud that has occurred in this industry.</u>
    - There are two major fraudulent acts that occur in this industry – "clean sheeting" and "wet paper" transactions. Clean sheeting occurs when an individual conceals medical problems on the life insurance application to obtain coverage, which would not have been issued had the true facts been given. These policies are quickly sold to viatical settlement companies, which in turn seek investors.
    - The second fraudulent transaction is the "wet paper" or "wet ink" transactions occurs when an individual purchases a policy and quickly turns around and sells the policy to the viatical settlement provider. The individual purchases the policy with the intent to resell the policy at a profit. Seniors, who are recruited to sell these policies, often make these purchases.
- Adds the second component of the investment area.

I have included attachments to my testimony. You will find: a two-page outline of the bill components; letters of support for the bill from the American Council of Life Insurers and three companies who provide capital to licensed Viatical Settlement Providers; news articles that appeared in the *Washington Post* and *Consumer Reports* addressing the need for such an industry, but also warning of the dangers our bill addresses; and, an article from the *Lexington Herald-Leader* showing that if we have this law in place, we can stop certain unlawful activities such as fraud, i.e., clean sheeting.

**Review of the bill (HB 2460)**

**Definitions**

Section 1 of this bill defines a viatical settlement broker, provider, and viatical settlement contract. Importantly, this bill provides a definition for fraudulent viatical settlement acts.

**License Requirements**
This section requires both a viatical settlement broker and provider to hold a license before they may engage in the viatical settlement industry.

**License Revocation and Denial**
This section provides reasons why the Commissioner may refuse to issue, revoke, or refuse to renew a license. Many of these items are now found in our present law.

**Contract and Disclosure Approval**
Presently, the law requires that this department approve all viatical settlement contracts. This section of the bill will still require contract approval, but additionally will require the approval of the disclosure statements given to viators.

Kansas Insurance Department believes that disclosure is a fundamental protection for people seeking to sell their life insurance policy, especially seniors, who are now the target of this industry. A decision to sell your insurance policy is a major decision and one that should be entered into with as much in information as can be obtained. Consequently, this section provides requirements such as:

- Disclosure be given in writing signed by both the broker or provider and the viator.
- Disclosure be given no later than the time the application for the viatical settlement contract is signed by the parties.
- Funds must be sent within three business days after the viatical settlement provider has received acknowledgment that ownership of the policy has been transferred and the beneficiary has been designated. The contract can be deemed voidable if the provider does not remit the funds within the specified time period.
- Viators must be informed that certain rights might be forfeited by the viator.
- A brochure, approved by the department, must be produced and given the viator.
- Disclosure that medical, financial, or personal information may be disclosed to others as needed to affect the viatical settlement contract. This is a key disclosure. In order to effect a viatical settlement, many people do not understand that personal information is passed on to investors. The Department believes that this information is crucial to viators who may reconsider the viatical settlement once they understand that personal information is given to investors.
- Disclosure that the insured may be contacted by the viatical provider or broker regarding his or her health status within the limitations on those contracts. Contacts with insureds are limited to once every three months for insureds with a life expectancy of more than one year and no more than once per month for insured's with one year or less.

**General Rules**
This bill provides certain rules that providers and brokers must follow:

- Notice to the insurer that issued the policy that it has or will be viaticated. A copy of the medical release and a copy of the viator's application for the viatical settlement contract must accompany the notice. This is a very important section because communication between the insurer and the viatical company is key to combat fraudulent activities that are occurring in this industry.

- The viator may rescind the contract for at least 30 days from the date of the contract or 15 days from receipt of the proceeds, whichever is earlier.

**Prohibited Practices**
This section prohibits any person to enter into a viatical settlement contact within the two-year incontestability period. There are listed hardship exceptions to this two-year limitation. If the policy is viaticated within that two-year period, independent medical information must be submitted to the insurer when the viatical settlement provider requests to affect a transfer of the policy to the provider. This is required to weed out any fraudulent activities.

**Advertising Requirements**
The purpose of this section is to provide prospective viators with clear and truthful statements in the advertisements of viatical settlements and sets out numerous guidelines and standards of permissible and impermissible advertising standards:
- Requires viatical settlement licensees to establish and maintain a system of control over all advertisements, regardless of by whom written
- Follows closely the extensive regulations governing life insurance advertising regulations.

**Fraud Prevention and Control**
This section is not currently in our law but provides requirements for brokers and providers to prevent fraudulent activities that are occurring in this industry. This section refers back to the definition of fraudulent viatical settlement act and requires:
- That a person that is engaged in the viatical settlement industry having knowledge of a reasonable belief that a fraudulent settlement act is being committed or will be committed is under a duty to notify the Commissioner, and
- Gives immunity to those furnishing information regarding the above.

This section also requires viatical settlement providers and brokers to submit an anti-fraud plan to the Commissioner. The plan must include:

-Fraud investigators – which can be employees
-Procedures to detect fraud
-Procedures to report possible fraudulent activities to the Commissioner
-Plan for anti fraud education and training of underwriters
-Anti fraud plans would not be considered an open record

**Closing Remarks**
In closing, Mr. Chairman and members of the committee, having your life insurance purchased in a viatical or life settlement can be a godsend to many Kansans, so what's why the Kansas Insurance Department requested that the Legislature allow us to regulate this industry, not ban it. However, there are problems with some of the investors who short-change and fleece consumers through viatical and life settlement fraud, and we feel that has left us with insufficient consumer protection.

In 1999, the legislature passed the existing law, but since that time the industry has changed and continues to change dramatically. In the last few years, the industry has evolved into including

life settlements for healthy seniors. Currently, this market is worth over $100 billion nationwide and there is no specific regulation of it in Kansas.

The proposed law is the NAIC model act adopted in December 2000 and has input of many groups before getting to the final stages of adoption. The proposed model act is no more burdensome for the agents and companies than is already in place for other life insurance agents or companies selling life insurance in Kansas. The advertising section of this model act, for example, was actually fashioned after the Kansas life insurance advertising regulations.

Kansans deserve the protection of this comprehensive law. It provides greater safeguards for viators' privacy, covers life settlements, and protects investors. We urge your favorable consideration of HB 2460. That concludes my remarks, Mr. Chairman, and I would stand for any questions.

# VIATICAL SETTLEMENTS ACT SUMMARY

Section 1 Title of act.

Section 2 Definitions.

Section 3 Licensure.

- Viatical settlement provider application fee is $1,000. Annual renewal fee is $500.
- Viatical settlement broker application fee is $100. Annual renewal fee is $50. (amendment we are proposing)
- Requirements for licensure

Section 4 License denial, non-renewal or revocation

Section 5 Viatical settlement contract, disclosure statement and advertising required to be approved by commissioner.

Section 6 Annual statement filed with commissioner.
Exemptions to disclosing the identity as an insured or the insured's financial or medical information.

Section 7 Examinations.

- Documents licensees are required to keep for five (5) years.
- Conducting an examination.
- Examination report requirements.
- Confidentiality and privacy issues with regard to information gathered during the examination and in the examination report.
- Conflict of interest and status of appointed examiner.
- Fees and procedures for examination.
- Civil cause of action deriving from examination.
- Investigation of suspected fraudulent viatical settlement acts and persons engaged in the business of viatical settlements.

Section 8 Disclosures.

- Disclosures to be provided to the viator with the application for a viatical settlement.
- Disclosures to be provided to the viator with the viatical settlement contract.

Section 9 Viatical Settlement Contract.

- Information a viatical settlement provider must obtain before entering into the contract.
- Confidentiality of the medical information obtained for the viatical settlement contract.
- Right to rescind option required in the viatical settlement contract.
- Procedures after the viatical settlement contract is executed.
- Failure to tender consideration consequence.
- Procedure for contacts with the insured for the purpose of determining the health status of the insured after the viatical settlement has occurred.

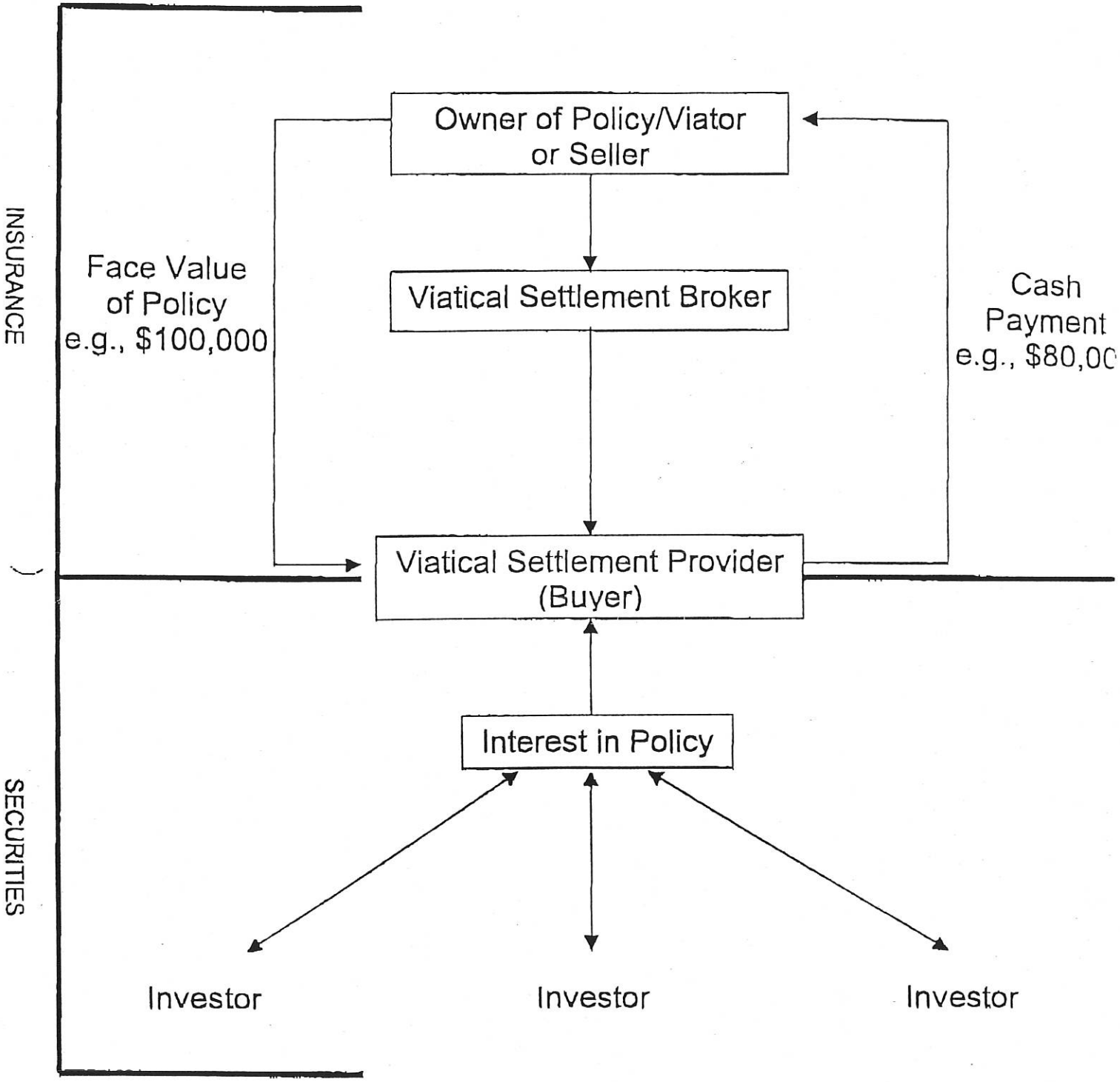
Section 10 Exemptions from entering into a viatical settlement contract within a two-year period commencing with the date of issuance of the insurance policy.

Section 11 Advertisement of viatical settlements.

Section 12 Fraud.

Section 13 Enforcement.

# VIATICAL SETTLEMENT PROCESS



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A·C·L·I AMERICAN COUNCIL OF LIFE INSURERS
FINANCIAL SECURITY FOR LIFE

JAMES D. HALL
SENIOR COUNSEL
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February 14, 2001

Mr. Marlyn Burch
Life Division Director
Kansas Department of Insurance
420 S.W. 9th Street
Topeka, Kansas 66612

**Subject: House Bill 2306**

Dear Marlyn:

I am writing you on behalf of the American Council of Life Insurers, whose 426 member companies account for 80 percent of the life insurance premiums and 81 percent of the annuity considerations in the United States among legal reserve life insurance companies. We have 340 member companies licensed to do business in Kansas. I am writing to express our support for your House Bill 2306, which would enact the Kansas Viatical Settlement Act of 2001.

ACLI and its members participated in developing the NAIC Viatical Settlement Model Law upon which your Kansas Act is based. During our participation in that development process we noted that you played a key role among the regulators assigned to develop the Model. It is therefore fitting that you would take the lead in introducing the HB 2306 for enactment in Kansas.

Viatication of life insurance policies is a business practice in need of regulatory oversight, particularly in the area of fraud related activity. We strongly believe such oversight is most appropriately conducted by the Department of Insurance, whose existing authority and expertise regarding insurance makes the Department a natural regulator for this emerging area of commerce. House Bill 2306 creates the needed regulatory oversight and places that authority with the Department of Insurance. Accordingly, we support your bill.

Very truly yours

James D. Hall

cc: Julie Spiezio – ACLI
Victoria Fimea – ACLI

**Viaticus, Inc  Enhance Life Benefits LLC**
**ViatiCare Financial Services  Life Capital, BV**

February 9, 2001

Kathleen Sebelius, Chair
NAIC Executive Committee
President, NAIC
Kansas Department of Insurance
420 S.W. 9th Street
Topeka, Kansas 66612-1678

VIA FACSIMILE 785-296-2283

RE: **Viatical Settlements Model Act**

Viaticus, Inc., Enhance Life Benefits and ViatiCare Financial Services are all institutionally funded provider companies. Life Capital, BV is an institutionally backed Financing Entity that provides capital to licensed Viatical Settlement Providers. All of these companies have worked closely with the National Association of Insurance Commissioners (NAIC) Viatical Settlements Working Group in the drafting of the Model Act

Thank you for allowing us to comment on the Viatical Settlements Model Act. **We have reviewed and support the proposed model act.**

The Act provides strong protections for consumers such as:

- Regulating advertising
- Addressing the issue of fraudulent viatical settlement acts
- Recognizing the role of institutional funding in the industry
- Regulating life settlements as well as viatical settlements
- Requiring disclosures to consumers.

We do however suggest one change to the model that was not fully reviewed due to time constraints. We had raised the issue of an exemption from licensure for licensed life insurance agents, CPAs, attorneys and financial planners. This concept was not fully fleshed out when initially proposed to members of the Working Group. Since then considerable work has been done to develop an appropriate exemption for these regulated professionals. Our four companies worked with members of ACLI, Allstate Insurance and NAIFA in the development of the current proposal.

The proposed model requires a licensed life insurance agent, certified accountant, attorney or financial planner to obtain a separate viatical broker license to participate in the business even if they engage in only one or two transactions a year and are primarily engaged in the insurance or financial planning industry, rather than the viatical industry. These individuals who have no desire to engage extensively in the viatical business are the most likely source of information for the occasionally client who may benefit from a viatical settlement. While we argue that all persons engaged in a significant number of viatical transactions should be licensed, it is unduly burdensome to require these otherwise licensed professionals to obtain an additional license on the chance that they may encounter one or two of these transactions a year.

To address the very limited involvement of these professionals, we propose the addition of language that would include them under the definition of broker (keeping them within the regulatory oversight of the Commissioner) but exempt them from the licensing, fraud plan and reporting requirements of the model provided they transact no more than five cases per year.

Each provider would have the responsibility to report annually to the Commissioner payments made to this type of agent, to assist the Commissioner in monitoring volume. These professionals do not perform the same functions as viatical settlement brokers. They do not actively advertise or solicit viatical business, do not negotiate the terms of the settlement agreement, and do not do any pre-underwriting steps commonly performed by viatical settlement brokers (i.e.; obtaining medical records, verifying policy coverage, etc.)

Requiring these licensed life insurance agents or other regulated professionals who do only a couple of transactions per year (if any) to be separately licensed as a broker would prohibit them from serving the needs of the clients -- possibly denying their clients information about and assistance with a viatical settlement. Further, we believe that the licensure requirement currently in the model act will lead many of these professionals to 'go underground' and work through unscrupulous brokers thereby avoiding regulation by the insurance departments of the very people in direct contact with the viator.

We would be happy to provide specific language for this proposed change to the model act or to work further with the working group if this were made a charge for 2001.

We appreciate the opportunity to comment on the model act and voice our support of the model. The Working Group did an outstanding job of working with the various interested parties and learning about the ways in which the industry functions and is evolving.

If you have any questions, please feel free to contact any of the signers of this letter.

Sincerely,

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William J. Kirven III, Chair, NAIC Executive Committee
Merwin Stewart, Vice Chair, NAIC Executive Committee
Bob Lohr, Secretary, NAIC Executive Committee
Lester Dunlap, Chair, NAIC Viatical Working Group
Carolyn Johnson, NAIC Viatical Working Group

including about 400,000 in Greater Cincinnati and Northern Kentucky.

Community Mutual Insurance Co. of Cincinnati merged with an Indianapolis insurer in 1995 for form Anthem.

Converting from a mutual insurance company - owned by policy holders - to a stock company is called demutualization.

Under Indiana, law the company's entire value is paid to members eligible under Indiana law in the form of stock, the company said.
The conversion is subject to approval by the Indiana Department of Insurance.

Any stock distribution would likely would include more than 1 million members - mostly in Indiana, Kentucky, Ohio and Connecticut - who are covered under Anthem health plans.

However, not all of the members in those states would be eligible for stock. The distribution could be governed by laws in the specific states.

"The details of who those members are have not been defined," said Anthem spokeswoman Lauren Green-Caldwell.

A spokesman for the Ohio Department of Insurance said that Anthem will most likely have to file its approval by Indiana officials and that distribution of the stock is governed by its contracts with employers.

A spokesman for the Kentucky Insurance Department said if an employer paid the entire premium, it would most likely be entitled to the stock to be distributed.

However, if the employer and employee both paid the premiums, each could be entitled to a share.

He said the department would hold a public hearing on the issue and that each case would be determined individually.
"If you look at our industry, it's rapidly consolidating into larger and larger companies," Anthem spokeswoman Patty Coyle Locke said.

Anthem said the conversion would not affect premiums and other terms of health care plans.

4. Viatical Settlements Could Be a Godsend, or a Swindle, for the Dying
The Washington Post
02/13/2001


For some they're a godsend -- a way to tap life insurance money to ease the debts and worries of impending death.

For others, they're an investment -- offering a tidy return from a sure, if

morbid, bet.

But for the shadier elements within a growing industry, viatical settlements are an opportunity to swindle both the insured and the investor. Indeed, viaticals (derived from a Latin word meaning "provisions for a journey") were named by the North American Securities Administrators Association as one of the top 10 investment scams of 1999, along with telemarketing schemes and get-rich-quick seminars.

Should you even consider entering into a viatical agreement? Perhaps, but certainly not without first thinking it through carefully.

Under a viatical settlement, a policyholder who can demonstrate that he has been diagnosed with a terminal illness sells his life insurance policy to a settlement company for a fraction of its face value. With the policy in hand, the purchasing company solicits investors who buy a percentage of the policy's death benefit. (An investor might, for example, spend $50,000 to purchase a 22-percent share of a $256,000 policy. Upon the insured's death, the investor would collect $56,320 -- a 12.6-percent return.) Out of its portion of the investment, the viatical company pays premiums on the policy to keep it in force until the viator (the person who cashes in his policy) dies. In some cases, the company may require that investors pay the premiums.

The amount a viator receives for his policy depends on his estimated life expectancy. Under a regulation developed by the National Association of Insurance Commissioners, a viator with an estimated life expectancy of six months should receive 80 percent of a policy's face value, but someone expected to live 18 to 36 months would receive 60 percent. As of January 2001, however, only nine states have chosen to adopt that payment schedule. In the others, it's hard for viators to know whether they got a fair deal. Too often, they don't.

Potential investors are often lured to viatical settlements through newspaper ads promising safe returns from a short-term investment. But because the Securities and Exchange Commission lacks authority to regulate viatical settlements, both salespeople and companies are free to make almost any claims they wish.

States have recently imposed stricter controls, but, even so, viatical companies rarely provide information about themselves, reveal returns experienced by investors in previous years, or disclose risk.

And there is risk. Many investors, for example, receive no proof that they own policies. Investors involved in a protracted deal, moreover, may discover that they must assume responsibility for paying the viator's insurance premiums. Or (as often happens) the viatical company could go out of business, leaving investors to guess what happened to the viator or where to send insurance premiums they might have to pay.

Still, for all its troubles, the viatical industry fills a real need. In the

absence of comprehensive health insurance that covers all costs, viatical settlements have emerged to help critically ill people who may otherwise be rendered destitute paying for medical care. And a new model law that states could use to protect investors is scheduled to be completed soon.

If you are interested in exploring the viatical option, check first for companies affiliated with one of two industry trade groups: The National Viatical Association (800-741-9465; www.nationalviatical.org) or the Viatical and Life Settlement Association (202-367-1136; www.viatical.org). You should also check a company's licensing with state securities and insurance regulators.

Before you sign over your policy, consult with a financial adviser. Settlements paid to those with less than two years to live are free of federal taxes, but collecting a settlement can disqualify a patient from Medicaid benefits.

http://www.washingtonpost.com

5. Question: What To Do With Regulator?
Credit Union Journal
02/12/2001


ORLANDO, Fla. -- Florida State Treasurer Tom Gallagher and State Comptroller Bob Milligan expressed diametrically opposite views on reorganizing state government prior to a January 2003 deadline for doing just that. Gallagher and Milligan spoke at a town hall meeting sponsored by the Florida league to discuss issues surrounding reorganization.

The reorganization of the state's financial regulatory agencies is necessary as a result of a constitutional amendment approved by Florida's voters in November 1998, that merges the constitutional duties of the treasurer and comptroller into one elected officer called the chief financial office, and abolishes the office of education commissioner and secretary of state, leaving a three-person cabinet. However, no direction was provided on the fate of the regulatory duties assigned to both offices statutorily. Under the adopted amendment the state cabinet will consist of the attorney general, commissioner of agriculture and the CFO.

Comptroller Milligan's proposal would take the regulation of the state's financial industries and place it in a separate department headed by Florida's governor and cabinet. Currently, five state departments are headed in this manner. Regulation of banks and credit unions, securities and insurance would be housed in a new department. A commissioner would head each area, and the whole department would have an executive director that would report to the Governor and Cabinet. Milligan said his goal was to get the politics out of regulation.

Treasurer Gallagher countered that all the regulatory functions of the treasurer and comptroller should be housed with the new chief financial

# Betting on death

Insurance settlements intended to help the dying have short-changed them and fleeced many investors instead.

**Sarah Lorenti and Scott Ericsson have never met, yet the two are** locked in a deal to the death. In early 1997, Lorenti and her husband, Raymond, then living in Naples, Fla., invested $50,000 to purchase a 22 percent share of Ericsson's $256,000 life insurance policy. According to papers they received from Mutual Benefits, the Fort Lauderdale company that brokered the deal, Ericsson, who does not want us to use his real name, had "advanced HIV disease" with a 6- to 12-month life expectancy. Under an arrangement called a viatical settlement ("viatical" comes from a Latin word meaning provisions for a journey), he would get a percentage of the policy for his immediate use. After he died and the insurance company paid off, investors would receive their share of the claim, in the Lorentis' case, $56,320—a solid 12.6 percent return. "The salesman said viaticals were better than CDs [certificates of deposit] or stocks," says Lorenti, 72.

Ericsson, a postal worker from the Midwest, is alive, and Lorenti is still waiting for the payoff. Though she continues to receive letters periodically from Mutual Benefits reporting that Ericsson's condition "remains terminal," Lorenti, whose husband has since passed away, now wants the funds to meet her own needs and worries that she'll never collect.

To disease-stricken people like Ericsson and investors like Lorenti, viaticals looked like an arrangement from which both sides could gain. Terminally ill patients facing devastating medical expenses could receive cash from an insurance policy to see them through their final days. Investors would be rewarded with a tidy return from a sure—albeit morbid—bet.

Such attractions have been the wellspring of a growing business. In 1998, according to a report by Conning & Co., an insurance research group, the 40 to 50 mostly small companies that made up the industry exchanged about $1 billion in life insurance policies, up from just $50 million in 1991. Now, the industry is moving to extend the marketing of viatical settlements to healthy seniors through so-called "life settlements," a vast market potentially worth $108 billion. Many viatical insiders believe that eventually Wall Street companies will sell shares in large pools of "used" insurance policies.

### LEGAL AND ETHICAL DILEMMAS

The industry has been dogged by problems—and thorny ethical issues. Insufficient consumer protection has left viators (the people who cash in their policies) with inadequate payments and investors stung after promised returns up to as much as 30 percent or more fail to pan out. Fraud has been so common a problem that the North American Securities Administrators Association, a group of state investment cops, named viaticals one of the top ten investment scams of 1999, along with telemarketing schemes and get-rich-quick seminars. Thirty-three of the 73 viatical companies CONSUMER REPORTS found operating in 2000 had been in trouble with regulators in the past two years. Among their problems: failure to register with securities or insurance authorities, misuse of investor funds, misstatements about the medical condition of patients, and a fraudulent practice called "cleansheeting." Under that scheme, viatical companies solicit patients with life-threatening chronic or terminal conditions to lie about their health and apply for life insurance policies, which are then resold to investors.

Yet despite all the problems and abuses, viatical settlements can be a godsend. Arline Maisel, her three brothers, and two sisters despaired when they learned in mid-1997 that their dad, stricken with prostate cancer, had six months to live. With three children still at home to support, Hank Maisel, 61, was too ill to work, and a failed business deal had left him broke. "He was only a few payments away from losing the house," says Arline. By selling half of Hank's only asset, a $500,000 term-life insurance policy, however, the Maisels were able to raise enough after the viatical company pocketed its $59,000 share of the proceeds to meet medical expenses and clear up debts. Hank died in 1999, and, says Arline, "I am convinced he lived an extra year thanks to the money."

### HOW VIATICALS WORK

Viatical settlements look fairly straightforward. A policyholder who can demonstrate that he has been diagnosed with a terminal illness sells his policy to a settlement company for a fraction of its face value, depending on estimated life expectancy. With the policy in hand, the purchasing company solicits investors who receive the death benefit when the viator dies. Out of its portion of the investment, the viatical company pays premiums on the policy to keep it in force until the viator dies. In some cases, the company may require that investors pay the premiums.

Any type of insurance can be used in a viatical settlement—whole life, universal, term, or group life provided by an employer.

**Despite all the problems and abuses, viatical settlements can be a godsend.**

But the policy must allow the viator to assign, or transfer, it to an unrelated beneficiary. And the viator must have owned the policy for a minimum of two years before he sells it.

Under the newer viatical arrangements called life settlements, an elderly person with a large life insurance policy he or she no longer needs would be able to convert the policy to cash. Steven Arenson, a vice president with Viaticus, a division of Chicago



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nsurance giant CNA, explains that his company's typical viator is 72 years old, has a high net worth, owns a $1.4 million policy, and has a life expectancy of about ten years. Viaticus does not sell to individual investors; it plans to hold the policies until maturity, calculating that at least some of its clients will die sooner rather than later. Other firms, however, are gearing up to buy policies from healthy seniors and sell shares to small investors.

**PREYING ON VULNERABILITIES**

Viators who are ill and often desperate may be at the mercy of viatical companies. Under a regulation developed by the National Association of Insurance Commissioners (NAIC), viators would be guaranteed to receive a minimum payment based on a sliding scale that depends on life expectancy. For instance, a viator with an estimated life expectancy of six months would receive 80 percent of a policy's face value, but someone expected to live 18 to 36 months would receive 60 percent. To date, however, just nine states (Arkansas, Connecticut, Kansas, Louisiana, Maine, Minnesota, Mississippi, Oklahoma, and Vermont) have chosen to adopt the payment schedule.

In the absence of standards, it's hard for viators to know whether they got a fair deal, though too often they do not. Joseph Belth, editor of Insurance Forum, a consumer-oriented industry newsletter, studied viatical transactions between 1994 and 1998 arranged by eight companies in Florida. He found that payment ratios varied from as low as 22 percent of a policy's death benefit to as much as 60 percent. Even within the same company, Belth found, similar policies paid out different proportions. Accelerated Benefits, an Orlando firm, for example, paid 25 percent, 33 percent, and 40 percent of death benefits to three HIV patients, each with a life expectancy of 48 months, who owned whole-life policies. The surprisingly wide variation, explains Jess LaMonda, Accelerated's president, is due to differences in premiums, brokers' fees, and loans against the policies.

Unpredictable and inadequate payments to viators aren't the only problem. Tom Foley, director of the accident and health division of the Kansas Insurance Department, is troubled by the potential invasion of viators' privacy. No laws currently require that the original policyholder's identity be concealed from investors. And while some companies do try to keep identifying information to a minimum, these efforts can be sloppy, allowing sensitive data to leak out.

That intrusiveness could have serious consequences. Viators run the risk that their policies may be sold repeatedly and end up in the wrong hands. The viatical industry has attracted some questionable players. Consider the case of Michael Lee Davis, who, along with several cronies, operated two viatical companies in Dallas. After a lengthy investigation by the Texas Department of Insurance, Davis was indicted for—and recently convicted of—cleansheeting. According to court papers, he solicited people with pre-existing terminal illnesses to apply for life insurance policies that have low face values and require no medical tests. For a fee between $4,000 and $7,000, the applicants would falsely attest to their good health, and one of Davis' partners, a complicit insurance agent, would approve the deal. Davis resold $3.6 million of the policies to investors.

**A death with dignity**

**Suffering with cancer and beset with debts, Hank Maisel accepted a viatical settlement on his $500,000 term-life policy. With the proceeds, he was able to meet expenses and ease his family's anguish. Says his daughter: "I am convinced he lived an extra year thanks to the money."**

What stunned investigators, however, wasn't Davis' scheme, which has become almost routine in the viatical business, but his background. In 1981, under the name Walter Alfred Waldhauser Jr., Davis confessed to hiring a hit man to kill the family of a friend to collect money from their estate, including insurance proceeds. The homicides got Waldhauser three concurrent 30-year sentences, but he was granted parole in 1990. Upon his release, he and another former prison inmate decided to go into the viatical business. (Texas law disqualifies applicants for viatical licenses if they had felony convictions within the previous ten years. Waldhauser's conviction was too old to count.)

Dangers for investors. F :tive investors don't hear about such problems. Like the Lorentis, they see an ad in a newspaper promising safe returns from a short-term investment. Since a 1996 federal court decision, which ruled that the Securities and Exchange Commission lacked authority to regulate viatical settlements, both salespeople and companies have been free to make almost any claims they wish. States have recently imposed stricter controls, but even so, viatical companies rarely disclose risk, provide information about themselves, or reveal returns experienced by investors in previous years—information easily obtained for stocks, bonds, and mutual funds. And investors are often introduced to viaticals by a trusted insurance agent or financial planner with whom they have done business for years. Such financial advisers may not know much about viaticals, says Bill MacDonald, enforcement director of the California Department of Corporations. Their chief concern, he adds, is "how much is my commission?"

The result is almost complete lack of understanding of basics on the part of investors. Promotional materials put out by companies like Taking Flight Investments, headquartered in Michigan, tout 42 percent returns from viaticals on patients with three years to live. But the company fails to mention that every year tacked onto the viator's life reduces an investor's return—in some cases, to less than what could be earned in a federally insured passbook savings account. Kathleen Blackham, chief deputy of enforcement for the Indiana Securities Division, notes that 80 percent of the policies she's reviewed in which her state's investors put money "have gone beyond their maturity date."

Many investors receive no proof that they own policies. Financial Federated Title & Trust (FinFed), a Lake Worth, Fla., viatical company, sold $117 million in viatical investments from 1996 to 1999. The company promised returns of 42 percent, but a lengthy probe by FBI agents revealed, in 1999, that FinFed and related companies owned only 70 policies worth just over $8 million. The company and a batch of related businesses used about $12 million of the proceeds collected from investors to pay off on policies. Most of the money went to FinFed executives' bank accounts, real-estate acquisitions, and a fleet of luxury cars, helicopters, motorcycles, and boats. Investors were kept in the dark, receiving form letters assuring them that viators' medical records had undergone review.

PHOTO BY ARLINE MAISEL



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ally, last year, the FinFed principals were charged with fraud (one was convicted and others are awaiting trial). The company was forced into bankruptcy.

The longer the deal goes on, the more likely it is that investors will face costly problems. For starters, they may discover that after a certain point they must assume responsibility for paying the viator's insurance premiums to keep the policy in force. Some viatical companies set aside only enough to pay the viator's premiums until the predicted date of death. If the viator does not die and the policy is allowed to lapse, whatever the investor put into the deal would be lost.

Over time, the investor could discover other traps. The viatical company could lose track of the patient and not know whether he is alive or dead; or the company could go out of business, leaving investors to guess what has happened to the viator or where to send insurance premiums they might have to pay. According to the Conning & Co. report, "firms go in and out of the business frequently."

### MORE PROBLEMS AHEAD

Because regulators have been slow to address the industry's many problems, both viators and investors are hard put to find a viatical company they can trust. It wasn't until 1993, eight years after the first viatical companies were founded, that NAIC developed a model state law to provide protections to viators. So far, 27 states have adopted some version of the statute, while another 6 developed their own laws. A new, more comprehensive model law that would provide more safeguards for viators' privacy, cover life settlements, and lay out protections for investors will be completed this month.

Viatical industry officials say that many of the problems could disappear if the industry were able pool the risks over thousands of policies, much like Ginnie Mae bonds do for home mortgages. William E. Kelley, executive director of the Viatical and Life Settlement Association, one of the industry's two trade groups, points out that under a pooling arrangement, people who sold their policies would face fewer risks that their privacy would be violated. Investors would spread their risk among perhaps a thousand policies at once and be able to sell shares in the pool when they wanted out.

Pools may offer investors more protection, but it's doubtful they would do much to improve returns. Joseph Belth, editor of Insurance Forum, simulated what investors could expect to earn from a model pool of 1,000 whole-life policies, each with a face value of $1 million and owned by a healthy 70-year-old man. He assumed that each of the viators would receive a settlement of $522,000—equal to the cash value in the policy they would be able to fetch simply by trading in their policies. Belth estimated that were they in the pool to pay the premiums, expenses, and interest to keep the policies in force until the viators died, the investors would end up losing $10,000 per policy.

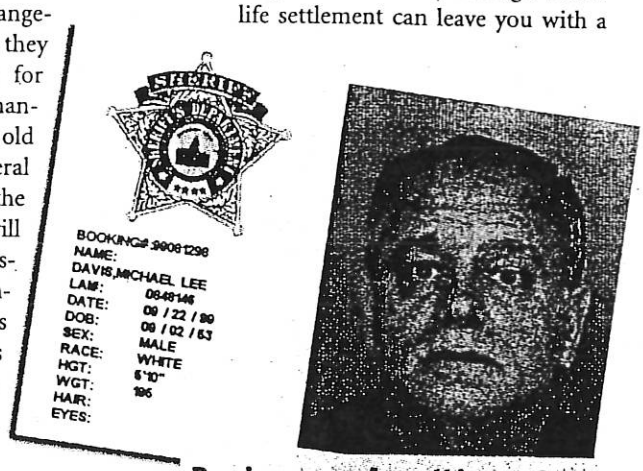
### RECOMMENDATIONS

For all its troubles, the viatical industry fills a real need. In the absence of comprehensive health insurance that covers all costs, viatical settlements have emerged to help critically ill people who may otherwise be rendered destitute paying for medical care. And, if the industry can work out arrangements for life settlements, they may be a source of cash for retired people who didn't manage to save enough for their old age. But until state and federal regulators can establish the necessary safeguards that will make it possible for the industry to serve these ends responsibly, viators and investors should take these precautions before entering into such arrangements:

**Viators.** It's unwise to make a major financial decision at a time of emotional and economic strain without first consulting your family or a trusted friend who can help you think through the situation carefully. Don't accept a viatical settlement until you've first fully investigated your alternatives. Many life insurance policies offer accelerated death benefits that allow policyholders with a life expectancy of less than six months to receive an early distribution of between 25 and 100 percent of the death benefit. You may also be able to arrange to borrow from family or friends, using future proceeds from your policy as collateral.

If you remain interested in exploring the viatical option, check first for companies affiliated with one of the two industry trade groups: The National Viatical Association (1200 G St., N.W., Suite 760, Washington, D.C. 20005; 800 741-9465; *www.nationalviatical.org*); or the Viatical and Life Settlement Association (2025 M St., N.W., Suite 800, Washington, D.C. 20036; 202 367-1136; *www.viatical.org*). Both groups have adopted a code of ethics with which members must comply. You should also check a company's licensing with state securi... and insurance regulators. Inquire with your state insurance department to see whether the law recommends a minimum payment for your policy, and get bids from several companies before accepting an offer. Before you sign over your policy, consult with a financial adviser. Collecting a viatical settlement can disqualify a patient from Medicaid benefits. Settlements paid to those with less than two years to live are free of federal taxes.

Anyone thinking of converting an insurance policy should exercise extra caution before going the viatical route. Because few states now regulate life settlements, you have no protected right of privacy. You will have to allow your medical condition to be tracked for the rest of your life. If those disadvantages don't deter you, ask your tax adviser or financial planner whether collecting a viatical life settlement can leave you with a hefty tax bill. And if you own a whole-life policy, don't accept less than the cash value for it.




**Buy insurance from this man?** Walter Alfred Waldhauser Jr. pled guilty to homicide charges in 1981 and was sentenced to hard time in a Texas penitentiary. But for eight years following his 1990 parole, Waldhauser (now calling himself Michael Lee Davis) and a fellow former inmate sold viatical policies until investigators indicted him for fraud.

Investors. Despite marketing claims to the contrary, viaticals are high-risk investments that could take years to pay off. And with gaping holes in the regulatory safety net, they present too many potential problems for small investors. Even well-heeled investors should approach these investments with great caution. They are not appropriate for use in Individual Retirement Accounts. IRA holders must start withdrawing funds no later than April 1 of the calendar year after they turn age 70½. If the cash isn't there, they will face a penalty equal to half the sum they were required to withdraw but didn't.



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Business
LEXINGTON HERALD-LEADER January 12, 2002

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Miami-based bank with Cuban-American ties closed by Treasury Department - Page B2

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Market Week
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# Guilty plea includes Kelco link

## Defendant says he got help faking data for policies

By Jim Jordan
HERALD-LEADER BUSINESS WRITER

A new defendant alleges that unidentified "officers and employees of Kelco Inc." helped him fake blood tests and provide false information to get life insurance policies to sell to Kelco.

Carmine Carpinone, 38, of New York was indicted by a federal grand jury Wednesday and pleaded guilty yesterday to an indictment that includes the allegations.

Prosecutors have said Kelco knew fraud was being committed to get insurance policies, but Carpinone is the first to allege that Kelco officers were directly involved in illegal acts.

Kelco's attorney, Bob Webb, denied Carpinone's allegations and attacked his character, saying he was lying to get even with Kelco and to get favorable treatment from prosecutors.

Neither Kelco nor any of its top officers have been indicted, and Kelco's founder and CEO, Steve Keller, has denied any suggestion of wrongdoing.

Another defendant, Keith Hadlock, 44, who was indicted with 15 others on Jan. 3, also pleaded guilty yesterday to the same charge as Carpinone — one count of conspiring to commit mail fraud, which could mean five years in prison and a fine of up to $250,000.

Both men are cooperating with federal investigators who raided Kelco's Lexington headquarters on May 19, 2000, and

See KELCO, B2

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# KELCO: Indictment lists ways defendant says he was instructed in fraud

From Page B1

seized 606 boxes of records.

The investigation involves "clean-sheeting," which occurs when a seriously ill person falsifies medical information to obtain a life insurance policy to sell to a viatical company such as Kelco.

The viatical company sells the policy to investors who pay the premiums and keep the policy in force until the insured dies and investors collect the death benefits.

Carpinone's indictment says "officers and employees of Kelco" told him:

- To change the order of his Social Security number to prevent insurance company computers from tracking his transactions.
- To leave blanks on insurance forms and policies "so that Kelco could insert the names of people or entities that would not alert insurance companies to the fact that Kelco was involved in the transaction."
- To "contact a person that Kelco used to substitute the blood of healthy individuals for the blood of unhealthy individuals applying for life insurance" so the unhealthy person could pass insurance company blood tests.

*Carmine Carpinone is the 18th person to be indicted in the Kelco inquiry and the third to plead guilty and agree to cooperate with prosecutors.*

The indictment did not say why Carpinone was concerned that his blood wouldn't pass the insurance company tests.

Carpinone also said Kelco executives met with him in New York and asked him to recruit other New Yorkers to participate in the conspiracy to get more policies.

Webb said that Kelco executives never met with Carpinone and that the company has a letter in its files ordering him to correct his Social Security number on documents he sent it.

Webb also said it would be nearly impossible to fake blood tests because they are done by insurance company employees or vendors.

As for the blanks left on insurance forms, he said that was a routine procedure because Kelco didn't know who would buy the policies and couldn't fill in the blank until a buyer was known.

"No officer of Kelco has ever told him to make false statements on insurance documents," Webb said.

Carpinone's whole story is "like something out of a fairy tale," he added.

Only one policy obtained by Carpinone and sold to Kelco was mentioned in the indictment.

In November 1997, he applied for a $250,000 policy from United States Life Insurance Co. that was sold to Kelco in January 1998 for $32,500.

Carpinone is the 18th defendant to be indicted in the Kelco investigation. He is the third to plead guilty and agree to cooperate with prosecutors.

The first was Charles Cole, who claimed to be a former Kelco manager in California, but Kelco said he was never an employee. Cole was indicted on April 5, 2001.

■

*Reach Jim Jordan at (859) 231-3242 or jordan1@herald-leader.com.*

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KAIFA
KANSAS ASSOCIATION OF INSURANCE AND FINANCIAL ADVISORS

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FAX: 785/233-2206

John C. Gann, LUTCF
Law and Legislative Chairman
Kansas Association of Insurance and Financial Advisors (KAIFA)

Testimony Before the House Committee on Insurance
House Bill No. 2640
February 5, 2002

Mr. Chairman and Committee Members:

I appreciate the opportunity to address you today on behalf of the members of the Kansas Association of Insurance and Financial Advisors. Our membership consists of 1,500 Kansas located in all Kansas counties who are actively engaged as insurance agents and brokers.

KAIFA is very concerned about viatical and life settlements in the state of Kansas and believes that there is a necessity of regulation of the these transactions by the Kansas Insurance Department and the Kansas Securities Commissioner.

In viatical and life settlements the insured person sells his or her life insurance policy for cash to a stranger or a syndicate of strangers. The insured person does this to generate cash to pay for the medical costs of terminal illness or to pay for the income needs of retirement. The cash needs of the seller are so great that he or she is not afraid at all of selling an old life insurance policy to someone who stands to make a money profit from the transaction, a money profit which becomes greater the more quickly the insured person dies.

The following more formal definition of the viatical and life settlements appears in the most recent issue of The Insurance Forum, "In a viatical or life settlement transaction ownership of a life insurance policy is sold for cash to someone who does not have an insurable interest in the life of the insured. Moreover, as a consequence of the transaction, the buyer of the policy thereby acquires a financial interest in the early death of the insured." (Volume 29, Number 2, Page 13, February, 2002).

Because most life insurance executives and life insurance industry regulators would find it very difficult to enforce laws and regulations prohibiting viatical and life settlement transactions, strict regulation of these questionable transactions is now the preferred method of public policy implementation.

There are several good reasons to strictly regulate viatical and life settlement transactions, the market for which is now being called the secondary market for life insurance policies.

1) Secondary market transactions undermine the long established principle of insurable interest.



*HOUSE INSURANCE*
DATE: February 5, 2002
ATTACHMENT # 4

2) The secondary market has provided an environment for fraudulent transactions to take place.

3) The secondary market has provided the mechanism for large amounts of life insurance to be diverted from the original purposes of the policies.

4) Secondary market transactions create numerous conflicts of interest.

The conflicts of interest are troubling to the management of many major life insurance companies and are strictly prohibited by many of these companies. These conflicts, according to various industry publications are:

A) Conflicts between the interests of the terminally ill patient who sells out of a policy and the health care provider who stands to receive some or all of the cash from the sale. The healthcare provider may regard the viatical payout as a windfall regardless of discount rates used and regardless of other financial considerations the patient may have.

B) Conflicts between the terminally ill patient who sells out of a policy and the profit motives of the viatical investment firm buying the policy. The viatical investment firm has no insurable interest in the life of the insured. The sooner the inured person dies, the greater the investor's profit. Both the insurable interest regulations and the transfer for value rules were established to prevent speculation, gambling and wagering on the lives of insured persons. But speculation on the life of another is precisely what happens in a viatical settlement.

C) Conflicts between the interests of the terminally ill person and the persons originally designated as the beneficiaries of the policy being sold into the secondary market. The original beneficiaries could argue in court that the policy was sold under duress, the threat of being without money to pay for medical expenses, and thereby, potentially nullify the viatical settlement agreement.

D) Conflicts of interest between the life insurance agent and the agent's insurance company. The agent could arrange to sell a life insurance policy to a terminally ill person by concealing information about the insured's illness from the insurance company underwriters. After the agent collects the first commission from the life policy sale, the agent could buy the inforce policy from the dying insured under a viatical arrangement and collect the death benefit and a substantial profit when the insured dies.

E) Conflicts of interest between the viatical investor and medical researchers. The development of new medical treatments extend the lives of terminally ill patients. When terminally ill persons who have sold out of their life insurance policies begin living longer that originally expected, the investment returns on viaticated policies deteriorates rapidly and places viatical investors at a tremendous disadvantage. The investors would have financial incentives to steer investment capital away from medical research that improved the quality of life and lengthened the human life span.

KAIFA is a proponent of House Bill 2640 as it will:

- Strengthen the powers of the Insurance Commissioner to prosecute fraudulent viatical and life settlement transactions.

- Strengthen the powers of the Insurance Commissioner to require full disclosure to potential viators of the nature, costs and tax liabilities of viatical settlements.

- Define fraudulent viatical settlement acts and establish the fines and penalties for criminal viatical acts.

- Establish advertising standards and guidelines that viatical providers must follow in public solicitation of viatical business.

- Require both a viatical settlement broker and provider to hold a license before they may engage in the viatical settlement industry and provide reasons why the Insurance Commissioner may refuse to issue, revoke or refuse to renew a license.

- Require that the Insurance Department approve all viatical contracts.

Another area of concern for KAIFA is the manner in which viatical investments have been sold as so called safe investments. Viaticals have been compared to various forms of investments with the lack of full disclosure on the part of the viatical and life settlement sales people. As mentioned in the testimony of Securities Commissioner Brandt, various cases have been investigated whereas agents have sold risky, unregistered investments to their clients. We believe that that viatical investments are securities and need to be regulated by the Kansas Securities Commissioner.

KAIFA is a proponent of the amendments to KSA 17-1262 proposed by Section 17 of House Bill 2640 as they will provide the Securities Commissioner with the powers to regulate the viatical and life settlements transactions as securities and protect investors by requiring more complete disclosure be made to investors and that individuals selling viatical settlements will be registered. We support the policy statement adopted by NASAA that is mentioned in Mr. Kannarr's testimony as it will be adopted by the Securities Commissioner and used in the regulation of viatical and life settlements as securities.

We strongly recommend the favorable consideration of HB 2640 as it will give comprehensive protection for current and potential viators and investors.

Thank you for your time and consideration.

KANSAS

Bill Graves
*Governor*

OFFICE OF THE SECURITIES COMMISSIONER

David Brant
*Commissioner*

# TESTIMONY IN SUPPORT OF HOUSE BILL No. 2640
## Viatical Settlements Act
Insurance Committee Kansas House

**DAVID BRANT**
Securities Commissioner
February 5, 2002

Mr. Chairman and members of the committee, thank you for this opportunity to testify in support of House Bill No. 2640 which would enact needed laws to regulate viatical settlement contracts and viatical investments.

First, I want to thank Insurance Commissioner Sebelius and her staff for their on-going cooperation in working together and in referring complaints from Kansans who have invested in viatical investments. Our two agencies have worked together to publish an informational pamphlet for the public and we have issued two joint letters which were sent to all insurance agents in 1999 and 2001.

I want to recognize Steve Hornberger, Director of Enforcement, and Wiley Kannarr, Associate General Counsel, as the Kansas securities staff experts on viatical investments.

Presumably, a legitimate viatical investment will repay the investor's principal upon the death of the insured. The problem is the question of when the insured will die – and many terminally ill people are living longer due to medical advances. The longer the insured lives, the lower the rate of return on the investment and the greater the risk in the timely payment of premiums to keep the viator's life insurance policy in force. And in some cases, the investors are now paying the premiums.

You have been provided copies of letters from Marvin Marsh of Manhattan and from LaVon Maxon of Seneca. Mr. Marsh and Ms. Maxon are examples of Kansans who invested in viatical investments. They were not told and they did not understand the risks they were undertaking. They will be lucky if they get their money back.

To date, our agency has handled thirty-one cases involving viatical investments. Based on the information obtained, we know that at least 131 Kansans have invested a total of almost $9.2 million in viatical investments. We estimate that $1.5 million has been repaid, some amount has been totally lost, and the remainder is at risk and outstanding with the investors uncertain about if and when they will receive the return of their principal.

*HOUSE INSURANCE*
DATE: February 5, 2002
ATTACHMENT #5

Investor Services 1-800-232-9580
http://www.ink.org/public/ksecom

618 S. KANSAS AVENUE
TOPEKA, KANSAS 66603-3804

We have investigated viatical settlement contracts packaged by the following viatical companies, all of which have been located out of state:

| | |
|---|---|
| Life Partners, Inc. | Waco, TX |
| Dedicated Resources | Del Ray Beach, FL |
| Viatical Solutions, Inc. | Dayton, OH |
| Legacy Capital Corporation | New York, NY |
| AMG, Inc. | Skokie, IL |
| Life Options International, Inc. | Tuscaloosa, AL |
| Mutual Benefits Corporation | Ft. Lauderdale, FL |
| Personal Choice Opportunities | Palm Springs, CA |
| American Benefits Group, Inc. | Atlanta, GA |
| Trade Partners, Inc. | Grand Rapids, MI |
| Aide the Living, Inc. | Iron Mountain, MI |
| American Benefits Services, Inc. | Lake Worth, FL |
| Beneficial Assistance | Baltimore, MD |
| Liberte Capital Group | Syvania, OH |
| Justus Viatical Group, Inc. | Pompano Beach, FL |
| Accelerated Benefits Corporation | Orlando, FL |
| Robin Hood International, Ltd. | Juno Beach, FL |
| Bald Eagle Viaticals | Traverse City, MI |

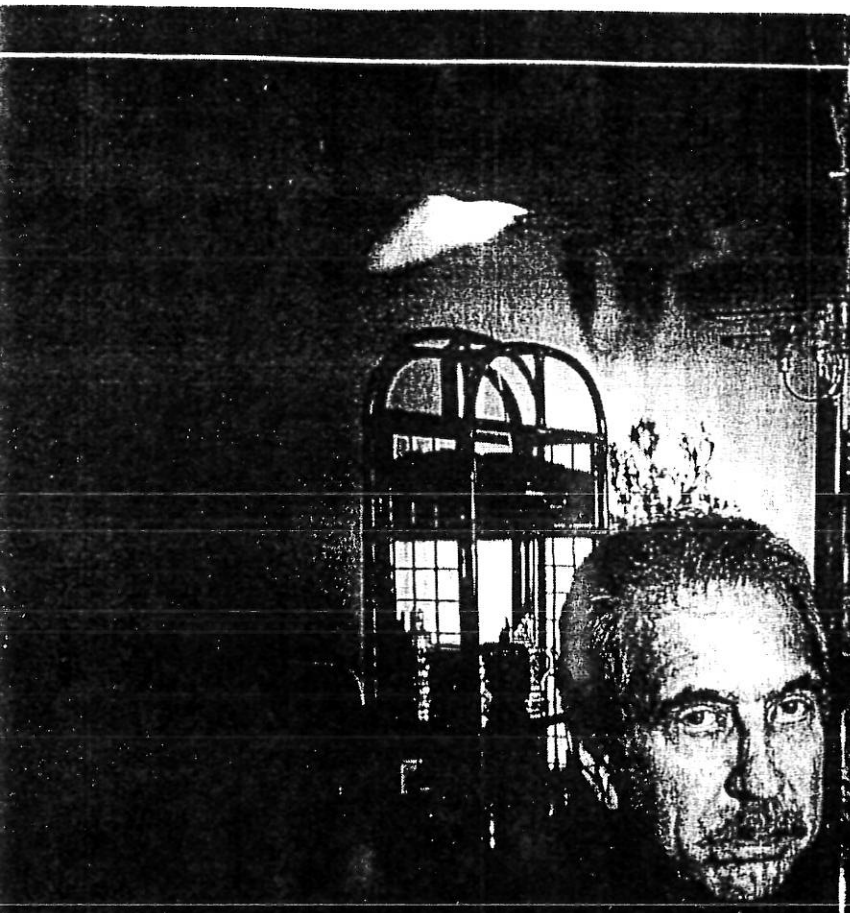
These companies paid commissions to salespeople to sell their viatical investments. To date, we have identified 18 insurance agents who sold these risky, unregistered, investments to their clients. 15 of the 18 are Kansas agents and they are from across the state including Topeka, Wichita, Lawrence, Manhattan, Lenexa, Oxford, and Overland Park. Of the 18 agents, seven were also registered to sell securities.

One of our biggest concerns has been the manner in which viatical investments have been sold as "safe" investments. Viaticals have been compared to bank certificates of deposits. Many of the newspaper ads and slick brochures have referred to "guaranteed return of principal." The lack of full disclosure prompted us to cooperate with the Insurance Department to develop the pamphlet which encourages investors to ask a number of questions before investing.

House Bill No. 2640 recognizes the need for functional regulation of viaticals. The Insurance Commissioner needs the enhanced powers to regulate the insurance aspects of a viatical transaction. As for securities regulation... Section 17, on page 30 of the bill, formalizes our determination that viatical investments are securities and authorizes the adoption of regulations. Wiley Kannarr will now present brief testimony to further explain the securities issues.

Thank you for your consideration.

Attachments:
March 1999 article from *Kiplinger's Personal Finance Magazine* entitled "Death Watch"
July 1999 Joint Letter to Agents to Warn about Pitfalls of Selling Viaticals
August 2001 Joint Letter to Agents to Clarify that Life Settlements are also Viaticals



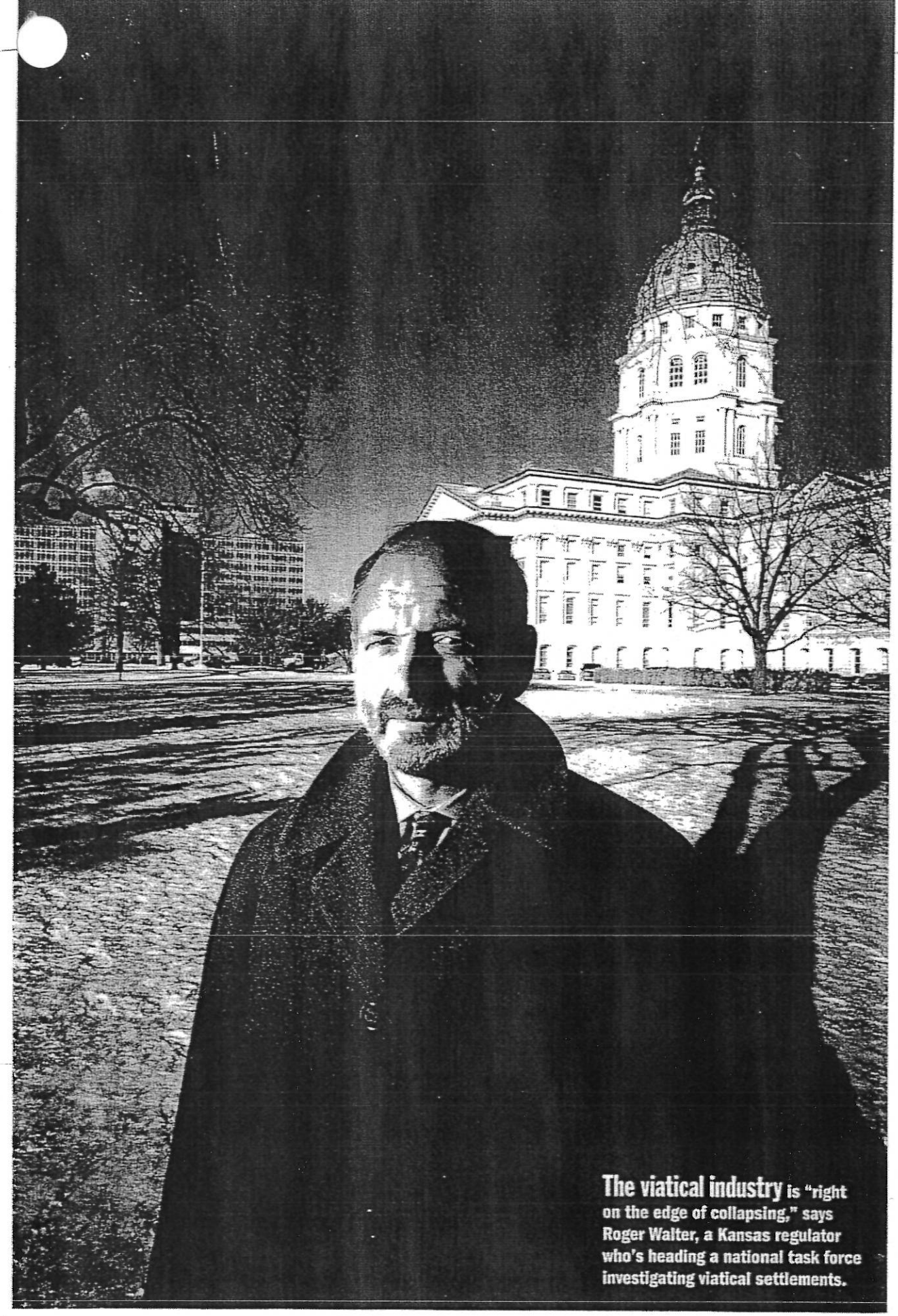
**Jerry Warner** and his mother, Vera, invested more than $45,000 in viatical settlements, then received an early payoff when the viatical company sold its policies. They lost more than $16,000.

# Dea… Wat…

By buying life insurance policies of the terminally ill, investors thought they were getting a… payoff from a humanitarian investment. Now they're waiting for the policyholders to die.

By Kimberly Lankford

Photograph…



**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.

**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

## 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.

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.

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

## 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.

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

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

# 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.

Kathleen Sebelius
Commissioner of Insurance
**Kansas Insurance Department**

David Brant
Securities Commissioner
**Office of the Securities Commissioner**

July, 1999

To Kansas Insurance Agents:

We are aware that insurance agents licensed and located in Kansas are being solicited to sell viatical settlement contracts. Under this sort of contract, a terminally ill person sells the death benefit in his life insurance policy in return for cash, which can be used for current expenses. Although this arrangement may provide some real benefits to the terminally ill insured, it can also create serious problems for the individuals that buy and sell the contracts.

As the sale of viatical settlements becomes more widespread, so do the problems associated with them. Defaults on policy premium payments, medical developments that increase life expectancies of the terminally ill, incompetence of promoters, and even fraud are just a few of the problems you may be selling your clients—and taking on for yourself.

**Viatical Settlement Contracts Are Considered Securities in Kansas**

Promoters of viatical settlement contracts, who solicit agents like you to sell them, often claim that these investments are not securities and that agents need not inform their broker-dealers of their activities or check with the Securities Commissioner before selling the investments. They make that claim based on a federal appeals court decision, commonly referred to as the *Life Partners* case.

You should not infer from the *Life Partners* case, however, that viatical settlement contracts sold in Kansas are not considered securities. The issues raised in the *Life Partners* case are far from settled. Only one federal appeals court has issued an opinion on the case; the Tenth Circuit, the federal appeals court that governs Kansas, has yet to rule on the issue. Given that many states and legal scholars disagree with the *Life Partners* opinion, one should not assume that the Tenth Circuit or the United States Supreme Court would affirm it. In any case, the *Life Partners* opinion is not binding on the Securities Commissioner of Kansas.

The Securities Commissioner of Kansas takes the position that most viatical settlement contracts meet the definition of an investment contract and are thus securities under the Kansas Securities Act ("the Act"). In the past year, the Office of the Securities Commissioner has investigated 14 cases involving the sale of unregistered securities by viatical companies, promoters, and agents.

If the viatical products that you wish to sell, or are selling, are in fact securities, you may violate not only the Act's securities registration requirements, but also the prohibition against selling securities without a license. Even if you are licensed to sell securities, you may violate the prohibition against "selling away"—that is, the prohibition against selling securities that have not been approved for sale by the broker-dealer by which you are employed. You must have the permission of your broker-dealer to sell any security. Selling away, in effect, constitutes selling without a license.

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618 S. Kansas Avenue
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1-800-232-9580 (Toll Free)

You should not rely on a viatical company to determine whether the investments you are selling are securities. You have the ultimate responsibility for knowing whether what you are selling is a security and ensuring that any sales of securities are made in compliance with Kansas law. Any of the violations described above could make you financially liable for rescinding the transactions and subject to regulatory sanctions by the Securities Commissioner. You should also understand that a violation of either the registration or antifraud provisions of the Securities Act may subject you to criminal prosecution for a felony.

Sellers of Viatical Settlement Contracts Must Follow Applicable Consumer Protection Laws

We are also concerned that viatical settlement contracts are not suitable investments for many of the investors to whom they are being sold. As with any investment, you as the seller must consider factors such as age, financial situation, and investment objectives of your client. Failure to do so may subject you to liability.

We are aware that some sellers of viatical settlement contracts have misled investors regarding the safety and return of the investment. Making misleading statements or material omissions of fact in the offer and sale of securities is fraud. Moreover, even if the viatical settlement contracts that you sell are not securities, making misleading statements or material omissions of fact in the offer and sale of those contracts would violate the Kansas Consumer Protection Act.

Sellers of Viatical Settlement Contracts Must Follow the Requirements of the Viatical Settlements Act

The Kansas Legislature recently passed Senate Bill No. 151, the Viatical Settlements Act, which will become law on July 1, 1999, and was sponsored by the Kansas Insurance Department. This act has many requirements that you must follow to solicit viatical settlement contracts in Kansas. These requirements include:

- **License.** You must obtain a license from the Insurance Commissioner to solicit viatical settlement contracts. The Commissioner can deny or revoke a license for a variety of reasons, including dishonest or fraudulent acts or a pattern of unreasonable payments to insureds.

- **Privacy.** You may not disclose the identity of the insured to anyone except under certain narrow circumstances defined in the Act. The Act also tightly controls who may contact the insured and the frequency of those contacts.

- **Disclosures.** You are required to disclose extensive information to the insured, including but not limited to the alternatives to selling the policy, warnings about the tax consequences and other consequences of selling the policy, the insured's right to rescind the sale within 15 days, the total dollar amount of the death benefit payable to the viatical provider, and certain information regarding the financing of the settlement.

- **Documentation.** To complete the sale of a viatical settlement contract, you or the viatical provider must obtain a statement signed by a licensed physician stating that the insured is of sound mind and is an otherwise appropriate candidate for a viatical settlement contract.

This is merely an overview of some of the requirements of the Viatical Settlements Act. You are responsible for learning and following all the details of the Act. Failure to do so will result in administrative action by the Insurance Commissioner. And keep in mind, the Viatical Settlements Act does not affect the separate authority of the Securities Commissioner to regulate the sale of investments in viatical settlements under the Securities Act, as described above.

We urge you to contact both the Office of the Securities Commissioner and the Kansas Insurance Department before you sell any viatical settlement contracts in or from Kansas. The best way to avoid financial problems, embarrassment, and sanctions is to check out any investment before you sell it. Do not hesitate to contact us if you wish to discuss this matter, either generally or regarding a particular viatical product.

Very truly yours,

KATHLEEN SEBELIUS
Insurance Commissioner

DAVID BRANT
Securities Commissioner

Kathleen Sebelius
Commissioner of Insurance
**Kansas Insurance Department**

David Brant
Securities Commissioner
**Office of the Securities Commissioner**

August 1, 2001

To Kansas Insurance Agents:

RE: Update on Viatical Settlements

Due to recent developments in the viatical industry, namely the increased marketing of life settlements or senior settlements, it is necessary to clarify the policy of both the Office of the Kansas Securities Commissioner and the Kansas Insurance Department with regard to these investment opportunities and our joint efforts to effectively regulate this growing industry.

We would also like to remind you, that contrary to what a viatical company may tell you, almost all viatical products sold in Kansas are securities. As the agent, you have the ultimate responsibility for knowing whether what you are selling is a security and ensuring that any sales of securities are made in compliance with the Kansas Securities Act.

**Life Settlements are Viaticals**

We want to make it clear that we consider a life settlement or senior settlement a viatical contract. The recent attempts by some members of the viatical industry to create products that no longer target only life insurance policies of terminally or chronically ill individuals in no way changes the analysis applied to viatical investments. The National Association of Insurance Commissioners (NAIC) in its adoption of the Viatical Settlements Model Act has rejected the argument by the industry that life settlements, senior settlements or similar products are not "viaticals". The Kansas Securities Commissioner concurs with this position and considers the following to be an accurate definition of what constitutes a "viatical investment":

> "Any sale or offer to sell the death benefit or ownership, or any 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 the life insurance policy or certificate. "Viatical investment" does not include:
>
> a. any transaction between a viator and a viatical settlement provider as defined by §2(L) NAIC Model Viatical Settlement Act;
>
> b. the assignment of a life insurance policy to a bank, savings bank, savings and loan association, credit union, or other licensed lending institution as collateral for a loan; or
>
> c. the exercise of accelerated benefits pursuant to the terms of a life insurance policy issued in accordance with the insurance laws of this state."

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**Recent Court Decisions**

In July 1999, we notified all agents that Kansas is not bound by and does not concur with the opinion of the Appellate Court for the District of Columbia issued in *Life Partners*. Our position is further underscored by two state court decisions issued this spring which consider viaticals to be securities. An Oklahoma District court in *Oklahoma Department of Securities v. Accelerated Benefits Corporation* held that viatical contracts sold on behalf of Accelerated Benefits were securities and that agents selling them were required to be registered under the Oklahoma Securities Act. Likewise, the appellate court of Arizona, in *Siporin v. Carrington*, held that sales of viaticals were subject to the Arizona Securities Act. This court specifically stated that it would not follow the *Life Partners* decision because it did not "advance the Arizona policy of protecting the public from unscrupulous investment promoters."

**Legislative and Regulatory Progress**

The Kansas Insurance Department has legislation pending which will be considered in 2002. The bill proposes implementation of the NAIC Model Viatical Settlements Act which clarifies that life settlements are viaticals.

The North American Securities Administrators Association (NASAA) has formed a viatical project group charged with the drafting of uniform guidelines for the regulation of viatical investments. Their recommendations are expected by December 2001.

Cooperation between NASAA and the NAIC generally and the Office of the Kansas Securities Commissioner and the Kansas Insurance Department continues to expand in an effort to protect all parties involved in viatical transactions. Through this continued cooperation we hope to provide a seamless functional regulatory scheme that provides for the protection of all Kansans and fosters opportunities for legitimate business.

We encourage you to contact us if you have any questions regarding the sale of viatical settlement contracts in Kansas.

Sincerely,

Kathleen Sebelius

KATHLEEN SEBELIUS
Insurance Commissioner

David Brant

DAVID BRANT
Securities Commissioner

5-13

KANSAS

Bill Graves
*Governor*

OFFICE OF THE SECURITIES COMMISSIONER

David Brant
*Commissioner*

**TESTIMONY IN SUPPORT OF HOUSE BILL No. 2640**
**Viatical Settlements Act**
Insurance Committee Kansas House

**WILEY KANNARR**
Associate General Counsel
Office of the Kansas Securities Commissioner
February 5, 2002

My name is Wiley Kannarr, Associate General Counsel for the Office of the Kansas Securities Commissioner. I am here today to address the amendments to K.S.A. 17-1262 proposed by Section 17 of House Bill No. 2640 regarding viatical investments.

I would first like to commend the work of the National Association of Insurance Commissioners (NAIC) in the drafting of its Model Viatical Settlements Act, before you as Sections 1-16 of House Bill No. 2640. Due to the spirit of cooperation that has developed among regulators with regard to regulation of the viatical industry, I and other members of the North American Securities Administrator's Association (NASAA) Viaticals Working Group were able to attend meetings of the NAIC Viaticals Project Group and provide and receive input of both regulators and industry representatives on the best manner in which to regulate this developing industry.

Viatical Investments as a Security

In November 1995, the Office of the Kansas Securities Commissioner issued an opinion that Viaticals were considered securities under the Kansas Securities Act. At that time, this opinion was in concurrence with the only legal precedent. That precedent was overturned in the Life Partners decision issued in 1996. For almost two years, there was little progress in regulating viatical investments as a result of that decision. As complaints of widespread fraud and unethical sales practices rose, Kansas and other state securities regulators reasserted regulatory jurisdiction.

As described by Commissioner Brant, we have engaged in numerous administrative actions since March 1998. Numerous other states have engaged in regulatory actions involving viaticals. Most notably, the Oklahoma Department of Securities received a favorable opinion on March 13, 2001, in its action against Accelerated Benefits

*HOUSE INSURANCE*
DATE: February 5, 2002
ATTACHMENT #6

Corporation. That opinion refuted the rationale employed in the Life Partners decision. Likewise, the court in Arizona, in a civil action, held that a viatical was a security for purposes of the Arizona Securities Act. In a civil action filed by an investor in a Dedicated Resources viatical in Shawnee County District Court, the court came to the same conclusion in response to a motion to dismiss on the basis that a viatical was not a security. In all of these cases, it was demonstrated that the Life Partners decision was not a proper interpretation of the test used to determine if a particular investment is an "investment contract" and, therefore, a security, and that the decision did not serve the prophylactic purpose of the various Securities Acts.

Exemption from securities registration

In addition to taking regulatory action against issuers and sellers of viaticals, NASAA has formed a project group with the purpose of creating a uniform statement of policy to be employed by the states in determining eligibility of viaticals to be sold in each jurisdiction.

The amendments to K.S.A. 17-1262 proposed by Section 17 of House Bill No. 2640 provide the Securities Commissioner with the ability to adopt the results of that committee's efforts. The proposed amendment provides a transactional exemption to the registration provisions of the Kansas Securities Act. The terms of the exemption require that sales be made through registered persons and that a filing is made in compliance with conditions set forth by the Securities Commissioner.

The NASAA Viaticals Project Group has completed a draft Statement of Policy and received approval to send it out for an internal comment period. The Statement of Policy is designed to protect investors by requiring more complete disclosure be made to investors and that individuals selling viatical investments will be registered, thereby imposing ethical guidelines on sellers and granting the Securities Commissioner the ability to address issues short of outright fraud.

The principal features of the proposed NASAA Statement of Policy are as follows:

1. Filing of a disclosure document with the state securities commissioner,

2. Providing both a pre and post investment disclosure document to each investor, detailing the features and risks of the investment,

3. Limiting sales only to suitable investors,

4. Requiring that the insurance policy or portion thereof being sold as a viatical investment be obtained in accordance with the NAIC Model Viatical Settlements Act or similar state law,

5. Requiring that an independent escrow agent be utilized to hold investor funds until the policy is transferred to the investor,

6. Filing of an annual report of activity by a viatical issuer, and

7. Limiting the availability of the exemption to persons who do not have relevant criminal or disciplinary history.

We expect that the Kansas Securities Commissioner will adopt the NASAA Statement of Policy once it is finalized, which we anticipate to occur in the summer or fall of 2002.

KANSAS TRIAL LAWYERS ASSOCIATION

*Lawyers Representing Consumers*

To: Members of the House Committee on Insurance

From: Kansas Trial Lawyers Association
Gary D. White, Jr.

Re: HB 2640

Date: Feb. 5, 2002

Chairman Tomlinson and members of the House Committee on Insurance: thank you for the opportunity to submit comments on HB 2640. I am Gary White, a Topeka attorney and a member of the KTLA Executive Committee.

KTLA opposes Sec. 7(e)(2-7) and Sec.12(e)(1) of this bill because it prohibits the public from obtaining documents by subpoena or court order in civil actions. The bill also prohibits prosecutors from obtaining the records in criminal prosecutions for embezzlement and other serious criminal proceedings.

Section 12(a)(1) provides that no person shall commit a fraudulent viatical settlement act. These fraudulent acts are identified in Section 2(f) and are designed to protect the public from a person who knowingly or intentionally defrauds a consumer for pecuniary gain. The bill further allows the Insurance Commissioner's office to investigate a person who commits such fraudulent acts.

The bill, however, prohibits an aggrieved consumer or a prosecutor in a criminal case from obtaining such investigative materials from the commissioner. This includes records that were obtained from the wrongdoer, his employer or other third persons. Specifically, Sec.12(e)(1) of the bill provides:

> The documents and evidence provided to subsection (d) of this section or obtained by the commissioner in an investigation of suspected or actual fraudulent viatical settlement acts shall be privileged and confidential and shall not be a public record ***and shall not be subject to discovery or subpoena in a civil or criminal action."***

This provision protects the wrongdoer by precluding disclosure of relevant and material documents. The provision also acts as a deterrent to an aggrieved consumer and prosecutors who are pursuing criminal charges against a person who has defrauded the consumer for potentially thousands of dollars.

*HOUSE INSURANCE*

DATE:

ATTACHMENT 7

*Terry Humphrey, Executive Director*

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Sec. 12(e)(1), and a similar provision in Sec. 7(e)(2-7), are much broader than are necessary and would bar the discovery of relevant documents, witness statements and other information obtained by or disclosed to the Commissioner or any other person in the course of an investigation even where a court has issued a subpoena or an order finding the documents relevant and requiring production of the records.

Please note that we are **not** proposing that the release of documents be subject to the Kansas Open Records Act. We acknowledge that the Open Records Act provides that criminal investigative materials are not subject to disclosure. However, while the criminal investigative records are ***not*** open records under the act, such records are subject to subpoena in civil and criminal cases where the Court has determined the records are relevant.

For example, the records related to blood tests or statements by a drunk driver are not subject to the Open Records Act. However, in a civil case by a person who was injured due to the fault of the drunk driver, the injured person can subpoena the records or obtain the records by Court order.

Similarly, questions have arisen whether investigative materials regarding consumer protection complaints filed with the Attorney General's office are available to the public under the Act so a subpoena or Court order is often utilized to obtain production of the records.

By handling the records in this way, the person being investigated is protected by barring general public access to the documents while allowing production of the documents where a Court has determined their relevancy to the proceedings. Under this procedure, the person who was investigated is also allowed to file a motion for protective order or motion to quash if there is a valid objection to production of the records. Such procedure balances the interests of the injured party and the wrongdoer regarding discovery of the information.

The actions of Enron/Arthur Andersen further demonstrate the need for these materials to be available by subpoena and/or court order. Such accounting irregularities could certainly be identified in an examination under Sec. 7 of this bill and the public interest in pursuing recourse should not be deterred by barring such investigative materials from subpoena and court order. Only the wrongdoer is protected by allowing such a bar.

Thank you for the opportunity to express our serious opposition to these sections of this bill. We encourage you to oppose these provisions of the bill.